



Impact of Having Options  
Will Vary Tremendously

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from Themselves

Fiduciary Duty Hits the Pensions Domain

Theme: Limits to Freedom of Choice

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The grade I get is not what matters to me. I'm all about the content: I want to truly understand something. I won't be satisfied until I do

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## NO CHOICE

Pension schemes exist to relieve people of having to make complicated decisions. If these matters were simply left up to individuals, there would be few who would save for retirement. And those who did save would generally do so in the 'wrong' types of investments, with too little, or often too much, risk. That has been the painful experience of countries where pensions are left up to individuals instead of being collectively regulated. The solidarity in collective schemes means that we take the worry out for the individual participants in those schemes and help them build a good pension. Dutch pensions consistently rank at the top of international lists for the very reason that we make saving for a pension mandatory.

But perhaps we are taking our solicitousness too far. One of the salient issues being raised in the national pension dialogue is the need for more freedom of choice. More self-direction could make it possible to adjust pensions to accommodate personal situations. The diversity of the working population continues to grow and pensions are increasingly becoming more related to life-cycle planning, alongside issues such as career, home ownership and health-care. More self-direction could also increase people's involvement in their pensions and, thus, overall confidence in them. People seem to be of two minds about this, however: on the one hand, they want more say over their pension; on the other, they want it handled for them. Pensions are, after all, a very complicated—and for many, uninspiring—business that can quickly lead people to choice overload and procrastination.

Between the Scylla and Charybdis of free individual choice and mandatory obligation is a world of what we now call choice architecture. By presenting options effectively, we can guide decisions in the right direction without having them taken over by the collective. Paradoxically, we can actually take advantage of human weaknesses in doing so: for example, automatic enrollment and opt-out systems rely on the fact that under the stress of choice overload, people prefer to put off making decisions. Thus, people can be automatically enrolled in a pension scheme, when starting a new job, say, but they always have the option of terminating that scheme, which requires an active decision on their part. Another way to direct decisions is by using standard options or defaults. Experience has shown that most people allow themselves to be easily directed in such cases, especially when it comes to complicated decisions about matters where they have little understanding.

This issue of Netspar Magazine is about choice. What do pension experts, researchers, and stakeholders in the pension debate think about the need for greater self-direction? And in the eyes of the regulatory agency AFM, what will it mean for the obligation to provide information and advice? These aspects are all covered in this issue in the hopes of providing an intricate picture of the state of the discussion on this critical topic. We have no choice: in thinking about the future of the pension system, we will also have to think about choice.

Casper van Ewijk, Director of Netspar



Roel Mehlkopf

## "IMPACT OF HAVING OPTIONS WILL VARY TREMENDOUSLY"

More freedom of choice and customization sounds good, but you need to also consider the costs. That is the message from Roel Mehlkopf, who, on the part of Tilburg University, participated in several Netspar studies in the past few years into the impact of more freedom of choice in the pensions domain.

As a researcher, Mehlkopf is not one to call for policy to head in one direction or another. That means we should not expect an impassioned plea for more freedom of choice or, conversely, a robust argument against more options. "As an economist, I just want to present the costs and benefits of the various options. It is then up to the policymakers to draw their own conclusions," he says.

Compared to other countries, pension plan participants in the Netherlands have very limited options, Mehlkopf has found. "In other countries, people tend to have more freedom in the payout phase, particularly. For instance, in Australia and England, you can decide to have a large share of the accrued capital paid out in one lump sum," he points out.

Dutch participants do have a few options, however. They can decide for themselves when to retire, within a certain range. And at many funds, they can take advantage of the so-called high/low formula, whereby payouts are higher for the first ten years and then lower after that. Another option available to people is to swap out a survivors pension for an old age pension.

Despite the fact that freedom of choice has become such a major element in the discussions concerning the new pension system, little is known about the use of existing options. "With Netspar and access to data from Netspar partners, we are studying the extent to which people take advantage of options," explains Mehlkopf. "We've noticed a big difference between funds, and we are trying to deduce the causes for that. It could have something to do with how the funds communicate or with the needs of their members."

"As a whole, having more freedom of choice would allow people to better adapt their pension to their own situation and preferences. The current pension system treats everyone about the same. On the other hand, there are costs and risks associated with greater freedom of choice. One big risk is that members will make the wrong choices due to a lack of knowledge or discipline. If that results in a smaller pension, it raises the question of whether the benefits outweigh the costs. But, as I said, it's up to policymakers to make the final decision."

