

# Balancing the Security and Affordability of Funded Pension Schemes Host Country Report

Ministry of Social Affairs and Employment

## 1. Introduction

This paper addresses the following subjects:

- key elements of the Dutch system;
- strengths of the Dutch system;
- threats and challenges;
- how to deal with financial uncertainty and demographic change: a new approach;
- possible questions about the Dutch system;
- additional information 1: facts and figures;

Additional information about the supplementary occupational pension schemes is included in the brochure 'The old age pension system in the Netherlands'.

## 2. Key elements of the Dutch system

The Dutch pension system consists of three pillars: a flat-rate state pension (AOW) related to minimum wages, occupational pension schemes and individual saving schemes.

### First pillar

The statutory (state) old age pension (AOW) provides all residents of the Netherlands at the age of 65 with a flat-rate pension benefit that in principle guarantees net benefits of 50% of the net minimum wage for each partner in couples or 70% for singles. All residents of the Netherlands between the ages of 15 and 65 are insured by the AOW. During the period of insurance entitlement is accrued by 2% every insured year. This leads to a 100% entitlement when reaching the age of 65, provided there are no gaps in the period of insurance. By its linkage to the minimum wage the AOW benefit follows also the indexation of the minimum wage to the contractual wage increases. Deviation from this indexation is only possible in case of wage increases or rises in social security contributions that harm economic growth and employment. The pay-as-you-go financed AOW has a contribution rate of 17.9% that applies to the lowest two income tax brackets (€32,738 in total). People who are entitled to a partial AOW benefit and who have, together with other sources of income, a total income below the subsistence level are entitled to social assistance.

## Second pillar

Supplementary occupational pension schemes are well developed in the Netherlands. The scheme can either be arranged company-specific, or industry wide. Occupational pensions are subject to negotiations between social partners and are financed by capital funding. In principal, participation in an occupational pension scheme is not mandatory, but in actual practice it is close to mandatory, either by the employer, or by the government.<sup>1</sup> So, in the Netherlands over 90% of all employees participate in a pension scheme.

Characteristically, the total pension benefit could result in about 70% of the final career salary or 80% of the average career salary. The final pay schemes usually have an accrual rate of 1.75% each year, while the rate amounts to about 2% for the average pay schemes. Occupational pension schemes are considered to be supplementary to the AOW. The AOW benefit is therefore included in most calculations of occupational pension schemes in order to achieve the 70% or 80% target after 40 years of contributions. This also applies to the contributions that are levied on the salaries minus a franchise in order to reckon with the AOW benefit. On average the contribution rate on the salary minus the franchise is about 20%. The way contributions are divided among employers and employees varies from one pension scheme to another.

The supplementary occupational pensions are indexed to wages or prices if the financial situation of the pension fund allows doing so. Likewise, the yearly adjustment of the acquired rights of active participants to the contractual wage increases is (i.e. in case of average pay schemes) also conditional to the funds position, frequently. Usually, if the funds assets cover less than 125% of the liabilities, the indexation of both pensions and acquired rights will be less than 100%. And it will drop to 0% if the coverage rate becomes 105% or less.

Besides the capital funded occupational pensions there are also private pay-as-you-go financed early retirement schemes, founded by the social partners in the aftermath of the first oil crisis. In 1995 social partners started to reform those schemes with a gradual transition to funded early retirement schemes and an immediate application of more actuarial fairness in case of working longer. By 2006 the government ended the favourable fiscal treatment of the pay-as-you-go financed early retirement schemes with a transition period up to 2015. This reform forced social partners to integrate the early retirement schemes in the traditional occupational pension schemes.

In response to the previous crisis most schemes shifted from final pay to average pay pension schemes.

The second and the third pillar are encouraged by tax deduction up to certain limits (annuity contributions are tax deductible and the pension payments are taxed).

## Third pillar:

The Dutch pension system also includes individual pension provisions, through annuity Insurance. The tax facilities enable, for instance, the self employed to build up a supplementary pension comparable with the pensions of employees.

<sup>1</sup> Mandatory participation in a branch pension scheme or in a pension fund for professional groups is imposed by the Ministry of Social Affairs and Employment after a request from representative parties in the branch.

## Labour market policy

One of the main challenges for the future labour market is ageing. The challenges the labour market faces has gained more importance through the crisis. Up till now, the impact of the crisis on the unemployment rate in the Netherlands is limited. In any case, due to ageing, there will be a shortage on the labour market in the near future. Moreover, it is important for sustainable public finances that 'everyone is participating'. For that reason, the Dutch government intends to keep as much as possible people in touch with the labour market, and in particular the older workers.

Concerning the labour market participation of older workers the Netherlands is on average in Europe. The employment rate of older workers is 53%, the average retirement age of Dutch workers is 63.2. A positive trend in the increase of employment of older people is observed since 2000. Significant social security and labour market reforms taken in the past period in the Netherlands have their effect on the labour market. Gradually, more people are working until the age of 65. However a further increase in the participation rate of older workers may be hindered by the following two problems on the labour market for older workers: The mobility of older workers is relatively low and employers are not inclined to employ older workers.

Looking forwards to the future labour market and the sustainability of public finances, it is important that the number of older workers who are active in the labour market will rise. For that reason, the Netherlands has launched several programmes to promote active ageing and to keep older workers employed. Important topics of the Dutch labour market policy are:

- a) Reinforce the employability of older workers;
- b) Improve opportunities for older workers to continue working, their mobility and the (im)balance between productivity and wage;
- c) Increase the statutory retirement age.

## Gender

Gender is not a determinant of poverty in old age in the Netherlands. Reasons for that are:

- the fact that the first pillar (AOW) provides all residents with a flat-rate pension. Factors such as low wages and work interruptions have no effect on the first pillar;
- the fact that many occupational pension plans also include survivors pensions;
- the relative high labour participation of women (in March 2011: 71,5%).

## 3. Strength of the Dutch system

In general:

The strength of the Dutch system is the combination of a good public basic pension, to which all citizens are entitled, a well functioning supplementary occupational pension scheme, the possibility - encouraged by tax facilities - to obtain supplementary individual pension provisions and a

labour market policy aimed at increasing the labour market participation of older people. Thereby, the Dutch system provides a balanced mix.

A balanced mix between different pillars is crucial to a sustainable and adequate pension system. Emphasis should not only be on the public part of the pension, but on all pillars and the labour market policy should be taken into account. Too much emphasis on capital funding makes a system vulnerable to inflation, too much pay-as-you-go funding makes it vulnerable to demographic developments. A balanced mix provides the best protection against specific shocks.

### The first pillar:

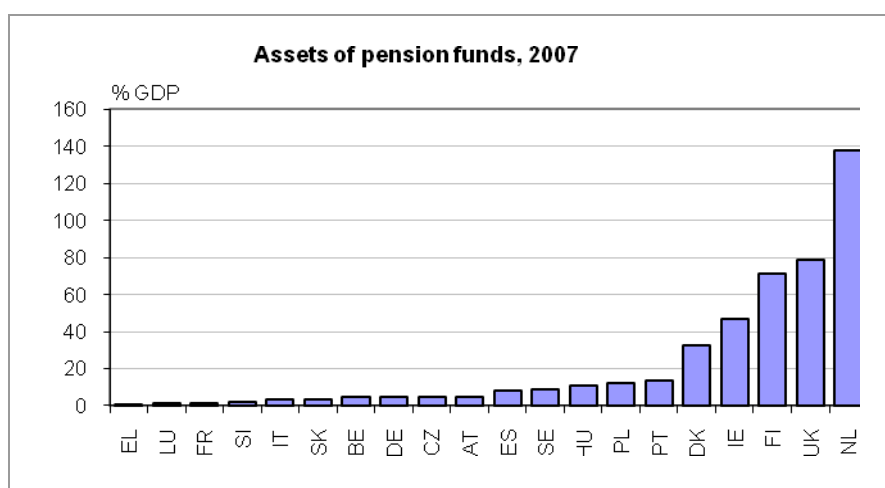
The AOW ensures that a relatively high minimum income is provided to persons aged 65 and over. It establishes income transfers from rich to poor and is an effective prevention against poverty in old age. It is therefore that the Netherlands has one of the lowest at-risk-of-poverty rates of people aged 65+ in the EU (10% versus 19% on average).

