We need to be even more transparent.

Risk profiling can be improved.

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Theme: Duty of Care
Martin van Rijn:

“EXACTLY BECAUSE WE ARE DEALING WITH MANDATORY ARRANGEMENTS, WE NEED TO BE EVEN MORE TRANSPARENT.”

In this interview Martin van Rijn (CEO, PGGM) sheds light upon the role of the duty to care for a mandatory pension fund. He makes the case for more transparency and discusses future developments in the way pension funds communicate with their members.

How important is the duty of care for a pension fund with mandatory participation?

Exactly because we are dealing with mandatory arrangements, we need to be even more transparent than with an arrangement based on voluntary participation. That is not just a duty of honor, but also because you need to consider that people cannot automatically opt out. So there is a much greater obligation to be transparent about the cost and return of investments. And that brings us to the next question: how far should we go in this? In my view we need to go pretty far: reporting direct and indirect costs, internal and external costs, etc. It’s not easy to communicate all this in a simple way. But that’s no excuse not to do it. This is part of the duty of good care that we have as a pension fund, to put it dramatically. Also it is important to communicate pro-actively to the members about the risks involved in pensions. Especially in the pension contracts that we now get, it is necessary to demonstrate the link between return and risk and pension performance, plus to show what options are available and what choices can be made in that regard. We notice that there is an enormous need among members to understand it.
Pension product providers have a statutory duty of care toward consumers. This includes establishing a risk profile for participants in invested pension plans. The risk profile is intended to ensure that the investments made are compatible with the level of risk that the participant can afford and wants to take. In a recent Netspar NEA paper, written with Benedict Dellaert, Marc Turlings observes that risk profiling can be improved. In this interview he talks about how this could be done.

Marc Turlings:

“IS IT REALLY SO BAD IF SOME PEOPLE CAN’T MAKE UP THEIR MINDS ABOUT A RISK PROFILE?”

Roel Mehlaup

How are risk profiles determined?

The Financial Supervision Act (WFT) outlines the basic principles for determining participants’ risk profiles. A provider of investment products must obtain information about a participant’s financial status, investment knowledge, investment experiences, financial goals and risk tolerance. Pension administrators, therefore, all more or less obediently follow that list of criteria in drawing up a risk profile.

In your paper you and Dellaert contend that the methods for determining risk profiles could be improved. They can be improved because the questions used for the profile assessment are not all specifically geared to the specific product and the goal you are seeking to achieve. And the whole purpose of a pension investment is to provide for your old age. That is why we recommend to develop a better method specifically for determining risk profiles for invested pension plans.

How can the questions be improved?

Take the way they ascertain risk tolerance; people are often asked about this in a general sense. That might generally be done in the form of a question like “Would a sudden drop in the stock market keep you up at night?” While that is certainly a question that explores risk tolerance, it is definitely not the best question. The question does not measure one’s risk tolerance with regard to income for your old age. Another example involves how they measure...
people’s financial status. The questions often focus on the participant’s existing financial position. But if you ask a 25-year-old who has just started working about his or her existing situation, you are giving short shrift to the splendid career that individual has ahead of him or her. We therefore argue in our paper that certain questions are not very relevant for determining the risk profile, and, if anything, sometimes even actually produce inaccurate results. One such problem area is investment experience, on which we take the rather strong stance that it makes no sense to question people about this. If we can all agree that it is smart for a worker just starting out to assume more risk, then it is truly wrong to interpret a lack of investment experience as being “conservative” for the purposes of the risk profile.

It should be possible to agree about a specific method for determining risk profiles for invested pension plans within the existing legal framework. The WFT states that information must be obtained “to the extent this is reasonably relevant for the advice concerning or management of the individual assets.” We could perhaps all agree, for instance, that certain aspects, such as investment experience, have no relevance for an invested pension plan. The AFM could help on this front. We could come up with a new standard for a risk profile assessment method as a sector. The AFM could then evaluate whether that method fell within the legal framework, in accordance with that “escape clause” in the WFT.

In the paper, you also suggest using scenario analyses to communicate with participants. What is wrong with the present form of communication?

Currently, projections are made of pension outcomes based upon a fixed return on investments. This gives little information about risks involved. It would be better if you were to illustrate real scenario analyses based on a probability distribution. Instead of a calculation of a steady return until the pension date, we think it is better to present the actual probability of the outcome of several scenario’s. And then it’s probably best to pick out three quantities: an average market, a good market and a poor market.

