

# Evaluating the Dutch Collective DB

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## Dutch collective DB

- Career pay formula
- Guaranteed non-indexed benefit
- Conditional indexation
  - Pre-retirement career pay benefits
  - Post-retirement cost-of-living increases
- With indexing, pre-retirement benefit targeted at 70% of pay
- ?? Incorporate phased retirement
  - If don't, assume they could



## Dutch collective DB

- Collectively sponsored (occupation or industry)
  - Could also have private employer sponsor
- Employer/employee contributions
  - Contingent on fund performance
- Significant equity investment
  - Intra- and intergenerational risk sharing



## Measurement Frameworks

- We know there are lots of other possibilities out there
- Tool to systematically evaluate possibilities using Retirement 20/20 “first principles”
- Allows compare & contrast
- Nothing will be perfect, but we can understand strengths & weaknesses



## Framework Design

- Looking at how well the design meets the needs of the four stakeholders
- Drawn largely from the detail of the 2006 report
  - In-depth evaluation (with composite rating)
  - Society, Individuals, Employers, Market



## Framework Design

- Also considers how well design meets headlines from the 2006 report
  - Self adjusting systems
  - Aligning roles with skills
  - New norms, work & retirement
  - Alignment with markets



## Framework Design

- Consider how well the design works “in the perfect world” and “considering moral hazard”
  - Baseline rating based on a perfect world
  - Column that discusses effect of moral hazard & gives a revised rating



## Moral hazard: defined

- When agents take actions that don't align with interests of stakeholders, particularly individuals or shareholders/owners.
- When stakeholders (particularly individuals) can be led to not act in their own best interest
- Regulatory risk is also considered to be a moral hazard (regulators may be guilty of overzealous regulation, affecting the action of individuals, employers and the markets).



## Why moral hazard?

- We struggled with how to rate designs
  - Based on theory (how well they can work) or reality (how well they do work)
  - Puts new (unknown) designs at an advantage
- Realized that you needed to weigh both what could be and what is
- Highlights the importance of governance structures



## Evaluation criteria

- Evaluate across 38 dimensions
  - Society (9), Individual (11), Employer (8), Markets (6)
  - General headline (4): Self adjusting systems, Aligning roles with skills, New norms for work & retirement, Alignment with markets
- Summary page shows 8 ratings (composite rating for 4 stakeholders plus 4 general headlines)



## Society criteria (9)

- Adequate
- Affordable
- Sustainable
- Robust
- Does not promote economic risk
- Does not promote political risk
- Does not lead to system failure
- Addresses imperfections of other stakeholders
- Promote social solidarity & integrity



## Individual criteria (11)

- Guaranteed income
- Predictability of income
- Retirement flexibility
- Portability
- Sensitive to employment conditions
- Sensitive to family needs
- Requirement for individual skills
- Investment risk
- Longevity risk
- Inflation risk
- Premature retirement risk



## Employer criteria (8)

- Supports primary business purpose
- Workforce management: attraction & retention
- Workforce management: transition of employees
- Responsive to owners
- Business risk
- Regulatory risk
- Fiduciary risk
- Litigation risk



## Market criteria (6)

- Maximizes use of markets
- Transparent (cost)
- Strong governance
- Efficiently priced
- Efficient risk bearing
- Allocation of risk



Society's Needs & Risks (Composite rating ■ )				
Plan being evaluated: Traditional Final Pay DB				
US/Canadian, corporate sponsor, single employer. Assumes plan is properly funded and administered.				
Criteria	Description	Rating	Evaluation	Moral hazard (& adjusted rating)
Adequate	Protects vulnerable citizens.	Yellow-Green	Protects those who are able to hold down employment for long periods of time; less protection for workers who change jobs frequently.	Adequacy depends on employer paternalism including the willingness to maintain benefit levels. Would employers provide benefits to all low-paid employees without statutes requiring such coverage? ■
Affordable	Does not take resources from other social needs. Ensures risk pooling done efficiently.	Yellow-Green	Private employer sponsorship does not put cost burden on state; however costs are generally tax deductible and tax sheltered pre-retirement. May not pool risks efficiently in markets	Managers may not use market hedging, preferring to gamble on market returns. ■
Sustainable	Sustainable across and within generations. Equitable across and within generations.	Green	Can be funded to directly allocate costs back to the current generation of owners/shareholders.	Can be tempting to push costs to future generations of owners/shareholders. ■





Employer Needs & Risks (Composite Rating: <span style="background-color: yellow;">■</span> )				
Plan being evaluated: Traditional Final Pay DB				
US/Canadian, corporate sponsor, single employer. Assumes plan is properly funded and administered.				
Criteria	Description	Rating	Evaluation	Potential moral hazard
Supports primary business purpose	Enhances core purpose of the employer's business.	Red	The employer needs to focus on its core business and not on managing the plan.	Action of accounting standards can add volatility to employer cost. <span style="background-color: red;">■</span>
Workforce management: attraction & retention	Enhances business value by allowing attraction and retention of the "right employees".	Yellow	Better at attracting older employees and retaining long service employees. Younger employees are indifferent to plan design, and short service employees are disadvantaged.	Moral hazard has minimal effect. <span style="background-color: yellow;">■</span>
Workforce management: transition of employees	Enhances business value by facilitating the orderly transition of employees.	Yellow-Green	Can provide incentives for employees to stay or retire on a voluntary basis.	As population ages and baby boom retires, do we need people to retire early or work longer? Incentives may not be set properly for generational shift. <span style="background-color: yellow;">■</span>



## Measurement Frameworks

The average rating of yellow-green is a composite of the nine society subcategories.