### The second pillar:

As the first pillar deals with poverty, the aim of the supplementary second and third pillar pensions benefits is to provide an adequate replacement rate that enables retirees to continue their pre-retirement living standard after retirement. Together with the first pillar the second pillar provides for a high gross replacement rate (88.3% in the Netherlands, which is above the OECD-average of 59%).

The funded second pillar makes the system better prepared for the ageing population. In a funded system, workers save for their own pension benefits and build up a huge pension wealth as the active labour force is ageing. Total assets of Dutch pension funds of more than 130% of GDP are by far the highest in the European Union (see figure 1). In pay-as-you-go systems future workers are expected to pay for the pension benefits of future retirees, even if the latter group is growing fast and ever higher contributions are necessary. Contrary to many other countries, through the funded second pillar a large part of the bill related to the ageing population has already been paid for.

Figure 1: total assets of pension funds (% GDP)



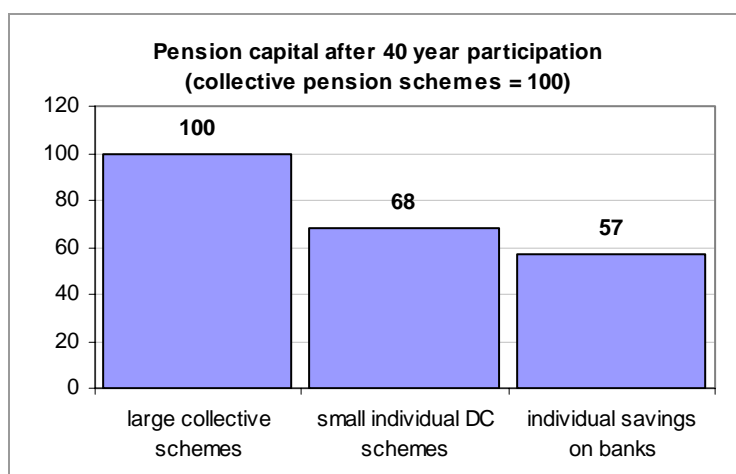
The Dutch pension system can – generally speaking – be characterized by a high coverage rate, a high replacement rate and relatively low costs. These features are realized by a delicate balance between security and affordability in which risk sharing arrangements and governance arrangements on a decentralized level (conducted by social partners on the level of individual companies and branches of industry) are crucial. In those risk sharing arrangements premiums can be raised or lowered or the outcome can be changed to members and beneficiaries (during the life cycle the contract can be improved, full indexation can be passed, rights can be cut and risks can be shared by future generations). These measures create the essential flexibility to keep the balance in the system. The rationale behind this is the notion that a high level of certainty in very long-term arrangements as a pension-contract cannot be found in guarantees but should be found in the system itself.

As mentioned above collective risk-sharing is one of the main characteristics of the second pillar of the Dutch pension system. All the actuarial and investments risks are shared by the members and beneficiaries of the pension schemes.

Each member pays a fixed percentage of his salary for his future pension entitlements and for each year of service pension rights are accrued.

Members benefit from collective risk-sharing. It protects them against their own lack of foresight and it facilitates solidarity between generations. Moreover, collectivities keep costs low. Economies of scale result in lower costs in administration (see additional information 1: facts and figures) and asset management. At an equal deposit, the pension capital of large collectivities can be much higher than with individual DC schemes or saving money in the bank. However, it should be noted that in addition to a higher return, investing money also involves more risks compared to savings.

Figure 2



The second pillar provides an important incentive to increase labour participation, because employees accrue pension rights for each year of service.

## 4. Threats and challenges

Dutch pension funds experienced considerable asset losses due to the crisis. At the end of 2007 their amount of assets was equal to € 684 billion (120% of GDP). During 2008 they fell to € 578 billion (97% of GDP). The average coverage ratio declined in this period from 144% to 95%. This caused pension funds to refrain from full or even to withhold indexation and, in some cases, to raise contributions in 2009 and 2010.

The Dutch government acted by introducing less tight demands on pension funds to restore their coverage ratios (they now have five instead of three years to restore the minimum required ratios of 105), to prevent that too drastic measures are taken in the process. Within fifteen years all funds have to reach coverage ratio of about 125%. In 2009 the pension funds benefited from the rebound on the stock markets by which total assets could raise to € 666 billion (120% of GDP) at the end of 2009. The average coverage ratio climbed to 109%. However, two factors became detrimental to a continued recovery: an unexpected rise in life expectancy and a further fall in the interbank swap rate. Both factors boost the liabilities of pension funds in 2010 by which the coverage ratio falls again.

In view of the problems the Dutch government decided to take a more fundamental look at the sustainability of the occupational supplementary pension system. Two studies were carried out:

- A strong second pillar, toward a sustainable system of supplementary pensions, by the Goudswaard Committee, January 2010;
- Pension: 'Uncertain security', Analysis of the investment policy and risk management of Dutch pension funds, by the Frijns Committee, January 2010.

The Goudswaard Committee described the following threats and challenges for the Dutch second pillar:

*The Netherlands has a unique system of supplementary pensions*

- The Netherlands has a unique system of supplementary pensions. The existence of *collectiveness and solidarity* ensures that risks are shared and *mandatory participation* guarantees broad cover. This makes forms of insurance possible that are not (easily) achievable in the market. This system also leads to relatively low administration costs and opens up the possibility of sharing risks with other generations.
- For the majority of participants, pensions were and continue to be synonymous with security. The assets of pension funds continued to grow steadily over a long period of time. Entitlements became more generous and year in year out pensioners could rely on increased benefits to compensate for higher wages or price inflation (indexation). In the 1990s, strong returns on investments meant that employers were sometimes given a contribution discount. There was a widely-held belief that it was possible to have a good pension at limited cost.

*... but the costs are increasing and the system is vulnerable to shocks ...*

- This picture changed after the turn of the millennium. The sharp fall on stock exchanges around the world and the structural drop in interest rates, which were initially masked by the boom on the stock markets, made it clear that a secure pension is far more expensive than was initially thought. Pension fund boards introduced sharp rises in pension contributions.
- Social partners switched within a short period from the traditional final salary pension scheme (based on an

employee's last-earned wages) to conditional indexed average earnings pension schemes (based on an employee's average earnings). Indexation of accumulated pension entitlements and benefits was linked to the funding ratio of pension funds. In this way the financial position of pension funds became more manageable. The downside was that part of the participant's pension became 'soft' in nature, in other words less secure.

- People did not become aware of this uncertainty until the recent financial crisis in 2008-2009. For the first time, participants were faced with the possibility of long-term cuts in indexation, and even the possibility of nominally reduced pension entitlements.