Will people understand that?

That’s the big question! In fact, that is the topic of our follow-up research. We are planning a follow-up study with Benedict Dellaert of Erasmus University into what means of communication are most effective and best understood by participants.

What about the people who still don’t understand?

You are naturally always going to have some participants who don’t understand things or who cannot make up their minds about a risk profile. Then you have to ask yourself, “Is that really so bad?” It might not be such a bad thing if you have a very solid default option.

In a recently published report, the AFM calls for a greater emphasis on the cost efficiency of pension funds. We have observed that there are still economies of scale to be achieved. While the cost efficiency of pension schemes is generally pretty good, we have found that there is noticeable room for improvement at many pension funds. The main reason for this is that pension funds do not always have their costs well under control. In fact, the basic message of the report is that controlling costs should be a top priority, because then you can administer things better as a pension fund.

Do you think cost efficiency will improve in the future? We are curious to see what happens with the new IORPs. They claim to be very cost efficient. That remains to be seen, but if it turns out to be true, then we think that will put pressure on the other insured schemes. It is quite possible, then, that the introduction of these IORPs will act as a quality incentive. This would primarily be true in cases where the employer selects a pension scheme as a means of remunerating employees, instead of merely looking after their interests.

Roel Mehlkopf

What is your opinion of the quality of the information on pensions generally provided?

The provision of information is extremely inadequate among some insurance consultants who advise employers. And the advice given to individual participants wanting to take advantage of the investment options for their defined contribution scheme has also fallen short. Things are not yet at the level we would like to see in that area. You have a situation where each insurer designs the risk profile for participants on its own. For example, there is tremendous variation in the questionnaires used to determine the risk profile. The differences are so extreme that we, as the regulatory agency that monitors professional conduct, find the practice questionable.

So, you would like to standardize the risk profile analysis?

That poses a dilemma for us. One option would be to provide general guidance on how to improve quality, but another would be to specifically dictate how the risk profile for participants should be determined. That would allow people to compare the risk profiles of different insurers.

Jan van Miltenburg (AFM):

“THE CURRENT UPO AMOUNTS ARE MISGUIDING PEOPLE.”

With Jan van Miltenburg of the Authority for the Financial Markets (AFM) we talk about developments in pension supervision. He explains his views on the quality of information, cost efficiency, paternalism and the upcoming pension reform.
What is your view of the communications sent to participants in the Uniform Pension Overview?
The UPO is a good thing to have, because the sector has been able to use it to set up the pension register. But we do not believe that they should continue to provide purely static information, with a set amount for the pension accrual, without informing people about the implications of the associated downside, namely shortfalls or insufficient indexing. Participants are prone to money illusion. At the very least, then, the current UPO amounts are misleading people. This is compounded by the fact that many participants do not understand risk. You need to help them by visualizing risk.

At a Netspar meeting in May, you held an impassioned appeal for restricting the number of options out there. That is my personal opinion. I have a problem with this trend toward more choice. We notice that the vast majority of participants tend to stick with the default option when faced with making investment choices. And I’m glad about that, because that relieves the employee of the responsibility, which is best. Participants have a difficult time thinking in the long term.

Have you noticed that the default options are being wisely chosen? In some cases we have seen default options that are really very cautiously established. Some providers like to maintain a default option that is, in our eyes, far too cautious, because they think that will prevent the participant from saying later that they took too great a risk. Whereas, we say to this: they took too little risk to accrue a decent pension. Those are the exceptions, though, not reflective of the overall situation.

What new developments do you expect in the near future regarding the duty of care? Should participants be faced with the decision whether or not to transfer the value of their old entitlements to a new pension plan, then some sort of advice or support must be available. The quality of this support – let’s just call it advice – must be high for it to have a chance of success. This means that the advisor must consider the interest of the participant before all else for the duty of care to be exercised properly. That is to prevent disappointments later on.

AFM JOINS THE NETSPAR NETWORK

Netspar is delighted to welcome the Netherlands Authority for the Financial Markets (AFM) as a new partner. Last May, AFM’s Managing Director, Harman Korte, and Frank van der Duyn Schouten, chairman of the Netspar board signed the contract. Netspar is confident that with AFM as new member the pension discussion within Netspar will be enriched.