Mehlkopf thinks it is very important that politicians and policymakers be well-informed in making those kinds of final decisions. "We outlined the costs and benefits of each option. We also showed what the differences between them were. The impact of one particular option is much greater than another," he points out. To measure that impact, Mehlkopf calculates the economic gain or loss, just like the Netherlands Bureau for Economic Policy Analysis (CPB). This is a purely financial exercise. "That means that we cannot include the non-financial gains and losses, such as choice overload or level of involvement, in our calculations," he explains.

The absolute figure (e.g., an economic loss of 4 percent) will not mean much to most participants. "It's not so much about that number. Our calculations show which choices have the greatest impact. Taking out 10 percent of the accrued pension capital all at once doesn't have such a big effect, for instance. The impact is about the same as that of the high/low formula. You see bigger effects in the event of poor distribution if members were to start investing themselves."

### Contributions

Mehlkopf took a job with the Dutch central bank (DNB), in their strategy department, this past summer. He runs through the options in the order that a member will have to deal with them: from contribution to payout. "The amount of contribution is fixed in the Netherlands. More freedom of choice at that stage would mean that workers could choose to pay less in contributions. In countries where that is left entirely up to the workers, this results in lower savings rates," he warns.

It is not too likely that saving for retirement will become entirely voluntary in the Netherlands. There is no support for that. "It is conceivable that you would be able to allocate some of your contributions to another purpose, such as paying off your mortgage. In a revamped system, that's an interesting option that we are now studying," says the researcher.

### Investment Policy

Another change might be that members would be offered more investment options when building their pensions. How great the need for this remains

## Almost everyone chooses the default investment profile

debatable, though. "Now, you can only do that with a DC scheme. We see that people make very little use of that option. Almost everyone chooses the default investment profile," Mehlkopf says.

The risk that members will make the wrong investment choices is another cost item that needs to be recognized. "We have learned from experience that people who invest on their own often fail to spread their investments sufficiently and tend to buy and sell at inappropriate times. If greater investment freedom is introduced, we need to think about ways to minimize those kinds of risks. That could happen with good choice architecture and by limiting the number of options. You could, for instance, offer a number of different risk profiles without having the members compile their investment portfolios themselves."

### Retirement

In many schemes, people can choose their date of retirement within certain boundaries. "People frequently take advantage of this option," says Mehlkopf. "In the near future, we hope to gain a better understanding of the degree to which people use certain options. In physically demanding professions, people probably take more advantage of the option to retire early. Schemes could be designed to take the needs of their members into account in this regard."

### Payouts

Options are still limited in the payout phase. Besides the high/low arrangement and swapping survivors for old age benefits, retirees have no options. The Federation of Dutch Pension Funds is one of a number of institutions calling for allowing people to withdraw a lump sum of up to 10 percent of the accrued capital. "To a certain

extent, it's comparable to the high/low formula," says Mehlkopf. "It could be a great solution for retired people who want to pay down some of their mortgage."

The economist expects the risks to be limited, as long as there is a maximum on the lump sum amount. "That prevents people from suddenly taking out too much and then having too little pension down the line," he says. For that same reason, he is not worried about moral hazard. "Someone who only has a few years to live will choose to withdraw a lump sum. But since it is no more than 10 percent of the pension capital, the overall impact of that will be limited."

### Providers

Even though not many politicians are pushing for more freedom of choice with regard to pension providers, this topic, too, was further researched. "Experiences elsewhere show a mixed picture. You would expect that greater competition between providers would lead to lower prices and better quality. But in Australia and Chile, for example, that did not prove to be the case, because members are not quick to change providers," Mehlkopf says. "When they make their choices, it is often based not on cost or performance, but on brand familiarity."

In Sweden, though, the experiences were more positive. "They opted for a different approach there. The social partners choose a provider. They have a much stronger negotiating position and know more than the participants. Those participants can decide to choose this preferred supplier or another provider."

The major deal-breaker in the debate about more freedom of choice is, of course, the uniform contribution system. This system makes it difficult to switch to another pension scheme, for instance. The Dutch cabinet has decided that it needs to be seriously reconfigured. According to Mehlkopf, the impact of uniform contributions differs depending on the option. "If you want more variation in terms of the contribution rate, then uniform contributions are an obstacle. On the other hand, you could easily introduce more freedom in the payout phase without the uniform contribution system being a problem."

