Netspar
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Measuring risk capacity

"Risk capacity is not just related to age"

R. Alessie, V. Angelini and L. Kleinhuis – University of Groningen & Stockholm University

Risk tolerance (willingness to task risks) and risk capacity (amount of financial risk individuals can bear) are key concepts for implementing adequate strategies in the new Dutch pension contract. We therefore measured age-related differences in risk capacity in a representative sample of the Dutch population to find out whether there are patterns or factors that pension funds should consider when making investment decisions.

Principal Findings

- Measures of income and discretionary wealth (wealth not locked up in mandatory occupational pension schemes) reveal strong differences in risk capacity across age groups.
- The most vulnerable groups in terms of risk capacity are households with a female head, those with lower education, and those not in employment.
- The gap between the risk capacity of tertiary-educated and non-tertiary-educated households decreases with age, both in relative and absolute terms.
- Although human capital decreases over the life cycle, the discretionary investment in risky assets increases with age up to the mid-50s.
- However, most of the population does not privately invest in risky assets. This applies to all ages.

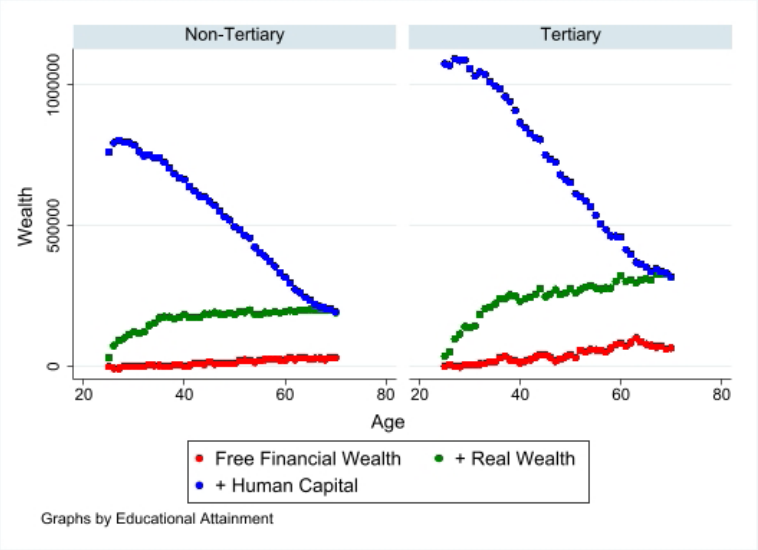

Figure: Risk capacity by age and educational attainment
Note: The figure plots the overall risk capacity and its composition in euros. Human capital is based on the income definition which excludes AOW. Based on data from the DNB Household Survey (DHS) for the years 2004 to 2019.

Key Takeaways for the Industry

- Pension funds should take the risk intolerance as well as the risk capacity of their participants into account.
- The distribution of risk capacity may differ substantially across pension funds. Further research into this is needed.

Want to know more? Read the paper
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