AFM has been responsible for supervising the operation of the financial markets since March 2002. This means that AFM supervises the conduct of the entire financial market sector: savings, investment, insurance and loans. By supervising the conduct of the financial markets, AFM aims to make a contribution to the efficient operation of these markets.

Duty of care, theme of this Netspar Magazine, is a very important issue for AFM, as argued by AFM’s Jan van Miltenburg, Manager Transparency Monitoring, in this Magazine. AFM employees were already involved in the Netspar task force Duty of Care, in which Benedict Dellaert (EUR) and Marc Turlings (Achmea), also interviewed in this Magazine, are active.
DUTCH MINISTRIES

In a list that includes pension providers, insurance companies and universities, the national ministries would almost seem intruders. And yet four Dutch ministries, those of Social Affairs & Employment (SZW), of Finance, of Economic Affairs, Agriculture & Innovation (EL&I), and of Education, Culture & Science (OCW), are closely involved with Netspar. That is because of the relevance that they see in the results of Netspar’s research efforts.

The Ministries of SZW, Finance, EL&I and OCW are tied to Netspar as subsidy providers. In addition, policy staffers of the various ministries regularly attend Netspar meetings and use Netspar publications as a source of information in establishing and structuring policy. Each ministry has its own reasons for connecting to Netspar. The involvement of SZW and Finance lies primarily in the fact that they are responsible for policy with respect to the pension system and the related tax incentives. EL&I attaches great value to linkage with Netspar because of the impact of pensions on the performance of the Dutch economy. And OCW is especially involved in light of the incentive subsidy that it provides to Netspar since 2005 because of the social relevance of research in the fields of pensions and insurance. Together these four ministries express the government’s stake and interest in the pension area.

Government policy with regard to pensions is set at various levels. The Ministry of Social Affairs & Employment establishes, via the Financial Assessment Framework, the financial criteria that must be met by pension funds. This ministry is also an important link in the negotiations between employers and employees regarding the design of supplementary pensions, such as in the recent pension accord. Consultation and legislation regarding pensions at European level are joint tasks of Social Affairs and Finance. The Ministry of Finance deals with the tax incentive treatment of supplementary pensions. Under the Financial Supervision Act, it is responsible for premium pension institutions, i.e. insurers that provide pension products in the second and third pillars. Economic Affairs is charged with supervision, via the Netherlands Competition Authority (NMa), of the competition rules applying to mergers between pension funds.

The recent economic crisis rudely awakened pension funds, government, and the general public out of the dream of pension certainty. Obviously it was already clear what aging and low birth rates would mean for the base of support of social security benefits and for the sustainability of government finances. However, the consequences of investment policy, premium levels, and whether premium entitlements should be conditional or not recognized until more recently. Here lies a challenge for the pension industry, both in terms of communication and the more technical aspect of the adjustment of pension contracts and investment policy. The national government mainly sets the enabling conditions. After all, pensions especially involve the social partners, while the government sets the fiscal and supervisory boundaries for the contract. These boundaries are crucial for a solid pension system that can cope with future uncertainties. In addition, supplementary pensions impact government finances and the competitiveness of our economy. For example, a more favorable tax treatment of supplementary pensions would impact public finance. Also, the level of state pensions and the accrual of supplementary pensions are interrelated. On top of that, the level of pension premiums affect our ability to compete as a nation. Higher pension premiums lead to higher labor costs and thus higher prices for products and services; and that impairs the competitiveness of the Dutch economy.

By bringing the pension industry, government, and the academic community into contact with each other, Netspar provides a platform for the linkage of knowledge, expertise, and contacts. The best international researchers work on answering questions that are both academic, practical, and policy-related. The various ministries therefore use insights from the research conducted by Netspar to substantiate their policies. In addition, Netspar provides good facilities for maintaining contacts with the pension industry. The ministries obviously connect with the pension sector not just via Netspar, but Netspar seminars are always a great opportunity to exchange ideas on specific subjects. Lastly, the schooling that Netspar provides ensures the inflow of university graduates into the sector. With a view to the challenges that the pension industry faces, that is hardly a superfluous luxury.
Autumn 2010

In the European Research Area

SHARE-ERIC: A New Phenomenon

The European Commission is increasingly aware that in order to remain competitive as knowledge society it is absolutely necessary to create a solid European research infrastructure. For this purpose the European Commission has created a new legal European entity, the so-called European Research Infrastructure Consortium (ERIC).