Insurers have acquired a great deal of experience in the past with offering people freedom of choice. One of the lessons that ASR's Arthur Arbouw has learned is that no one benefits from too many options.

## Arthur Arbouw

# "YOU HAVE TO PROTECT PEOPLE FROM THEMSELVES"

"There is a big difference between intentions and behavior," says Arbouw, deputy director at ASR. "When you ask people if they want more freedom of choice, they confirm. Then, in practice, they make little use of the options they've been offered." Netspar research also shows that pension participants are of two minds when it comes to choice. They like the idea of having more options, but on the other hand, they also appreciate it greatly when pension funds take all the work out of their hands, so that they practically don't have to make any decision.

Arbouw, who has worked at ASR and its predecessors since the mid-nineties, has seen the drawbacks of too much choice firsthand. "About ten years ago, insurers were outdoing themselves offering product variations," he says. "But consumers didn't take advantage of almost any of those options. Meanwhile, the insurers had to maintain the systems for offering them, which meant higher costs. In hindsight, it was a complete waste of time." The insurance industry has responded to the financial crisis by returning to basics. "We want to offer simple products without too many options. An added benefit is that customers understand them better," he points out.

Because of that experience, Arbouw has reservations about the possible expansion of options and greater customization in the pension industry. "We should be careful about offering all sorts of investment options," he continues. "We know, for instance, that individuals are not as good at investing as professionals. You have to prevent members from making all the rookie mistakes of inexperienced investors."

Arbouw does understand the call for more freedom of choice. "More and more of the risks have shifted to employees. It used to be that the employer said, 'Don't worry; I'll take care of your pension.' Now, employees get the money and the employers don't feel responsible for their retirement savings. It's only logical, then, that employees should have a greater say over their pension capital."

But Arbouw believes that if greater freedom is introduced in terms of investing, then the number of options needs to remain limited. "For the investment annuities, consumers had a choice from about fifteen funds," he continues. "Turned out, 90 percent of them chose the same fund. No one out there wants 83 options."

Arthur Arbouw



In terms of pension products, Arbouw would prefer to see it limited to three, not five, packages. "I think you should have a standard option, an offensive and defensive version of that," he says. "Those investment options should be further managed by professional investors. The products you put in the window have to be good. I'm convinced that such a strategy would produce better results than allowing individual investment freedom."

As soon as people are given more options, fiduciary duty starts assuming a greater role, as well. Until recently, pension funds had little to do with this phenomenon because everyone received the same product. "The risk with greater fiduciary responsibility is that providers are going to nail down their legal responsibilities," Arbouw explains. "Members will have to sign all sorts of forms saying they've understood all the information and read all the warnings. The providers want to protect themselves against complaints that way. I hope it doesn't come to that. That was never the purpose of implementing the fiduciary duty act."

### DC Schemes

Arbouw thinks it will be no easy task to give people more freedom of choice in terms of the payout of their pensions, as presumably planned for DC schemes. He warns against having expectations that are too high. "Retirees prefer to receive a fixed benefit," he says. "As soon as you start investing some of that after the date of retirement, there's a chance that benefits will be cut at some point. And if people haven't taken that into account, there is a problem. It's important for members to keep on top of their pension benefits."

One dilemma is that members can't make informed decisions unless they have a good understanding of their financial situation. "There are vast groups of people who don't have that understanding. They are expecting, for instance, a pension equal to 70 percent of their final salary, whereas it is going to be less," says Arbouw. He fears that few people are prepared to pay

what it takes to obtain that kind of overview. "If you want a financial plan from a certified financial planner, it will cost you easily 1,000 euros," he says. "There are not many people that can, or are willing to, pay that."

The solution, to his mind, is financial planning light. "Software programs that record your financial information and then provide an overview are getting better and better," he continues. "For instance, we now use a pension check tool and the Nibud pension pie chart, with its five segments. We also use so-called customer journeys to help people visualize their choices. These kinds of tools need to become more accurate, however. It is important to also have a good estimate of your spending pattern. It would help if it were possible to make the Nibud data available by postal code."

*The official retirement age is shifting. That means you will be responsible for deciding when your supplementary pension goes into effect.*

These financial planning tools can help you gain a better grasp of your retirement situation well in advance, according to Arbouw. "Many members don't realize until it's too late, that their retirement savings are less than what they were counting on. If you could show that to them sooner, people would still have a chance to take action. Usually, it comes down to households having to save more and thus adjust their spending patterns."

