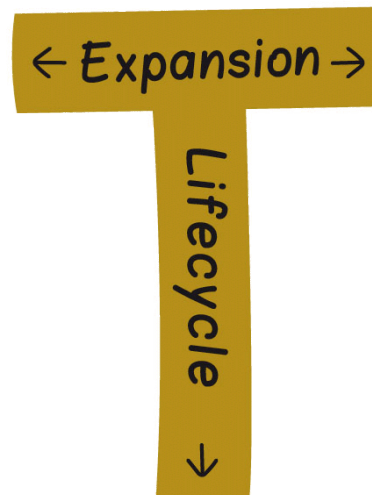


Pensions in Transition

2019–2023 Netspar Research Program



May 2018



2019-2023 Netspar Research Program¹

Netspar's core mission remains ensuring income provisions for retirement

The crux of Netspar research is a focus on forms of income provision for retirement. These provisions are accrued during a person's working years for use in retirement; two major phases of the life cycle. Various developments affecting both the working stage and the retirement stage now require that researchers make connections to other domains and branch out into more academic disciplines. We therefore envision the new research program as a T.

Expanded life-cycle focus and broader range of old age topics

The T stands for "Transition." This pertains to both the potential transition to a new pension system and the transition from a product-oriented pension industry to a participant- or customer-oriented one. Standard products can increasingly be designed to accommodate the circumstances and preferences of participants and customers. In addition, private citizens are being assigned greater responsibility in a job market that has become increasingly flexible and for giving and receiving long-term care. Many independent contractors in the pension system are responsible for their own retirement savings; when people switch jobs or industries more frequently, they are more frequently confronted with decisions about their pensions; and people have had to assume greater responsibility with regard to survivors pensions. Private citizens are expected to be self-reliant and make responsible decisions regarding their finances, careers, health, and insurance arrangements. How much responsibility can citizens handle, however? How can services best be designed so that they offer support to people through customization or an understanding of action prospects (with or without a reliance on digitalization and big data)?

¹ This research program was drafted based on Netspar NexT and discussions with the Supervisory Board, the Foundation Board, the PRC, and various partners.

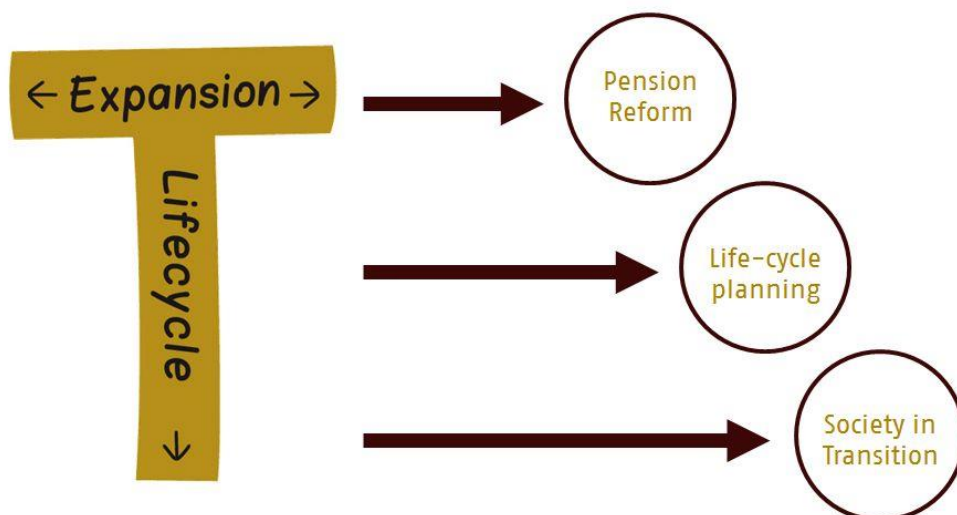


Figure 3: Research agenda

The vertical stem of the T represents the life cycle. Netspar plans to extend its focus to earlier stages in the individual's working life. Later phases of the retirement period will also be addressed, in connection with the increased responsibility for personal health and care. The horizontal arm of the T represents the expansion of old age concerns to include not only retirement provisions, but also health, care, housing, and general well-being. For the purposes of that expansion, we will be engaging other disciplines alongside the financial-economic core that remains at the heart of Netspar.