Apart from scientific visibility this legal status provides various privileges, amongst which simplified procurement procedures and VAT exemption. We are proud to announce that SHARE, the Survey for Health, Ageing and Retirement in Europe, is the first research infrastructure in Europe that has been awarded the ERIC status. It can be expected that having the ERIC status for SHARE will strengthen the position of the social sciences in the increasingly competitive European research arena.

Thanks to an efficient operation by the Dutch Ministry of Education, Culture and Science, the EC decided to appoint Netspar in the Netherlands as the European seat of SHARE-ERIC. Next to that, the German, Italian and Dutch nodes have special central tasks and responsibilities for the survey as a whole. Netspar considers this as a new landmark in its development and a substantial step towards a stronger European orientation.

As indispensable as telescopes are for astronomy and microscopes for biology, just as indispensable is data for research in social sciences in the 21st century. Collection of data in social sciences has become a science in itself. Particularly when research focuses on international comparisons it is extremely important that the underlying data satisfy high standards of representativeness and reliability in order to reach trustworthy conclusions.

SHARE is a longitudinal survey in which more than 50,000 Europeans in the age category 50+, from 20 different European countries, are interviewed every two years. The survey is based on Computer Assisted Personal Interviews, while special care is devoted to the translation of the questionnaires into national languages. The interviews include questions about income security, personal wealth, pensions, living arrangements, social networks, physical and mental health but also physical measurement of grip strength and blood pressure. At present the 4th wave of SHARE is on the way.

The SHARE-data are freely accessible for every scientist who registers and promises to use them for scientific research only. So far over 2000 scientists from all over the world are registered as SHARE-data users. Publications based on SHARE-data range from highly theoretical to strongly policy oriented.

In every participating European country the SHARE organization has a national scientific node, which is selected based on the advice of SHARE’s international scientific council. The leaders of the national nodes act as local country team leaders and are responsible for the execution of the successive waves in their country. For the Netherlands Netspar has been selected to play this role.

More information is available on the SHARE website: www.share-project.org

Discussion Papers (DP) are produced by all Netspar researchers and Ph.D. students who are involved in one or more Netspar research programs or themes. A DP aims at publication in high-standard scientific journals. It is usually the output of a research proposal funded by Netspar. It is published on the Netspar website jointly with a management summary. The DPs are discussed during Netspar activities and digitally published on our website and SSRN.

Euwals, Rob, Annemieke van Vuren and Daniel van Vuuren
The Decline of Early Retirement Pathways in the Netherlands: An Empirical Analysis for the Health Care Sector (DP 06/2011-055)

Franzoni, Francesco, Eric Nowak and Ludovic Phalippou
Private Equity Performance and Liquidity Risk (DP 06/2011-056)

Dimitrova, Stephen, Roy Koorenberg and Peter Wakkier
Ambiguity Attitudes and Portfolio Choice: Evidence from a Large Representative Survey (DP 06/2011-054)

Henkens, Kene and Hendrik van Dalen
The Employer’s Perspective on Retirement (DP 05/2011-053)

Panel Papers (PP) outline the implications of new developments in the academic literature for policy questions faced by Netspar’s partners. The PPs are meant for professionals in the pension and insurance sectors and are discussed twice a year during one-day panel meetings. Representatives from academic and private sector partners, as well as international academics, act as discussants. The papers are published in a special PP booklet series.

Pelsers, Antoon
Pricing in incomplete markets (PP 25)

Cannons, Edmund and Ian Tonks
Annuity Markets: Welfare, Money’s Worth and Policy Implications (PP 24)

Koopmanschap, Marc, Claudine de Meijer, Bram Wouterse and Johan Polder
Determinants of health care expenditure in an aging society (PP 22)

Broer, Peter, Thijs Knapa and Ed Westerhout
Risk factors in pension returns (PP 21)

NEA (Netspar Economic Advice) Papers describe and motivate the position of the author on a policy-relevant topic. In contrast to the PPs, these papers contain strong statements. Although Netspar as such is impartial, individual researchers of Netspar may very well have (and express) a personal opinion. Netspar simply offers a forum for in-depth discussion.