Arbouw expects that a larger group of people in the future will reach the conclusion that their pension is too scanty. "Now that the savings percentages have been lowered, workers are not saving enough for retirement. That is bound to have a negative impact on future pensions" he says.

Despite his reservations about increasing freedom of choice, Arbouw realizes that participants are going to invariably be faced with more choices in the future. "The official retirement age is shifting. That means you will be responsible for deciding when your supplementary pension goes into effect. Up to now, that wasn't too stressful. The retirement age was fixed at 65. Members need to know what the consequences are of retiring earlier or later. But it is a huge job for insurers to provide that overview, because we have to implement thousands of different regulations. It's easier for pension funds, because they generally only have to contend with one regulation," he points out.

### Heavy Opposition

Insurers work directly with the employers who arrange pension schemes for their personnel. Some companies want to give their employees complete freedom in terms of the investments. "That tends to be employers who have a lot of personnel in the upper income brackets. The thinking is that those employees are sufficiently self-sustaining to take on that investment freedom," Arbouw says, "but we still don't think that's a good idea. That group, too, can make investment mistakes that would cause their pension to shrink. We believe that we, or some other comparable institution, are in a better position to set long-term investment policy."

That premise means that the insurer must sometimes say no to potential clients who desire greater investment freedom. "We believe in our story and stick to that. We are a commercial company, but insurers also have a social role to play, in addition to the fiduciary duty that applies to us. We want to ensure that our customers act responsibly with regard to their pension. We are able to do that with the products that we offer," Arbouw concludes.

# FIDUCIARY DUTY HITS THE PENSIONS DOMAIN

If participants end up getting more choice in their pension plans, they will need to make more consequential decisions about their financial future. Those might not always be based on the right information. That places extremely high demands on the provision of advice, information to help participants make decisions, and on the choice architecture. That is how the Netherlands Authority for the Financial Markets (AFM) looks towards the debate on options.

The shift from a rigid pension system to schemes that would allow participants more personalized options is a development that both José Meppelink and Arjanneke Sandtke of AFM see coming. Meppelink is a policy analyst who helped draft the regulatory agency's position paper on the future of the so-called second pillar (or workplace) pensions. Sandtke has been a regulator of pension providers since 2011.

"Participants are going to have to bear more risk. It's only understandable, then, that they would also want more say over their pension savings," says Meppelink. But once you start talking about decisions with far-reaching financial consequences, AFM points to the risks involved. "We know from behavioral economics that people have a tendency to put off making complicated decisions that won't have an impact until over the long term," she continues. "People also have difficulty understanding the risks involved."

Because people put off saving until later, their current pension obligations are not up for discussion. "You could question the scope of that obligation," Meppelink says,

"and question who should fall under it. At the moment, independent contractors are at the other end of the spectrum. They have all the freedom, whereas other workers are required by law to build a pension. Those independent contractors display the same kinds of procrastination as others. As a result, some of them are not saving enough for retirement. We need a better balance."

Meppelink does not rule out some requirement for independent contractors, as well. "I can imagine that the government would look into whether independent contractors can be encouraged to start saving some form of occupational pension in the second pillar and, if that weren't effective enough, that there would be some form of compulsory program with, say, an option for pulling out." These are commonly known as opt-out schemes.

## Fiduciary Duty

The idea of offering more pension options is relatively new. "If participants have more choices, then the notion of fiduciary duty is going to grow in importance in the

pensions domain," proposes Sandtke. That notion is central to providing financial products and advice. Pension funds have had little to do with it, because the fiduciary duty requirements stipulated under the current Pensions Act are limited.

"A simple example shows the intersecting areas," she continues. "If you want to buy an annuity, the provider and/or adviser has to first meet a host of Financial Sector Supervision Act requirements. For instance, the consultant must know the customer's situation and provide appropriate advice. Pension providers already provide similar options, but they fall under different legal requirements. That means they are subject to a different fiduciary duty by law."

In the debate about the future of the pension system, four areas in which people should have more choice keep recurring. First, participants should have more influence over the contribution amounts. Second, some people argue that they should have more say over the

investment policy. Third, people are pressing for more freedom in the payout phase. Retirees should be given the option of withdrawing some (say 10 percent) of their pension capital in one lump sum. And fourth, there is talk of allowing people to choose their own pension provider. Which options will ultimately be implemented is still a topic of discussion, but the draft bill for the new variable pension benefits outlines more options in the payout phase, for example.