*... and that raises questions about sustainability.*

- Both crises have shown that the system is extremely vulnerable to shocks. Together with the uncertain development of the economy and the financial markets in the coming years, the question is which factors will put additional pressure on the system in the longer term. To what degree does population ageing undermine the system's resistance to shocks? To what extent will employers remain willing, in the light of the size of pension assets and international accounting standards, to bear a structural part of the pension risks? How will population ageing affect the solidarity between younger and older generations.

The Frijns Committee mentioned the following threats and challenges for the Dutch pension funds:

- The Dutch Pension funds are faced with major challenges due to the low birth rates and ageing of the population. The combination of longer life expectancy and an unchanged retirement age makes pensions more expensive. Population ageing makes pension funds more vulnerable and erodes their ability to recover. The share of pension contributions decreases relative to the pension commitments and the duration of the pension commitments declines. It becomes increasingly difficult to deploy pension contributions as an effective control instrument.
- Pension funds are 'ageing giants': more than 60% of total pension assets is earmarked for pensions that have already commenced or will commence within 10 years. This means that the pension funds' investment horizon is becoming shorter, thereby affecting their ability to recover from negative investment results. Major disruptions in financial markets can turn ageing giants into 'sinking giants': institutions that are no longer able to meet their commitments.
- Pension funds have become more dependent on financial markets. They have invested ever increasingly in marketable securities such as shares, real estate and alternative investments. This partly arises from the need to achieve a higher return in order to keep pension costs low. This in turn has led to a considerable increase in the risk profile of pension funds. At the same time, it is expected that the pension funds will protect the accumulated pension entitlements and maintain the level of the nominal funding ratio. In times of crisis, the increased risk profile can result in substantial decreases in the funding ratio of pension funds, as also happened in 2008. Crises will continue to occur and it is therefore important to make allowance for them.
- A major cause of the decreased funding ratios of pension funds is the drop in the interest rate they use to calculate the net present value of future pension benefits. Since the introduction in 2007 of the FTK (Financieel Toetsingskader - Financial Assessment Framework), pension funds are obliged to value their (nominal) liabilities based on the market interest rate (the term structure of interest rates). This makes their (nominal) funding ratio sensitive to changes in the market interest rate. Extreme falls in the market interest rate, such as occurred in 2008, are also accompanied by extreme increases in the value of the liabilities.

## 5. How to deal with financial uncertainty and demographic change: a new approach

The Goudswaard Committee concludes that with the current ambitions and assumptions on security, the Dutch second pillar pension system is not sufficiently durable due to the ageing of the population, the lengthening of the life expectancy and the increasing vulnerability to financial risks. Choices have to be made if the essential characteristics of the system – a pension provision based on collectiveness and solidarity - are to be preserved. The system should be developed further so that a new balance arises between the ambition, the security and the costs of pensions. The committee believes there are good opportunities to achieve this along the following along two lines:

### *Lowering the pension ambition*

- A first possible solution is to limit the ambition with regard to the level of pensions. (...) Social partners could elect to revise downwards the standard of 70% of last-earned wages at the age of 65. The same number of years spent accumulating pension entitlements then results in a lower percentage of accumulated benefit. By continuing to work longer, people can ensure their pension benefit reaches the same level again.
- In addition, consideration can be given to incorporating life expectancy in the pension schemes. Automatically linking pension benefit or the retirement age to rising life expectancy makes the system more durable because it means that a source of cost increases has been removed.

### *Higher risk-taking by participants*

- A second possible solution is to take a different approach to uncertainty. This requires certain risks to be borne more explicitly by the participants. As a result, the accrual of pensions will become more in the nature of conditional (or 'soft') entitlements.
- A greater role for conditional entitlements requires a pension contract to specify more precisely the strategy in relation to future windfalls and setbacks and to whom these will be allocated. Social partners and the pension fund boards will have to make their views known in this regard in advance more so than is the case at present.

Lowering the ambition or accepting a higher risk also requires explicit and clear communication in this regard. Participants must be informed as well as possible and in the clearest possible terms about the expected purchasing power of the retirement benefits and the degree of uncertainty in them.

The Minister of Social Affairs and Employment sent a letter to parliament on 7 April 2010. In this letter the Cabinet endorses the conclusion of the Goudswaard Committee that the Dutch second pillar system is not sufficiently durable.



The key elements of this letter are:

- It is important not to hesitate but to take measures in due time;
- There are sufficient possibilities to adapt the system if government and social partners work together;
- When we adjust the system, we can keep its strengths;
- A sustainable second pillar should allow pension contracts with an ambition in real terms (an ambition including indexation), which are conditional to life expectancy and shockproof against events on the financial market.
- A sustainable second pillar requires clear communication about the risks to the participants and needs to be supported by an adjustment of the legislation (the financial review framework)
- Social partners must have the opportunity to negotiate about the possible adjustments of the second pillar pension system. Their agreement will be the starting point for the adaption of the legislation by the Cabinet.

On 4 June 2010 the employers federations and trade unions federations (the social partners forming the Labour Foundation) reached an agreement: the Pension Accord Spring 2010. They also concluded that the fundamental principles of the Dutch system – collectivity, solidarity and compulsory membership – must remain intact, and that a new balance must be struck between aim, security, solidarity and costs. The headlines of this agreement are as follows:

**a. Regarding the statutory (state) old age pension**

The social partners propose adjusting the state pension retirement age to reflect the increase in average life expectancy beyond the age of 65.

The social partners proposed the following system for adjusting the state pension in light of increasing life expectancies:

- The average number of pension years for the generation who retired and received a state pension (with the macro average remaining life expectancy at 65) in the period between 2000 and 2009 will be used as a reference period for linking the state pension age to increased life expectancy.
- The state pension age will be periodically adjusted, based on pre-agreed reference dates, to changes in the macro average remaining life expectancy at 65 in comparison to the 2000-2009 reference period.
- A change in the state pension age will be announced 10 years in advance and will be made every five years. This means that (assuming that each change will involve a maximum adjustment of 1 year) the first raise to 66 will enter into effect in 2020, and that the next step for 2025 will be agreed and announced in 2015. Based on our current understanding, the state pension age will have to be raised to 67 by 2025.

b. Regarding supplementary occupational pension schemes

Contribution stabilisation for supplementary pension schemes

The increase in pension contributions to the cost-coverage level has raised those contributions by approximately 50% since 2000. The Goudswaard Committee calculates (based on an estimate by the Netherlands Bureau for Economic Policy Analysis [CPB]) that failing to change the pension policy could lead to comparable contribution increases. The parties agree that this must be avoided and cannot and will not become a reality.

Dealing with the increase in life expectancy:

The adjustments to the state pension in the first pillar and the occupational pension in the second pillar must be harmonised by taking into account longer life expectancy. What is needed is a change from the current pension contract to one that will confer on future generations the right to the same number of pension years for the same number of accrual years. The social partners believe that pension contracts must be adjusted with effect from 2011 to take into account the consequences of increasing life expectancy. This must be done in a fund-specific way that does not affect contribution amounts. The retirement age and the state pension age must be harmonised. On a decentral level social partners can choose from at least two methods in order to incorporate the increasing life expectancy in the pension contracts.

The fiscal retirement age for occupational pension schemes will be in line with the state pension age.

Progressing towards shockproof, transparent pension contracts

In the Pension Accord Spring 2010 it is also stated that occupational pension schemes should become more shockproof against events on the financial markets including adjustments in short term contributions and benefits, while maintaining stable contribution rates over time.

The current pension contract is insufficiently shockproof against developments on the financial markets (interest, returns, inflation). As a result of demographic changes, the contributions measure has become increasingly ineffective in terms of absorbing financial setbacks.