The authors present the NEA Papers at meetings and discuss them with the audience. NEA Papers are also published in a booklet series.

Crom, Sybald van, Anne de Kreuk, Ronald van Dijk, Michel Veldekoop and Niels Vermeijden
Marktoplossingen voor langere levenswarmoede (NEA 42)

Pikkaart, Martin and Gert Bos
Doorzame pensioenen, uit angst voor vervaldag (NEA 41)

Bovenberg, Lans, Wouter Koolewijn and Niels Kortleve
Metavooruitzichten voor een duurzaam pensioen (NEA 40)

Veldexperimenten in onderzoek van Netspar
De gouden standaard bij beleidsvoorbereiding (NEA 39)

De gouden standaard bij beleidsvoorbereiding. Veldexperimenten in onderzoek van Netspar (NEA 38)
NETSPAR 2.0: A NEW PHASE FOR NETSPAR AND ITS PARTNERS

As of April 1, 2011 Netspar has entered a new phase in its existence. After six year of childhood Netspar is reaching the stage of an adult networking organization, with active participants in both the academic world and among practitioners.

Netspar's innovation agenda describes seven PILs:
1. Risk management during working life
2. Risk management during retirement years
3. The art of choosing
4. Supervision of fully funded pensions: solvency and transparency
5. Risk sharing and distribution among generations: full funding, pay-as-you-go, taxation
6. The labor market
7. Heterogeneity within generations and the position of senior citizens

Topicality Projects
Topicality Projects are short projects (up to half a year) and aim to formulate solutions to topical, well-defined issues. Scientists and industrial partners are involved in the project by, for example, joint supervision of the researcher, or co-authorship of NEA- or Design Papers.

Pros and cons of explicit and implicit age differentiation in proposed contracts
Possibilities in choice design while preserving solidarity and collectivity
Linking retirement age to development in life expectancy
Communication on insecurity of pension payments: conduct effects
Communication on insecurity of pension payments: comprehensible information
In what way influences communication about insecurity labor supply?
Supply: effects of retirement age raising and part-time retiring on effective retirement behavior

Small Vision Projects
A Small Vision Project basically consists of a PhD- or post-doc project for a maximum of three years. Both scientists and industrial partners are involved in the project by, for example, joint supervision of the researcher, or co-authorship of NEA- or Design Papers.

Large vision projects
A call for new large vision projects, which usually include several PhD students or post-docs and active involvement of both senior researchers and practitioners, is expected in the spring of 2012. These large vision projects will be the successors of the Netspar theme projects that contribute and still contribute to Netspar's goals.

More information
On our website www.netspar.nl you may find a lot of information on the new Netspar position, projects and grants. If you have any questions, please contact the Netspar office, +31 13 466 2109 or info@netspar.nl.
Netspar, Network for Studies on Pensions, Aging and Retirement, started operations in 2005. It is a network connecting two main groups: pension practice and pension science. The first group consists of ministries, supervising agencies and other civil service institutions, pension funds, pension providers, insurance companies, banks, asset liability management companies. The second group consists of Dutch and non-Dutch pension researchers, and Dutch universities.

Core Values
The core values of Netspar are independence, accessibility for new entrants, and openness to dialogue and interaction between stakeholders. Netspar recognizes the importance of diverse types of knowledge, various disciplines, and methodological approaches. It does not support particular policy positions, but is instead dedicated to promoting a wider understanding of the economic and social implications of pensions and retirement. It strives to effectively disseminate unbiased research output among public policymakers, professionals and trustees in financial institutions and the academic community.

Mission
Netspar endeavors to bring the pension debate to a high level of sophistication and to create high-quality solutions for present and future challenges with respect to an aging society. Furthermore, Netspar aims to position the Netherlands as a center of knowledge on pensions and social security both in- and outside Europe, both in the academic and the financial world and in policy circles. With this, Netspar wants to safeguard sustainable pension and insurance systems that share risks equitably and efficiently. The strive is to set an example how public and private parties in the service industry can work together with researchers in the social sciences in an efficient and mutually beneficial way to stimulate social innovation. Next to that, Netspar strives to act as an intellectual conscience of the community active in pensions and social security.