"For all of those options, it still needs to be determined, first and foremost, whether participants are in a position to make those decisions," says Meppelink. "If we think the participant's choices won't lead to better decisions, then the question remains as to whether this form of optionality should really be introduced. That might be the case, for instance, when we know from behavioral economics that participants have difficulty making these kinds of decisions and that introducing these options brings with it high costs."



Arjanneke Sandtke



José Meppelink

If such options are introduced, pension providers will have to demonstrate what the impact and risks of certain choices will be. "The Pensions Communications Act, enacted in July of this year, offers some starting points," says Sandtke. "All information must provide a meaningful overview of the options available and be customized to the needs and desires of the members. All information must be accurate, clear, and balanced."

That requires critically reviewing all communication of pension providers. "They would be smart to test their materials to make sure they're understandable for their members," Sandtke points out. "Information is only worthwhile if the members can understand it. Beyond that, pension providers can learn from one another. We collect and share examples of best practices to show people how to approach things."

"Members should be able to use the information they receive from their pension provider to get a comprehensive overview, preferably of the whole picture, so via a website like mijnpensioenoverzicht.nl (my pension overview). They need to be able to determine how much pension they will receive, more or less. Then, they need the right insight to assess that. They have to be able to estimate if that pension will be sufficient."

Finally, good information provision must also include a trading perspective. "If a participant reaches the con-

clusion that he has not built up enough pension, you need to be able to explain to him what he can do about it," she believes. "Even if you provide that overview, insight and trading perspective, people have to be willing to take that information in. You need to package it attractively and be aware of behavioral economics. Use the right timing for personal information and clearly announce what the purpose of the information is. Other things that help are clear language, a recognizable framework and providing a simple overview of the information."

Since there will still be large groups of people who do not want to have to make financial decisions, pension providers will have to offer a good default option. "That places high demands on pension providers and the social partners. They have to develop a standard option that will be sensible for the majority of participants. Given how heterogeneous that group is, that is no easy task," Sandtke concludes.

"Experience has shown that it is also important to limit the number of options," interjects Meppelink, "Too many choices create stress. Then you overshoot your objective. If, however, the options actually align with the needs of participants, then we can expect positive effects. And people will, in all probability, become more engaged in their pensions."

Most of the participants of a round table discussion on this topic agree that there is a limited need for freedom of choice. Two of the four experts offer proof of this themselves: they do not want anything changed on their pension plan. They do have high hopes for a more individual approach toward members.

## OFFERING MORE CHOICE IS NOT THE ONLY WAY TO BOOST INVOLVEMENT

"I'm saving in a pension with Pensioenfonds Zorg & Welzijn (care and welfare pension fund). I'm very happy with it. I don't need more options to choose from." That is Gerjoke Wilmink's answer to the question of what options she'd like to see in her current pension scheme. She's the director of Nibud, the national institute for budget information. She is one of four experts from diverse backgrounds, called together for a round table discussion on the topic of freedom of choice and pension plans at Aegon's head office. Other participants are Frits Bart (Aegon), Ronald Janssen (Ortec Finance consultancy firm) and Klaartje de Boer (VCP Trade Union Federation for Professionals).

De Boer, who is also saving her pension with Zorg & Welzijn, neither desires more freedom of choice. "But I would like to know more about how developments affect my own pension capital. I want to be able to clearly see how the fund is dealing with certain risks, such as the longevity risk. At the moment, I can't figure out what impact that will have on my pension or how those risks are being distributed among members," she says.

### More Freedom of Choice?

The notion of freedom of choice elicits a whole range of questions. Is there a need for more freedom of choice? If so, what kinds of choices need to be offered?



Frits Bart



Gerjoke Wilmink



Will participants take advantage of them? How can you ensure that individuals make well-informed decisions? Who determines what package of choices will be offered? Where can members go to receive guidance and advice? Should the options be introduced only for certain groups? Can you leave decisions that have such a major impact on someone's financial future forty years hence, say, up to those same individuals, who, as a rule, have a very poor understanding of financial matters? Will the elements of solidarity inherent to the pension system be undermined if individuals are allowed more freedom?