The social partners see two primary alternatives for the current nominal contract:

- a “hybrid contract” with one layer of lower accrual with a large degree of nominal security and a second, fully performance-dependent layer (profit-sharing);
- a completely flexible (in real terms) contract.

c. Improving the labour market position of older employees

Older employees' participation on the labour market has gradually increased over the past decade, partly as a consequence of changes in social security and early retirement regulations. The implementation of the changes to the state pension and supplementary pensions agreed in the Pension Accord will further encourage this positive development. In addition, incentives are needed to make it more attractive for employers and employees to continue their mutual relationships.

The social partners will therefore develop an additional policy agenda to substantially improve the labour-market participation and mobility of older employees. This policy will discuss all of the relevant topics: age-conscious staff policies, recruitment and selection, employability, training, job flexibility (including aspects influencing their legal position and social security, as well as the “perverse incentives” in local schemes).

The Pension Accord Spring 2010 is under discussion with the Dutch government in order to determine which amendments in regulation can contribute to realise the desired new balance between ambition, security, solidarity and costs. Given the necessary adjustments it is important that the European regulatory framework leaves room for sufficient flexibility.

## 6. Possible questions about the Dutch system and approach

The following questions can be discussed during the Peer Review.

- a) What are the strengths and weaknesses of the Dutch system, which consists of a combination of public pay-as-you-go financed basic pension and supplementary occupational retirement on a funded basis? Points of interest can be: sustainability, affordability, safety, suitability, solidarity.
- b) Which problems occur if such a system faces financial crises and/or demographic changes?
- c) How should such a system adapt to demographic changes?
- d) How should such a system adjust to financial crises? How to deal with uncertainty?
- e) What do other Member States and European stakeholders consider to be key elements of good practice?
- f) Which elements of the good practice are transferable to other Member States?

## Additional information 1: facts and figures

		2007	2008	2009
<b>General information</b>				
	<i>x1000</i>			
1	Inhabitants	16 382	16 446	16 532
2	0-14	2 963	2 943	2 950
3	15-64	11 043	11 073	11 109
4	65+	2 372	2 421	2 473
5	Employed labour force 15-64 (≥12 hour a week)	7 309	7 501	7 469
	Employment of employees (full-time equivalents)	5905	5992	5930
	Unemployed labour force 15-64	344	300	377
	<i>amounts in euro</i>			
6	Legal minimum wage	16 963	17 442	18 060
7	State pension (couple, full right)	17 014	17 536	18 442
8	State pension (single, full right)	12 336	12 707	13 217
9	Average gross wage full-time employee	37 281	38 492	39 320
10	Average wage costs full-time employee	47 467	49 186	50 273
	<i>amounts in million euro</i>			
11	Gross Domestic Product	571 773	596 226	571 979
<b>First pillar: state pensions</b>				
12	Benefits	25 198	26 446	27 580
13	Premiums	17 637	20 288	17 883
<b>Second pillar: pension funds</b>				
14	Benefits	23 018	24 599	25 364
15	Cost of administration	1 746	1 958	1 934
16	Premiums	25 242	26 239	28 066
17	Total investments	684 138	577 519	666 247
18	Funding ratio (ultimo, percentage points)	144	95	109
<b>Second pillar: collective schemes provided by insurance companies</b>				
19	Benefits	7 121	6 739	6 469
20	Cost of administration	2 093	1 584	1 506
21	Premiums	7 750	8 036	7 898



Ministerie van Sociale Zaken en  
Werkgelegenheid

# The old age pension system in the Netherlands



# Index

Index	1
Introduction	3
1. Principles of the Dutch pension system	5
2. First pillar: the state old-age pension (AOW)	7
3. Second pillar: occupational pensions	9
4. Third pillar: private pension provisions	13
5. Occupational pensions and legislation	14
6. Tax legislation and pensions	20

## Introduction

The Dutch pension system has three main pillars: a flat-rate state pension (AOW) related to minimum wages and financed via payroll taxes, occupational pension schemes which are capital-funded, and individual saving schemes.

The present outline focuses in particular on the second pillar that is the supplementary pension as an element of labour compensation, and the laws relevant to it. It also provides a brief outline of the state old-age pension.

More information on current developments in the area of pensions in the Netherlands can be found on the international website of the Dutch Ministry of Social Affairs and Employment: [www.english.szw.nl](http://www.english.szw.nl/benefits/old-age-pension) (benefits/old-age pension).

# 1. Principles of the Dutch pension system

The Dutch pension system may be characterised in terms of three pillars, namely:

- basic state old-age pension under a statutory insurance scheme (first pillar);
- supplementary pension schemes by virtue of the employer (second pillar);
- private savings for retirement (third pillar).

The Dutch General Old Age Pensions Act (AOW) provides for basic state pensions for people aged 65 and over. In addition, the AOW scheme includes a supplementary allowance for partners and beneficiaries who are under 65 and have either no income or an income below a certain level. The Dutch Surviving Dependants Act (ANW) provides for state benefits for people whose partner has died and for children younger than 16 who have lost one or both parents.

Supplementary to the state pensions and the largest pillar in terms of the overall Dutch pension system are the occupational non-statutory pension schemes. The employer usually pays more than fifty percent of the pension contributions. This system of supplementary pension schemes has a rich history and is the backbone of the old-age pension system in the Netherlands. In per capita terms, the Netherlands has one of the largest pension reserves in the world.

The third pillar includes the personal annuities offered by insurance providers, supplementary to the AOW and/or the occupational pensions.

## *Various types of pension provisions*

In the Netherlands there is a mixed system of public and private provisions. Public means that the provisions are regulated by law, private means that the provisions are regulated by the employer or that people, individually, make pension arrangements with an insurance provider by buying an annuity insurance or endowment insurance. The Dutch pension system guarantees that everyone aged 65 and over enjoys a decent standard of living and will continue to do so in the future.



	Character	Who exercises control?	What is it?
1st pillar	Public	Regulated by law	Basic state pension: AOW
2nd pillar	Private	Regulated by law	Supplementary pension (collective schemes)
3rd pillar	Private	Individual action	Supplementary pension (individual): annuities, endowment

In comparison with other countries, the basic old-age pensions account for a minor part of the total provisions for old age. The joint capital of all pension providers is much higher, namely EUR 725 billion (source: 2007 Annual Report, Dutch Central Bank). More than 8.5 million people receive a pension benefit or have acquired vested pension rights.

It is possible that people do not receive a supplementary pension from their employer because there is no obligation for employers to make pension commitments to their employees. Alternatively, it may be because people have not been engaged in paid labour or were self-employed. Those people can opt to supplement their AOW benefit by arranging individual pension provisions, such as life insurances, a fiscal old-age reserve for entrepreneurs, and endowments.

Although there is no statutory obligation for employers to offer a pension scheme to their employees, more than 95% of employees are covered. These second pillar schemes are therefore best thought of as quasi-mandatory.

#### *Funding*

State old-age pensions are financed according to the pay-as-you-go (PAYG) system: today's contributors finance the pension payments made to the retirees of today.

Second and third-pillar pensions are primarily financed by means of funding. Pension benefits are financed by pension contributions paid in the past and accumulated by investment yields.

## 2. First pillar: the state old-age pension (AOW)

The first pillar includes state regulations that provide for an income for people aged 65 and over or after decease. Two forms of old-age provisions are involved:

- General Old Age Pensions Act (AOW). This statutory social security (state) old-age pension provides all residents of the Netherlands aged 65 and over with a flat-rate pension benefit that in principle guarantees 70 percent of the net minimum wage;
- Surviving Dependants Act (ANW). A surviving dependant's pension is a flat-rate benefit payable to the surviving partner after the other partner passes away and after the decease of parents.