We discuss the central topics of the new research program below. We start by providing an inventory of the research questions that will be fleshed out in consultation with the partners. Many of these questions contribute to addressing the issues raised in the NWA's Towards Resilient and Productive Societies route and the Dutch government's Coalition Agreement. It is essential for us to conduct research now on topics that will come into play in the short, medium, and long term.

SHORT TERM

Prolonged Job Proficiency for Older Workers

Society is aging: whereas in 1950, there were seven people in the potential workforce for everyone over the age of 65, now there are only three, and by 2040, the number is expected to be only two. In an effort to improve the financial sustainability of its public finances, the Dutch government decided in 2015 to increase the social security entitlement age to 67 in 2021, with increases after that linked one-to-one to life expectancy. This curbed the rising social security expenditures, indeed making the public finances more financially sustainable. Overall social sustainability, however, is

not yet guaranteed: the increase in the normal retirement age raises the question of whether everyone will, in fact, be able to continue working to that higher age.

How can we ensure that people remain healthy and productive until they reach retirement? We want to avoid any accompanying increase in disability cases as the retirement age continues to rise. Moreover, large disparities exist between socioeconomic groups. What are the trends affecting differences in earning capacity and life expectancy (healthy or otherwise), and how can we accommodate these differences in our pension arrangements and disability insurance plans? What implications does all this have for our level of prosperity and social cohesion? What can employers, workers, the government, pension funds, and insurers do to minimize or insure against the risk of a shortened work life? In this regard, we are thinking about such things as: How can we improve lifestyles among the working population to keep workers fit? Do training and retraining help, and how do we stimulate that? And how can employers structure and distribute the work to keep older employees proficient as long as possible?

Pension Contract

The aging population is also putting pressure on the financial and social sustainability of our supplemental pension system. The number of participants paying contributions into company pension plans is declining compared to the number of retirees, and disappointing investment results can no longer be compensated by increasing premiums. To improve the low level of funding for meeting pension obligations, caused by the financial crisis and low interest rates, pension entitlements and benefits have not been indexed and have even been cut. This has damaged public confidence in our pension system.

The recent great recession demonstrated that our current pension plans amplify cyclical movements in the real economy. In a recession, the value of pension liabilities increases (due to a drop in interest rates) as assets decline (due to negative investment returns). This leads to higher premiums and/or lower benefits at a time when consumer expenditure is already under pressure. Conversely, in an economic boom, high interest levels and favorable investment returns create high funding requirements, so that funds can end up further stimulating consumer expenditure. The procyclical effects of our pension contract can negatively affect the economy and require reform.

A great deal of research has been conducted on how to improve the financial sustainability of our supplemental pensions, how to decrease the procyclical effects, and how to increase transparency and structure the system so that it better conforms to the changing labor market, with its greater mobility and higher number of

independent contractors. Netspar has played a critical role in that.² Although no definitive action has been taken yet on a new pension contract, the Dutch Social and Economic Council (SER) has explored many contract options, including one with personal pension savings "pots" and collective risk sharing. In the Coalition Agreement, the preference is also for personal pension assets with elements of collective risk sharing.

Many research questions will inevitably arise in the coming years regarding the details of any new pension contract. These might include concerns about the distribution of financial risks (e.g., equity and interest rate risk) between groups/age cohorts and the intergenerational sharing of systematic longevity risks that cannot, or just inadequately, be transferred to the financial markets. The transitional issues associated with adopting new pension plans also demand attention. Other vital points concern communications about pension arrangements new and old and the question of how we can increase people's faith in the pension system with a new pension contract.

And More...

Also in play in the short term are issues such as promoting retirement saving among independent contractors, introducing flexibility in the payout phase, and developments in Europe regarding product development and regulation. Although the wealth creation of independent contractors on average does not lag that far behind that of employed workers, it displays much greater variation. As a result, a relatively large number of independent contractors have very little savings. To encourage retirement saving among this group of the population, we need a better understanding of the influence of preferences, pension awareness, and behavioral motivations (e.g., procrastination) among it.