The experts have answers to some of these questions, but to others, it is anybody's guess. That is due sometimes to a lack of research and sometimes to the fact that the answer will only become clear once certain choices are actually made. "Let us make sure, if options are introduced for consumers, to think long and hard about the alternatives we offer. Choosing to put in more or less money is usually more attractive than choosing an investment strategy," says Janssen. "Despite the many studies, this is still an area about which little is known."

### Needs

"Greater freedom of choice sounds sexy," says De Boer, who is taking part in the Dutch Social and Economic Council's deliberations about the future of the pension system. "Almost everyone says yes to that, but then people turn out to take very little advantage of the options offered." One Netspar study likewise showed that participants were very ambivalent on this topic. On the one hand, they want more freedom of choice; on the other, they like it when pension funds make most of the tough decisions.

"A recent study by the Central Planning Agency also revealed that for participants, the most important thing is having certainty about their pension benefits—more important than freedom of choice," says Wilmink. "And we shouldn't overlook the fact that more freedom of choice could increase people's sense of involvement in their pensions. That's a separate issue from whether or not they take advantage of that freedom of choice. Greater involvement could lead to greater pension awareness."

Janssen, who also has experience as a financial planner, points to the fact that almost everybody finds it difficult to imagine their lives in thirty years' time. "Yet it helps people in making decisions about such things as their pension if you can somehow make that picture real," he explains.

Bart, Director of Policy & Client Management at Aegon Pensions, is the biggest proponent of expanding the number of options for people. "Pension schemes adopt a one-size-fits-all approach that everyone has to squeeze into. They don't take the differences between individuals into account," he says. He feels that his own pension scheme, for example, does not properly accommodate changes that transpire over the course of a lifetime. "The amount of the survivors pension benefit is fixed. But it would be better if it were tailored to your personal situation. I could imagine, then, that it would be higher if your spouse isn't working while the children are young or lower if he or she starts working more," he explains.

As a partner at Ortec Finance, Janssen is saving a pension on his own. Under the current rules, he will have to purchase a fixed pension as of his retirement date.

He thinks that's too rigid. "I would welcome more flexibility in the payout phase," he says. "There's growing talk about how to make such things as reinvestment and flexibility in terms of the amount of the benefits payout possible."

Bart finds it remarkable that ordinary citizens make their own choices in a host of areas, but have no say when it comes to pensions. "The decision as to whether or not to buy a home is your own responsibility," he points out. "The same holds true for important matters such as having children or choosing an education. But with pensions, we act as if people have no personal responsibility. They cannot choose to put some of the contributions toward an education if they believe that will improve their chances on the job market."

### Contribution Leeway

One particularly thorny issue is that of giving people greater say over the amount of their contributions. Most experts fear that participants will be tempted to not save enough and run into problems later, and society will be left holding the bag. They propose a basic provision that cannot be deviated from.

"The basic premise of our pension system is that you can keep living your same lifestyle upon retirement," says De Boer. "If you start paying less in contributions, it will be difficult to build an adequate pension. Linking contributions to labor income remains the best way of building a good pension. With that link, moreover, contributions move in sync with changes in your income." De Boer is saying this on the day that the Netherlands was praised by the financial services company Allianz, which had conducted a comparison of the pension

systems of various countries. The Netherlands topped the list because of its robust social security benefits and mandatory supplementary pension, with fixed instead of lump-sum payouts. In another international comparison, by the advisory body Mercer, the Netherlands also consistently scores well, ranking in the top three for many years now.

As director of the public service agency Nibud, Wilmink warns about underestimating the financial illiteracy of large groups of people. "You can't start making decisions until you understand your financial situation. We notice, for instance, that many people have no grasp of their spending patterns, let alone that they know what they'll need once they retire. And we're not just talking about people on a tight budget but middle-income folks. That group is increasingly running into financial problems." Once someone is in the dumps, it becomes even harder for them to take action. "If you are totally consumed by money worries, it becomes more difficult to make prudent decisions about financial matters," she explains.

Gaining insight into your financial situation is quite a big job. One of the biggest obstacles is that your information is spread out across various institutions, such as the internal revenue service, banks, insurers and pension funds. None of those parties have a complete overview. "Various efforts have been made to input all that information into one program, but those have stalled every time. At Nibud, we've abandoned that route," Wilmink continues. "We have had better luck with simple online tools. People just have to fill in a few answers about such things as saving, investing, or paying off loans. Then the program uses those few data



Klaartje de Boer



Ronald Janssen



points to offer some avenues to think about. Anyone who decides they do want to invest or pay off more of their loans will have to see an adviser."