### *Vesting of pension rights*

Since the introduction of the AOW in 1957, the intention has always been to entitle all people aged 65 and over to full AOW old-age pension rights. In principle, all residents of the Netherlands between the ages of 15 and 65 are insured. Entitlement to AOW pension is accumulated at a rate of 2% for each year of insurance. This leads to a 100% entitlement to the relevant pension benefit upon reaching the age of 65, provided there are no gaps in the period of insurance. If one has lived outside the Netherlands for any length of time, one will not accrue any AOW pension rights during this period unless someone has paid a contribution for voluntary insurance. At 65 people receive a lifelong AOW benefit. At the end of 2008, 2.7 million people were receiving AOW pension benefits amounting in total to EUR 27 billion.

### *AOW benefit: domestic situation*

The AOW benefit is a flat-rate one based on the net statutory minimum wage. The amount of the benefit does not depend on any former income or on contributions paid in the past. Housewives who have never paid contributions are also entitled to an AOW benefit when they reach the age of 65. The amount of the AOW benefit depends on the domestic situation of the retiree. There are different benefits for single people, single parents and married couples.

Assuming they have full entitlement to the state old-age pension, on 1 January 2009 the gross pension rates for singles is 70 percent of the statutory minimum wage per month (EUR 1001), while both partners in a couple (either married or living together officially) are each entitled to a pension benefit amounting to 50 percent of the statutory minimum wage (EUR 686).

### *Reduced AOW pension: supplementary national assistance*

The old age pension entitlement of people who have been insured for less than 50 years is reduced proportionately. People who have not acquired the full AOW pension rights may be entitled to supplementary national assistance. There is a separate national assistance standard for persons with a reduced AOW pension, enabling them to receive as much as people with a full AOW pension. Municipal authorities decide whether a person is entitled to an additional allowance. In addition, supplementary national assistance qualifies for a capital exemption.

### *Supplementary allowance for a partner under 65*

A person aged 65 with a partner under 65 may be entitled to a supplementary allowance if the partner's

income is limited. The amount of the supplementary allowance depends, among other things, on the partner's income and ends when the partner reaches the retirement age of 65. Single parents will receive 90 percent of the net minimum wage (EUR 1271). This supplementary allowance will be abolished in 2015.

#### *Funding*

In the pay-as-you-go system in the first pillar, the AOW is financed by contributions levied on earnings at a rate that is statutorily limited to a maximum of 18.25 percent. Once this contribution is no longer adequate to cover costs as a result of the ageing population, the deficit will be met from the public purse. All taxpayers contribute to this system, including retirees who do not pay any AOW contribution.

#### *Administration and supervision*

The tax authorities collect the AOW contributions through income tax. The administrative body for the AOW is the Social Insurance Bank (SVB). For a number of municipal authorities, SVB administers the supplementary national assistance for people aged 65 and over who have not acquired the full AOW pension rights. In order to prevent these older people from running into financial difficulties, all retirees that are entitled to supplementary national assistance will be paid by SVB in the near future.

The members of the Boards of Directors and Advisors of SVB are appointed by the Minister of Social Affairs and Employment. The minister is politically responsible for social security, such as the AOW and ANW, and its adequate implementation. In connection with this responsibility, SVB is obliged to submit its annual plan and budget to the minister for approval. In addition, SVB periodically reports to the minister about its performance and activities. SVB is subject to supervision of the Work and Income Inspectorate (IWI), a section of the Ministry of Social Affairs and Employment. Among other things, IWI supervises the administration of the statutory employee insurance schemes carried out by a number of other administrative bodies.

### 3. Second pillar: occupational pensions

*The main characteristics of the second pillar of the Dutch pension system are mandatory participation, collective risk sharing and the system of transfer of pension value. Annually, employees accrue equal pension rights for each year of service, in most pension schemes amounting to about 2% of their salary. Each employee pays an equal fixed percentage of his salary for his future pension entitlements. This average contribution rate does not depend on age, sex or income. Annually, accrued pension rights of all members are conditionally adjusted in the same way by wage indexation or price indexation. Finally, each pension fund has an investment policy that treats all members and retirees in the same way.*

Occupational schemes are highly developed in the Netherlands due to collective sector agreements that ensure the quasi-mandatory coverage of more than 95 percent of the employed population. Occupational schemes cover private and public-sector employees including civil servants. Mandatory industry-wide pension schemes cover all employees in the respective industry, including private and public-sector employees. In the case of all other schemes – voluntary industry-wide and company-specific pension schemes – coverage is regulated by the applicable scheme regulations. Members of a profession may establish profession-wide pension schemes that are implemented through profession-wide pension funds. The Minister of Social Affairs and Employment may make participation in a profession-wide pension scheme mandatory for the profession as a whole upon request of an organisation or organisations representing the majority of the profession concerned.

The second pillar serves to supplement the first. As a member in the pension scheme, a person accrues entitlements to a retirement pension, partner's pension and orphan's pension, and the person is usually insured for a disability pension which supplements the public disability benefit. The employer usually pays the major part of the contribution for the supplementary pension. The future pension benefit is in fact deferred salary for the employee. The employer has to deduct pension contributions from the salary and transfer these contributions to a pension provider.

#### Pension providers

Capital funding is necessary in order to achieve a solid supplement to the PAYG first pillar. In the Netherlands, the money intended for supplementary pension schemes may therefore not be included in the company's risk capital in order to protect the beneficiaries' rights. Funding must take place through a legal entity which may be a pension fund or an insurance company. A pension fund can exploit the potential of intergenerational risk sharing, whereas insurance companies cannot. The basis for this solidarity is constituted by mandatory participation in pension schemes.

Social partners may decide which coverage level they prefer, company-specific or industry-wide, and also which institution will administer the accrued pension assets.

1. *Company-specific pension funds (12% of the members):* they may be linked to one or more companies e.g. Philips, AHOLD, and Heineken.
2. *Industry-wide pension funds (76% of the members):* they may be linked to more than one branch of industry. There are non-mandatory funds e.g. for employees in the public transport sector, Dutch Railways, and there

are mandatory funds e.g. ABP for civil servants, for employees in the metal and electrotechnical industry and the building industry.

3. Insurance providers who have to deal with approximately 30,000 group life insurance contracts for separate companies.

An employer may also opt to have the pension scheme administered by an institution for occupational retirement provisions (IORP) with its seat abroad.

Social partners appoint their own representatives to the board of a pension fund. These representatives must protect the interests of the fund's members in a balanced way.

The bulk of the accrued assets are administered by pension funds. The Dutch pension system consists of 651 pension funds (end of 2008); 543 of these funds are single-employer funds, 95 concern industry-wide funds (of which 69 mandatory) and funds are for professional groups. Together, these schemes cover approximately 6 million members. The amount of assets held by pension funds in 2008 was approximately EUR 445 million.

A limited proportion of the pension assets under the second pillar (approximately EUR 70 million) are accounted for by so-called direct schemes. Instead of being administered by pension funds, they have been outsourced by 22,000 mainly smaller employers to insurance companies for more than 800,000 employees.

The number of pension funds is gradually decreasing. Among other things, the decrease in the number of single-employer schemes is due to cost-influencing factors, such as scale, pension fund type, scheme type, outsourcing and reinsurance.

Members of a given profession may opt for a *pension fund for professional groups* (0.5% of the members). These funds concern groups of self-employed people who exercise the same profession (i.e. only active members and retirees and no employer), such as general practitioners and civil-law notaries.