One of the plans in the Coalition Agreement involves introducing greater flexibility in the payout phase by allowing people to deduct a lump sum upon retirement. By analyzing regulatory changes in other countries, we can examine such variables as who took advantage of the lump sum option, what that money was used for, and whether this led to a form of selection. Research into the use of the option of deducting sizable amounts such as a lump sum, together with targeted experiments, could also provide insight into the question of how to best provide information and how choice architecture should be designed to increase the well-being of participants.

² Including I. Boelaars, L. Bovenberg, D. Broeders, P. Gortzak, S. van Hoogdalem, Th. Kocken, M. Lever, Th. Nijman, and J. Tamerus (2014), *Analyse van de duurzame vormgeving van het Nederlandse collectieve aanvullende pensioen (Analysis of the sustainable design of the Dutch collective supplemental pension)*, Netspar Occasional Paper.

MEDIUM TERM

In addition to focusing on the transition between the final years of the accrual stage and initial years of the payout phase, Netspar plans to further expand its purview to include the initial phase of a person's working life and their later retirement years.

Working Life and Connections to Housing, Household Composition, and Human Capital

During the first half of a person's working life, the balance between pension and retirement savings and education, the housing market, and household composition is extremely important. Saving for retirement is particularly impeded at this stage in life because of greater flexibility in job contracts, higher costs of living (since mortgage interest is only deductible if the mortgage is annuitized), college debt, and the cost of raising children and investing in their future. This raises questions about the level of contributions to, and tax treatment of, various forms of pension and retirement savings, in combination with wealth creation through home ownership.

The creation of new pension contracts is also prompting new questions about how to harmonize investment policy with individual circumstances and preferences. Lines of research will include the best ways of dealing with investments in illiquid assets and integrating exposure to certain personal risk factors. We will also be examining people's preferences with regard to socially responsible investing and how sustainability might play a new role in investment policy. Other major fields of research will include the effects of Dutch and European legislation and policy discussions, including the solvency rules, and the desire for funds to invest more nationally.

People are vulnerable to risks such as divorce and widowhood. Moreover, the chance that someone will change spouses or partners in the course of their lifetime has grown considerably. This requires a robust design of the survivors pension and of the legislation pertaining to pensions and divorce to prevent financial problems for single people and blended families.

At the same time, investing in one's own job proficiency and career are essential throughout a person's working life. In the past decade, the age at which most people retire has increased steadily. Careers now last longer, and increasingly, a single degree earned at the start of one's working life is no longer sufficient. Greater occupational flexibility is being demanded of people, and career switches (compulsory or otherwise) will become more commonplace. This all produces greater income uncertainty, which in turn affects people's optimal saving behavior. The necessity of continuing education and training is growing, as well. This is currently left up to the people themselves and their employers. It tends to be pursued by people with a

relatively high education level and decreases with age. The question is what the roles of the government, the employee, and the employer should be in financing continuing education for different levels of the population so as to prevent underinvestment in human capital.

Currently, the transition from a working life to retirement tends to be rather abrupt. There is a great deal of ignorance about part-time retirement options, and almost a quarter of people over the age of 60 indicate that it is not possible for them to work fewer hours at their organization. The increase in the length of people's working lives and in the length of retirement could result in a demand for flexible retirement. Research has shown that part-time retirement does not lead to greater workforce participation as expected, because the additional length of time worked does not compensate for the lower number of hours worked per week. Nevertheless, greater flexibility in the transition to retirement could have positive effects on people's health and job/overall satisfaction. Additional research is required to determine the best design for ensuring a good form of flexible retirement.

Retirement Stage: Connections to Housing, Care, and Quality of Life

At the point in life at which people withdraw from the labor market, they experience great variations in life expectancy, social networks, and care needs. Rising costs for healthcare and long-term care mean there is a greater urgency to study the balance between self-sufficiency and collective care. One important research question in this regard is the extent to which private insurance plans and informal care can play a role in supplementing public wellness and healthcare services. The design of the financing for such arrangements plays an important role in this. What financing model could be used to sustainably and effectively promote the quality and accessibility of both institutional and informal care?

A growing number of older people want to continue living independently at home. What impact does that have on their quality of life? Social networks increase one's quality of life, but when people suffer from health problems, these ties can become weaker and that can lead to loneliness. Are there particular groups in need of professional attention so as to prevent loneliness? Many elderly people are eager to stay in their homes, but they are a heterogeneous group in terms of their ability to care for themselves. This has implications not only for them, but also their adult children. What effect does them staying in their homes for longer have on the well-being of their adult children? How able, and how obligated, are they to provide care for their aging parents? Is there evidence of excessive strain (especially at the bottom of society, where people cannot afford to purchase care), and if so, how can we improve matters?