### Choice Architecture

All of the attendees think it is only logical to apply the latest findings from behavioral economics to any choice architecture that pension providers might implement. "The way you present choices can greatly influence the way people make decisions," is how Wilmink summarizes such findings. "On a site that helped students determine how much they could borrow, one of the pages early on showed a maximum amount. That led to relatively high loan amounts. Nowadays, the starting point is a loan of zero euros, which has cut the number of students who borrow the maximum in half."

Another thing that greatly affects behavior is the terminology used. "It makes a big difference if you call an investment risky or you emphasize the chance of earning a higher return," Wilmink continues. "In addition, experience has shown that people often choose the middle option. Providers need to take that into account."

Another insight is that there is no point in presenting all too many choice. "Offering people too many options is counterproductive," says Janssen. "People won't be able to decide and then they'll postpone making the decision." Accordingly, the four experts argue that there should be a limited number of options introduced.

Few people have the self-discipline needed to routinely set money aside. Here again, behavioral economics has some useful information to impart. "In the past, people were okay with the indexation of contributions. As a

result, they had to pay in more each year. In terms of saving, you can accomplish this by putting aside a portion of your annual pay raise. And without even noticing it, you'll be saving more and more."

### Payout Phase

The Dutch pension system is known for paying out life-long fixed benefits with conditional indexation. In countries such as Great Britain and Australia, retirees have the option of receiving their benefits in one lump sum, instead of in monthly payouts. Most Dutch policymakers think that would be taking things too far, but some are in favor of researching the value of allowing people to withdraw some of their pension earlier.

Bart finds this an undeniably attractive idea. "It wouldn't involve tremendous sums. The average pension is worth about 100,000 euros. If you were allowed to withdraw 10 percent at an earlier point, you might be able to realize a particular dream, such as taking a trip you wouldn't have otherwise been able to afford. It's a way of having pensions align better with personal needs."

De Boer is less enthusiastic. She is worried that people will take out too much. "Your supplementary retirement savings are intended to provide lifelong benefits. People who want more than that can save for it under the third pillar (personal retirement savings plans)." De Boer believes, though, that if people are allowed to withdraw some of their accrued pension capital in the future, there should be strict conditions attached. "For instance, that the money will be used to pay off some of their mortgage. And people have to be well informed about the long-term risks involved," she asserts.

### Providers

Although allowing people to choose their own provider is not high on the list of priorities for policymakers in the pension industry, Bart thinks that is an attractive prospect, as well. "It doesn't matter if you work for someone or are a freelancer; the member tells his employer which provider to transfer the premiums to. And this saves all that bother with burdensome rollovers. What's more, it's much more manageable for the member. The providers could be pension funds, insurers, or PPI's, he says. Bart also sees parallels to healthcare, as he explains, "That used to be tied to your employer. It was a form of forced patronage. These days, it's completely normal for you to choose your own health insurer."

De Boer does not think many employers or employees have much need of this. "There are employers who voluntarily sign up with industry pension funds. They like having such a fund to handle their pension scheme. I think switching between providers will lead to higher costs," she says. De Boer's assessment is supported by the results of a study performed by the SCP (Netherlands institute for social research). This showed that while members of poorly performing funds might indeed want to leave them, they did not have a very high opinion of other funds either. So, they did not think their situation would improve too much by making the change.

### Involvement

Bart believes that one of the reasons members have so little interest in their pension plans is that they cannot change anything anyway. "You do all your financial

planning around that. Consumers make their own decisions about their mortgage, their savings, their insurance, but not about their pension," he says.

But encouraging greater involvement does not necessarily have to occur through offering more freedom of choice. Each of the four experts can propose other ways to accomplish this goal. "If members were to be given more say, perhaps through the Accountability Council, that would also lead to greater involvement. A fund could ask members for their opinions about various dilemmas it faces," suggests De Boer.

Janssen, who uses ALM models for private clients at Ortec Finance, has high hopes for adopting more personalized interaction with members. "With the advancements in digitization, funds could easily make their information more personalized. Members feel more like they are being directly addressed when they receive information specific to their situation," he points out.

"It is likely that many people are going to end up with less pension than they expected," Wilmink warns. "That's why it is so important that we do a better job of managing expectations. That could be done by alerting members to the problem early on. I suspect that it's easier for many people to accept less income if they have been warned in advance. Then they have time to get used to the idea and possibly take additional measures."