## Characteristics of occupational pension schemes

### *Types of pension schemes*

A pension scheme may include three elements: *old-age pension, partner's pension and disability pension*. Not every occupational pension scheme includes all these elements. Trade unions and employer organisations jointly decide on the contents of a pension scheme.

The occupational *old-age* pension benefit is paid from the retirement age (usually 65) until the date of death.

A *partner's pension* is paid out to one's next of kin after one's death. Sometimes, the benefit is linked to the state old-age pension and depends on the salary and maximum attainable number of years of service (accrual basis). An increasing number of pension funds are offering a partner's pension on a 'risk basis'. In the event of death while still in paid employment, the partner will receive an allowance comparable to a 'normal' pension scheme. However, if the employment relationship is terminated, the partner's pension is cancelled too.

It is possible to swap pension rights. Swapping pension rights means that at the time of retirement, one converts claims to a partner's pension into a higher old-age pension. One can also convert the claims to retire earlier. Swapping is not possible with all pensions. It is only possible with pension schemes that include a compulsory partner's pension and in which the partner's pension is guaranteed on an 'accrual basis'. Swapping is not possible with a partner's pension on a 'risk basis'. There are pension schemes that arrange for one's pension accrual to continue when an employee becomes occupationally disabled in full or in part. For the part that one is still able to work, one will pay pension contributions himself. For the part that one is unable to work, one does not need to pay contributions. Disability pension is supplementary to occupational disability benefits (Work and Income according to Labour Capacity Act).

## Pension agreements

The nature of the pension arrangements agreed between the employer and the employee must be established explicitly in the pension agreement. Pension risks arise when the financing of a pension scheme offers insufficient guarantees for achieving the planned benefits. These risks may be linked to the pension commitment. Due to demographic changes (longevity and return) a different approach to risk sharing has been introduced. Pension arrangements are made in many different ways. In the Netherlands, the basic agreement should be either a *defined benefit* (DB) scheme, an agreement for the payment of a capital sum or a *defined contribution* (DC) scheme. *Collective Defined Contribution* (CDC) schemes – that is, schemes which combine a defined benefit promise to the participant and a fixed premium for the employer – will have to qualify as one of these agreements. Only if buffers are high enough will they qualify as DB schemes.

The majority of Dutch employees are in DB occupational pension schemes in which the financial or longevity risks are borne by the scheme sponsor. Benefits to the members are based on a formula linked to the members' wages or salaries and length of employment. A DC scheme is a pension scheme by which benefits to members are based solely on the amount contributed to the scheme by the sponsor or member and any return on that investment. The investment risks during the accrual stage are borne entirely by the individual. Ultimately, when the retirement age is reached, the total amount accrued will be converted into benefits or an annuity.

A shift is taking place from pension schemes based on final pay to pension schemes based on average earnings over the accrual period in order to create a more balanced distribution of risks between employers and employees. In 2000, 59 percent of the active members had a final pay pension scheme, whereas in 2008 the corresponding figure was 1 percent and, for members of a career-average scheme, 87 percent (31 percent in 2000), respectively.

### Types of pension scheme, 2000-2007 (expressed as a percentage of active members)

	2000	2001	2002	2003	2004	2005	2006	2007	2008
<i>Defined benefit</i>									
Final pay scheme	59	56	54	49	12	11	10	3	1
Career-average scheme	31	32	32	35	73	74	77	85	87
Other	8	8	8	10	10	9	9	1	0.5
<i>Defined contribution</i>									
Other	1	3	3	3	3	4	4	5	5
	2	1	3	3	3	2	0,5	3	2

Source: DNB Statistics Bulletin, December 2008

In DB agreements, the benefits are linked to the earnings in the accrual period. If pension benefits are based on income before retirement, then the pension scheme is a *final pay* scheme. With every career step, the pension entitlements will be raised to the level of the actual basic value of the pension benefit. If pension benefits are related to lifetime average earnings, then the pension scheme is a *career-average* scheme. In a career-average scheme, the pension rights are linked to the income in a specific year and are indexed to the general level of consumer prices in a subsequent year. Periodic indexation is generally not guaranteed and is a discretionary power of the pension fund board.

Another possibility is a pension scheme with a combination of final pay and career-average elements. The basic principle is a benefit based on final pay but which, once a certain age is reached, no longer includes increases in income in the build-up of the future benefit. This levelling is called a *moderated final pay scheme*.

#### *Average contribution amount*

In the Dutch system of occupational pensions, the contribution is a fixed percentage of earnings (about 16 percent of the gross income). Solidarity is achieved by levying an average contribution: all members pay an equal percentage of their salary or an equal contribution to the pension provider, which will invest this contribution until the retirement date. The average contribution amount is divided among all affiliated employers and is based on average earnings or on another criterion.

There is therefore no direct link between the annual contribution payments and the employee's pension accrual in a certain year. In addition, the determination of the contribution rate does not depend on age, sex, health and income.

#### *Basic value of the pension contribution*

Occupational pension schemes are considered supplementary to the old-age state pension. This AOW benefit is therefore included when calculating the occupational pension benefit. AOW and occupational pension benefit together usually amount to 70 percent of the final pay. The part of the income over which no additional pension entitlements are accrued, because the part is expected to be covered by the AOW, is known as the *offset* (franchise). The gross income less the offset is the basic value of pensionable earnings.

## 4. Third pillar: private pension provisions

The Dutch pension system also includes individual pension provisions, either through annuity insurance or endowment insurance (providing a lump sum), encouraged by tax reliefs up to certain limits. This third pillar of the Dutch pension system is relatively small. Employees can opt to supplement their pension to compensate for a pension deficit due to gaps in pension accrual.

For most employees, participation in a pension scheme is automatically linked to the contract of employment. Self-employed persons are not linked to an employer and cannot participate in a supplementary pension scheme. In many cases, they must ensure that their AOW state pension is supplemented by individual pension provisions. Self-employed persons can also add a percentage of their company's profit to the special tax allowance on an annual basis. The tax authorities will take that amount into account in the tax return and tax payment over that amount will be deferred.

### *Life-course savings scheme*

With the life-course savings scheme, the Dutch government gives financial support to every employee who wants a period of leave during his or her working life for parental leave, education, partial early retirement or old-age pension. People can save 12% of their annual pay up to 210% of the gross annual salary. Being a savings scheme, it guarantees the personal contribution of the employee.



## 5. Occupational pensions and legislation

### Safeguarding the affordability of the pension system in the long term

The legal framework of occupational pensions consists of the Pensions Act (PW), the 2000 Mandatory Participation in an Industry-Wide Fund Act (Bpf 2000), the Mandatory Pension Act for Professional Groups (WVB) and the Equalisation of Pension Rights in the Event of a Divorce Act (WVPS).

#### Pensions Act

The vast majority of those employed in the Netherlands participate in an occupational pension scheme. Occupational pensions are subject to negotiations between employer associations and trade unions. The government's role with respect to supplementary pensions is to ensure that pension entitlements are actually fulfilled. Once an employer has made a pension commitment to his employees, this commitment must be implemented in the way prescribed in the Pensions Act. The commitment is therefore subject to the protection of the Pensions Act.

The Pensions Act came into effect on 1 January 2007. The basic principle of this Act is to safeguard the financial security of pension entitlements, individual security and protection of participants and security in the pension institution's operational management. To this end, this Act constitutes a technical revision and modernisation of pension regulations. For instance, a clear and transparent division of responsibilities between the employer, the employee and the pension provider is arranged. Major policy changes relate to the surrender of small old-age pensions upon the end of participation, transfer of pension value if the employment relationship or participation is terminated, transparency regarding the information provided to members and financial supervision. The Pensions Act also has provisions to improve the access to pension schemes.