LONG TERM

Labor Market Developments

The traditional employer–employee relationship has come under pressure in the labor market. This is due not only to the aging population, but also a growing volatility in the wake of technological developments and international competition, all of which are pushing risks increasingly onto individual households.

A growing group of workers is no longer bound to a single employer. People tend to work in ever-more varied, flexible working relationships (e.g., as independent contractors). These trends threaten the traditional social certainties and are causing workers to assume ever-greater responsibility for managing their own pensions and retirement affairs. There are also implications for pension providers, who now tend to communicate more directly with their members instead of primarily the employers.

Growing Responsibility for Providers and Participants

Ever-evolving changes in the employer–employee relationship are resulting in new arrangements. Consequently, providers of pension products could be given more responsibility for supervising their members. An important area of study in this regard is understanding what participants want and how the trust of participants from various strata of the population and various generations can be secured.

Opportunities Afforded by Digitalization and Big Data

Digitalization and big data provide opportunities for helping people cope with their growing responsibility. Big data make it possible, to an ever-increasing degree, to connect together various domains of life (such as housing, healthcare, job market conditions, social networks, and domestic conditions). One thing in need of consideration is to devise a financial infrastructure through which families could more easily obtain a comprehensive overview of their financial situations. Research is needed to determine how such a financial infrastructure and data (big and otherwise) could be used to make pension products and the related communications more personal and improve financial advice. These technological developments could also affect market structures. Will it lead to financial advice being provided by pension funds and insurers or will other parties start to assume a greater role?

Choice Architecture

Providing people with personal financial advice does not necessarily mean that they will make the right decisions. Freedom of choice requires scrupulous guidance to lead participants to the solutions that suit them best. That is why developing good choice architecture is so essential. This raises the issue of how much participants stand to gain from greater customization and freedom of choice, along with the questions of what types of arrangements should be offered and what kind of behavior that might lead to. At the same time, numerous governance and ethical questions come into play regarding fiduciary duty and other responsibilities on the part of providers toward

pension participants, privacy protection, and preventing misuse of the information. Fiduciary duty will increasingly be required in advance instead of afterward.

Risk Sharing and Redistribution

The growing availability of information about people is also affecting the extent to which risks, such as longevity risk, can be insured. Participants can always, after all, be segmented into homogenous groups. One vital research question, therefore, is how to structure solidarity in both primary insurance and predictable reinsurance for sharing risks in a society characterized by a greater degree of heterogeneity and freedom of choice. What role can employers, employees, pension funds, insurers, and the government play in protecting workers against risks and in uniting individuals in circles of solidarity? Special attention will need to be given to the more vulnerable groups of society.

Dutch National Science Agenda

This research program is aligned with various so-called cluster questions presented in the Dutch National Research Agenda (NWA).

NWA 034: How robust is the welfare state, given the changing composition of the Dutch population (e.g., including aging-related challenges)?

NWA 037: How has the most recent major recession impacted society, and how can financial systems be reformed to avert such crises in the future?

NWA 038: How do we strike the right balance between freedom and responsibility (individual and collective)?

NWA 041: What is the "inequality problem"? In other words, what social and economic inequalities exist in the Netherlands and what are the identifiable trends? Are there any systems we could develop that might promote greater equality and keep our level of prosperity high or even improve it, or is there an intrinsic incompatibility between equality and other goals we pursue such as economic growth? Too much inequality can undermine both economic growth and social cohesion.

NWA 048: How can we encourage self-reliance and social participation?

NWA 049: How can we ensure that our labor force and labor-market organizations remain robust and resilient as they face the challenges of the 21st century?

NWA 071: What do we mean by "quality of life"?

NWA 093: How can we promote innovativeness, quality, and accessibility in institutionalized and informal forms of care?

NWA 108: What social changes are imminent owing to advancing technology and how will they affect prosperity? ... Market structures are being heavily disrupted, creating new relations.

NWA 109: How are new technologies and big data impacting the effectiveness of public administration and the constitutional state?