Bart is a proponent of tying pensions to what is happening in the here and now. "It is difficult for anyone to imagine their situation in thirty years. What's more, it's also not that helpful anyway, because so many things can turn out differently than you thought," he says.

He thinks targeted pension information is a better way to go. "When someone you know dies, you start thinking about the financial consequences of your own death. That's when you would like to know how things stand for your dependents." He cites another example: when your parents retire. "That's another moment when people have a heightened pension awareness," he says. "The trick for pension providers is to capitalize on those types of moments and bring the message home for people. They need to get much better at that."

*Consumers make their own decisions about their mortgage, their savings, their insurance, but not about their pension.*

## STUDENT PROFILE: JORI ARTS

He graduated cum laude from both the bachelor's and master's programs in finance. Jori Arts (23) is smart, well-organized and sets his sights high. An ambitious self-starter at the very beginning of his career.



Jori Arts

*The grade I get is not what matters to me. I'm all about the content: I want to truly understand something. I won't be satisfied until I do.*

*Your capstone project, the study "DC Defaults & Heterogeneous Preferences" at APG, got a grade of 9 out of 10. Your research there was even extended for two months through an employment contract. What did you study?*  
My research pertained to the freedom of choice in the second pillar of the pension system: What standard investment strategies should pension providers offer, based on the heterogeneity of their membership base? Pensions are an abstract and difficult concept for many people, so they tend to avoid thinking about them. But with freedom of choice, the decisions and responsibility come to lie with the members. How can pension providers provide that freedom of choice? I investigated the characteristics pension providers need to look at in order to decide that.

*How did you develop an interest in pensions?*  
The study I did for my final project for my bachelor's won the Netspar Thesis Award. That was my first contact with Netspar. And that fueled my interest in pension themes. I think it's very interesting how pensions take shape, given that they're such a difficult topic for so many people. My research was the perfect foundation for pursuing the Netspar track toward a master's in Finance.

*What did you think of the Netspar track?*  
When I attended events as part of the track, I noticed that companies were often surprised about the knowledge students were acquiring at Netspar. That knowledge

is of inestimable worth. It would be a sin not to use it. That's exactly why I also performed my capstone research under the Netspar track. Netspar proposes an issue that is truly relevant to the professional field; that's what makes the research so important.

*Your academic results and now your first professional experience have been more than impressive. How do you do it?*  
My work is very structured; I achieve results by setting a goal and organizing things well. The grade I get is not what matters to me. I'm all about the content: I want to truly understand something. I won't be satisfied until I do.

*What's next?*  
I'm fascinated by the interface between the academic world and professional practice, especially when it comes to research. I will be finishing up my study at APG this fall, and then I'd like to do a traineeship. Eventually, I see myself working at a large organization in their research and development department on, for example, pension and insurance themes.

# RECENTLY PUBLISHED PAPERS

On this page, we present a list of the papers recently published as part of the Netspar series on this magazines' theme. Netspar publishes both Industry Papers (which target practical matters) and Academic Papers. You can find a complete list of all Netspar papers, along with the PDF versions, on our website, [www.netspar.nl](http://www.netspar.nl).

## Theme Freedom of choice

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**Lever, Marcel, Eduard Ponds, Rianne Cox and Manuel García Huitrón**

Netspar brief – 3

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*Keuzevrijheid in de uittreedleeftijd*

**Soest, Arthur van**

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**Li, Yue, Mauro Mastrogiacono, Stefan Hochguertel and Hans Bloemen**

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Project: Second and a half pillar for the self-employed?

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**Fuchs-Schündeln, Nicola and Michael Haliassos**

DP 05/2015–027

### Colophon

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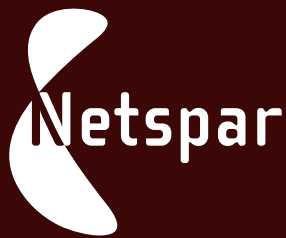
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Netspar, the Network for Studies on Pensions, Aging and Retirement, is a 'think tank' and knowledge network. Netspar is dedicated to promoting a wider understanding of the economic and social implications of pensions, aging and retirement. Expertise from scientific research is used to transfer knowledge through publications, events and education. With that, Netspar actively contributes to the social dialogue between policymakers, scientists and pension and insurance practitioners.

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