#### *Responsibility triangle*

In the old-age pension system of the Netherlands, the employer, employee and pension provider are in a triangular relationship. The Pensions Act specifies a number of mandatory legal documents between the three parties involved. The basic principle of the Pensions Act is that social partners are primarily responsible for the occupational pension provisions. They jointly decide on the contents of the pension agreement. The employer is responsible for placing the pension contributions outside the company by joining an industry-wide fund, establishing a single-company fund or outsourcing the accrued pension assets to an insurance company. Finally, the pension provider is responsible for drawing up pension scheme regulations in accordance with the pension agreement and which comply with legal requirements. The pension provider is also responsible for the provision of information to members and beneficiaries.

#### *Equality of rights*

An important aspect of collective pension schemes is the gender equality in contribution and accrual system. This is tailored to the average participant, both with respect to the contribution rate and to the

retirement benefit. Other protective measures to safeguard the pension rights are equality in treatment of full-time and part-time workers, of workers with a temporary appointment and a permanent position, and of pension rights of retired persons and early leavers (people with non-contributory entitlements that remain with previous employers). Since 2005, pension benefits based on DC pension schemes have been the same for men and women. Anyone who feels that they have been subject to unequal treatment may go to court or approach the Dutch Equal Treatment Commission, which can launch an investigation into any complaint. The Commission is an independent body of experts. Contrary to court rulings, decisions of the Commission are not binding.

Under the Dutch Pensions Act, the accrual of old-age pension rights under a pension agreement begins no later than the date on which an employee reaches the age of 21.

#### *Surrender of small old-age pension upon the end of participation*

Pension rights of a deferred beneficiary may not be exchanged for a lump sum (surrender) unless, on the basis of the right to old-age pension accrued up to the moment of end of the participation, the old-age benefit will amount to less than EUR 417.74 (in 2009) per year on the regular retirement date. The costs of administering small old-age pension entitlements are relatively higher than the benefits expected.

#### *Transfer of pension value if the employment relationship or participation is terminated*

Pension rights are fully transferable when people change jobs. There is a legal requirement to index pension rights of people leaving a scheme before retirement in exactly the same way as pensions in payment are indexed. Vesting periods are very short (generally two months).

If the employment relationship or participation on an individual level is terminated, the person in question may transfer the pension value to the pension provider of the new employer. However, that person is not obliged to transfer pension entitlements to the pension provider of the new employer. If the pension value is left behind by the pension provider of the previous employer (deferred pension rights), this provider will pay out later.

#### *Information*

The information-related provisions of the Pensions Act became effective on 1 January 2008. These provisions are expected to boost pension awareness. This may be significant if people expect a deficit in their old-age income, wish to leave the labour market before the age of 65 or want to live abroad. They may then consciously buy additional pension products to compensate for insufficient old-age income.

On joining the pension scheme, members must be adequately informed about the contents as well as the implementation of the pension scheme. These documents must clearly and understandably state the objectives of the pension fund and the rights of the scheme's members and beneficiaries. Material changes in these objectives or rights must be reported to them in a timely manner. For instance, within three months after the accrual of pension entitlements has started, the employee is entitled to information about the contents of the pension scheme ('starting letter') from his employer. The

employee must be informed by the pension provider about the development of the pension entitlements. This information must also show whether the pension scheme qualifies as a DB agreement, a DC agreement or a capital agreement. The implementation agreement to be formed must also include the information provided by the employer to the pension provider.

In addition, from 1 January 2009 onwards, the so-called indexation label will be included in the annual pension statement that is provided by the pension provider. This label offers insight into the quality of the indexing (adjustment to price development) of the pension scheme. It represents both the expected indexing for the coming 15 years as well as its certainty by also representing the indexing in a 'bad case' scenario. The label will also help the individual changing jobs to make a choice about whether or not to transfer pension value to a new pension provider.

The pension portal, which is an initiative of the pension sector, must also be mentioned. This portal will come into effect in 2011. With the introduction of the pension portal, people will be able to view their accrued pension rights online, including the benefit under the General Old Age Pensions Act (AOW).

It is also important for objective and non-commercial information about pensions to be available. That is why the Dutch government supports projects of the *Pensioenkijker.nl* foundation, in which the main stakeholders in the pension sector are participating. The pension awareness of Dutch people is monitored annually in March by *Pensioenkijker.nl*.

#### *Pension fund governance and participation councils*

The board of a pension fund normally consists of an equal number of employee and employer representatives. The board is supposed to take into account the interests of all active members, deferred members and retirees of the fund and ensure that each of these groups feels equally represented. Furthermore, a pension fund must organise itself in such a way as to ensure proper governance. In short, a governing body must clearly understand its responsibilities, how those responsibilities must be borne, how internal supervision is arranged, and how and to whom the governing body must report.

The Guidelines for Pension Fund Governance were developed by the Labour Foundation. This foundation formulated a number of basic premises. A governing body must periodically account for its policy to all stakeholders (or their representatives), namely active members, deferred members, retirees and the employers who are financially involved. There must therefore be an accountability body. In addition, there must be effective and transparent internal supervision of the governing body's own performance. It is up to the individual pension funds to determine the way in which these guidelines are implemented. Since they are part of the Pensions Act, the guidelines are legally binding.

The guidelines also apply to pension insurance companies. In this case, the insurance company must account to the employer for the results achieved, to the extent that this is relevant to the pension and administration agreement. The employer must inform his Works Council and representatives of retirees of the above-mentioned results. In addition, the insurance company must ensure effective and transparent internal supervision of its own performance.

In addition to the guidelines, there are also rules regarding the representation of retirees. Industry-wide pension funds are obliged to establish a council of participants. A single-company fund may have a council of participants or admit retirees to be a member of the pension fund's board. There are some single-company pension funds that have both forms of representation. The council of participants has the right to prior consultation on a large number of issues. Furthermore, by law the ratio between employees and retirees (or their representatives) in the council of participants must be equal to the ratio between active members and retirees.

#### *Financial supervision*

There is a financial regulatory framework to ensure that a pension fund has sufficient assets to pay out pension benefits. The Financial Assessment Framework (FTK) is the part of the Pensions Act that lays down the statutory financial requirements for pension funds. The main principle of the FTK is that pension funds must decide on cost-effective contributions and must build up regulatory funds of their own to ensure additional reserves of 25 to 30 percent in order to guarantee their members a pension benefit. A fund whose own assets have fallen below its basic limits must draw up a recovery plan, outlining how it will eliminate the reserve deficit and/or funding shortfall.

According to the FTK, pension funds must state in a clear way whether or not they will index the pension rights and under what conditions they intend to do so. If prices are going up the pension rights will follow later. This indexation is virtually always conditional. In the Netherlands, there is an element of risk sharing through discretionary indexation and increases in contributions. It is not required for pension funds to have additional reserves to cope with future indexation. On the other hand, each pension fund must report to the supervisory authority that the level of financing achieved and the degree to which claims are awarded to members meet the expectations raised. Their indexation label indicates the degree to which their commitments keep up with inflation under normal conditions and what happens in a bad case scenario.

#### *Supervisory structure*

Pension schemes and pension providers are professionally monitored and supervised by two regulatory authorities, namely the Dutch Central Bank (DNB) and the Netherlands Authority for the Financial Markets (AFM). Under the Pensions Act, the Minister of Social Affairs and Employment is politically responsible for the Dutch old-age pension system. In addition, he must ensure that the supervision exercised is legitimate, effective and efficient.

DNB monitors the financial position of pension providers and assesses whether they are financially sound and able to fulfil their future obligations. DNB is also responsible for the material supervision, i.e. for the requirements imposed on pension providers.

The most important issues dealt with by AFM are better provision of information to members, current and former, and beneficiaries, and the maintenance of the duty of care when pensions are being accrued through investments. This means, in particular, that pension providers must properly inform their customers and must act according to particular standards when applicable. The intention is to improve members' and current retirees' understanding of the pension-related information provided so that this information can be used in personal choices about the accrual and use of pensions.

## Mandatory Participation in an Industry-wide Pension Fund Act (Wet Bpf 2000)

Under the 2000 Mandatory Participation in an Industry-wide Pension Fund Act, when social partners make a collective pension agreement in a specific industrial sector for all of their members, and if the representatives of organised businesses in this sector file a request, then the Minister of Social Affairs and Employment can declare the collective pension agreement binding for all other employers in that particular sector. In this way, agreements between social partners are made binding for everyone in the sector and internal solidarity is optimal, for example in the graphics and media industry or the metal industry. Employees can easily change jobs within the sector without consequences for their pension accrual. For participation in a pension fund to be declared mandatory, however, the employer organisations supporting the request must employ at least 60% of the employees in their sector. No corresponding figure is prescribed for employee organisations.

In certain defined cases, employers can be exempted from participation in a mandatory pension scheme, for example if a company already has a pension scheme that is at least equivalent.

## Mandatory Pensions for Professional Groups Act (WVB)

The Mandatory Pensions for Professional Groups Act came into effect on 1 January 2006. The Minister of Social Affairs and Employment can declare the collective pension agreement binding for all professional members in a particular sector. This occurs at the request of more than 60 percent of the professionals affiliated with a union of professionals. The agreement consists of regulations concerning information, supervision, solidarity, representativeness and so on. As pension schemes for professional groups are not based on pension commitments made by employers, such schemes are only partially subject to the Pensions Act. A pension scheme for professional groups is based on an agreement between self-employed professionals in a particular profession. At present, there are 13 pension funds for professional groups, e.g. for pilots, civil-law notaries and medical specialists. A pension fund or insurance company may administer the pension assets.

## Equalisation of Pension Rights in the Event of a Divorce Act (*Wet verevening pensioenrechten bij scheiding*, WVPS)

Pursuant to the Dutch Equalisation of Pension Rights in the Event of a Divorce Act, in the case of a divorce or ending of a partnership, both former spouses or former partners are entitled to 50 percent of the old-age pension accrued during the marriage or registered partnership. The pension provider pays out a share of the accrued pension entitlements to each of the former partners individually from the pension date of the partner that has accrued pension rights.

Pension sharing will always be applicable, unless it is excluded in advance or in a divorce agreement, so there is no need for intervention by a judge. The benefits will be paid out as long as both former partners are alive. When the ex-partner passes away the person liable for pension sharing will receive a full old-age pension again. If the person liable for pension sharing passes away, the payment of pension benefits will stop, but the surviving individual can have a right to a special partner's pension.

#### *Partner's pension*

Not every occupational pension scheme includes a partner's pension. If there is an arrangement for a partner's pension, however, this benefit will be paid out to the next of kin. Sometimes, the benefit is linked to the state old-age pension and depends on the salary and maximum attainable number of years of service (accrual basis). Not all pension schemes link the amount of a partner's pension to the old-age pension, however. There is an important distinction between partner's pension on an accrual basis and one on a risk basis. Many pension schemes feature a partner's pension on a risk basis. This means that no capital is accrued for the surviving individual.

## 6. Tax legislation and pensions

Tax reliefs play an important role in ensuring an adequate standard of living during retirement. Contributions to pension products are tax-deductible and taxed in the pay-out period (EET system). In addition, marginal tax rates will be lower during retirement than employment, offering further benefits. Tax legislation is therefore very influential in the Dutch pension system. The pension facilities encourage members of the public to make financial arrangements during their active lives to ensure adequate old-age provisions.

In general, supplementary pension schemes are subject to the following fiscal limitations. Pension accrual is maximised to 100 percent fiscal pay at the age of 65, at least. The yearly accrual of final pay systems is maximised to 2 percent. The accrual rate of career-average systems varies from 2 percent to 2.25 percent per year.

Contributions to voluntary early retirement schemes and pre-funded flexible pension schemes are no longer deductible from taxable income. A transition period applies. It is still possible to leave the labour market before reaching the age of 65, but only at one's own expense:

- if an employee wishes to receive his old-age pension before the age of 65, then the pension benefit will be lower because the accrued pension capital has to be paid out for a longer period;
- the life cycle savings scheme – a tax facility that makes it possible for workers to reserve salary and days off in order to take up paid leave later – is a savings arrangement that guarantees the personal contribution of the employee and can also be used for early retirement.

### *Financial incentives to retire later*

It is also possible to work beyond the age of 65 (i.e. to retire later). This is only possible, however, with the approval of the employer and if the pension scheme supports longer working lives and active ageing. By completing more years of service, one accrues more pension rights. The pension benefit can be paid out later and will therefore be higher. Broadly speaking, every year of postponement yields a pension accrual of about 9 percent. Deferring the retirement date therefore yields a considerable increase in pension benefits and might be an attractive way of compensating for a possible pension deficit.

It is possible to combine receipt of the state old-age pension benefit with work. The after-tax earnings of employees aged 65 and over are higher than those of employees under 65. This is a consequence of the fact that people aged 65 and over are no longer compulsorily insured under insurance schemes for employees and no longer pay a contribution for the state old-age pension.

Under tax legislation, payment of pension benefits must start when an entitled person reaches the age of 70 at the latest. If people aged 70 and over are still in paid employment, there is no more pension accrual.

#### *Partial retirement*

The rules on pension deferral vary between occupational schemes. It is possible to combine the occupational pension scheme with work. Indeed, some schemes allow a member to draw a pension and continue to work with the same employer. For the working part, the employee can still accrue pension rights.

If the employee decides to work part-time during the ten years preceding his retirement, he continues to accrue full pension rights if the part-time job is equal to at least 50% of his original terms of employment. In this way, the combination operates as an incentive to retire later.

#### *Link with individual pension provisions*

In the case of a pension deficit, people can buy annuity insurance which is encouraged by tax reliefs. The contribution is deductible from income tax; the future benefit will be taxed. The Bank Savings Act came into effect on 1 January 2008. The aim of this Act is to encourage saving for one's old age by means of a savings account or an investment right with a bank.

In addition, employees are able to save money from their gross income in a fiscally favourable way by means of the salary savings scheme or the life-course savings scheme. The basic principle of the salary savings scheme (*spaarloonregeling*) is that employees pay less income tax and less contribution for national insurance. On the basis of the salary savings scheme, an employee may save EUR 613 (2009) of his earnings annually. These savings may be used for buying annuity insurance or as a self-imposed contribution for additional third-pillar pension products.

The life-course savings scheme (*levensloopregeling*) has a similar operating procedure. This savings arrangement enables employees to reserve a part of their salary to be used during periods of unpaid leave in the future. Fiscally attractive, employees can reserve 12% of their salary up to 210% of their gross annual pay.

Payment of taxes over the reserves is deferred to the moment the savings are used. The arrangement requires the cooperation of the employer, who has to offer the scheme to his employees. The arrangement increases the possibilities for employees to adapt the time spent on work, care, education and leisure. Furthermore, being a savings scheme, it guarantees the personal contribution of the employee.





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