The ratings for the nine-subcategories are shown in the color line. They are color grouped so you can see how many of each rating were received.

Ratings for each subcategory were adjusted for the effects of moral hazard. This shows the new color line after moral hazard is considered as well as a new composite rating.

Society (composite rating)	Meets society's needs and risks.	Yellow-Green	Individual criteria ratings:  Plans protect long-service workers well (less so short-service workers) avoiding the need for more government sponsored benefits.	Adjusted composite rating: <span style="background-color: yellow;">■</span> Ratings after moral hazard:  System depends on employer paternalism, and employer moral hazards require government regulation, which destabilizes system.
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Traditional Final Pay DB Plan US/Canadian, corporate sponsor, single employer. Assumes plan is properly funded and administered.				
Criteria	Description	Rating	Evaluation	Effect of moral hazard
Self-adjusting	Automatically adjusts to changing demographic and economic conditions.	Red		
Aligns roles with skills	Aligns stakeholders' roles well with skills.	Yellow		
New norms for work and retirement	Could support flexible work arrangements, e.g. phased retirement, return to work, etc.	Red-Yellow		
Alignment with markets	Could use market mechanisms effectively to hedge risks.	Yellow-Green		Rating after moral hazard:
Society (composite rating)	Meets society's needs and risks.	Yellow-Green	Individual criteria ratings:	Ratings after moral hazard: Adjusted composite rating:
Individuals (composite rating)	Meets individuals' needs and risks.	Yellow-Green	Individual criteria ratings:	Ratings after moral hazard: Adjusted composite rating:
Employers (composite rating)	Meets employers' needs and risks.	Red-Yellow	Individual criteria ratings:	Ratings after moral hazard: Adjusted composite rating:
Markets (composite rating)	Meets markets' needs and risks.	Yellow	Individual criteria ratings:	Ratings after moral hazard: Adjusted composite rating:



## DB, DC & Dutch collective

- In process of evaluating many different designs
- “Final” ratings for DB/DC
- “First cut” rating for Dutch collective
  - Warning: ratings decline on further examination



## DB, DC & Dutch collective

Ratings before moral hazard	DB	DC	Dutch
Self-adjusting	Red	Yellow-Green	Yellow-Green
Aligns role with skills	Yellow	Red-Yellow	Green
New norms work/retirement	Red-Yellow	Yellow-Green	Yellow-Green
Alignment with markets	Yellow-Green	Yellow	Yellow-Green
Society (composite)	Yellow-Green	Yellow	Yellow-Green
Individuals (composite)	Yellow-Green	Red-Yellow	Yellow-Green
Employers (composite)	Red-Yellow	Yellow	Yellow-Green
Markets (composite)	Yellow	Yellow	Yellow-Green



## Stakeholders: DB vs Dutch

Before moral hazard	DB	Dutch
Self-adjusting	Red	Yellow-Green
Aligns role with skills	Yellow	Green
New norms work/ret.	Red-Yellow	Yellow-Green
Alignment with markets	Yellow-Green	Yellow-Green
Society (composite)	Yellow-Green	Yellow-Green
Individuals (composite)	Yellow-Green	Yellow-Green
Employers (composite)	Red-Yellow	Yellow-Green
Markets (composite)	Yellow	Yellow-Green

Dutch plans could replicate benefits to individual/society of DB plans and better align with employer needs and potentially with markets



## Stakeholders: DC vs Dutch

Before moral hazard	DC	Dutch
Self-adjusting	Yellow-Green	Yellow-Green
Aligns role with skills	Red-Yellow	Green
New norms work/ret.	Yellow-Green	Yellow-Green
Alignment with markets	Yellow	Yellow-Green
Society (composite)	Yellow	Yellow-Green
Individuals (composite)	Red-Yellow	Yellow-Green
Employers (composite)	Yellow	Yellow-Green
Markets (composite)	Yellow	Yellow-Green

Dutch plans potentially do a better job than DC plans to align stakeholders' needs, risks and roles.



## Themes: DB, DC & Dutch

Before moral hazard	DB	DC	Dutch
Self-adjusting	Red	Yellow-Green	Yellow-Green
Aligns role with skills	Yellow	Red-Yellow	Green
New norms work/ret.	Red-Yellow	Yellow-Green	Yellow-Green
Alignment with markets	Yellow-Green	Yellow	Yellow-Green

Like DC, Dutch plans incorporate the self-adjusting aspects of DC and reflect new norms for work/retirement without the misalignment roles and skills or suboptimal use of markets.



## What about moral hazard?

Dutch, considering moral hazard	Before	After
Self-adjusting	Yellow-Green	Yellow
Aligns role with skills	Green	Green
New norms for work and retirement	Yellow-Green	Yellow-Green
Alignment with markets	Yellow-Green	Yellow
Society (composite)	Yellow-Green	Yellow
Individuals (composite)	Yellow-Green	Yellow
Employers (composite)	Yellow-Green	Yellow-Green
Markets (composite)	Yellow-Green	Yellow



## Moral hazard

- Are the self-adjusting mechanisms sufficient ...
  - Market corrections, industry declines, demographic shifts
- Will individuals understand what is at risk?
- Balancing hedging with equity investments to lower contributions/increase indexing?
  - In periods of high inflation/low equity returns?
- Intergenerational risk sharing
  - May not translate outside of the Netherlands



## Measurement Frameworks

- Now looking at new designs
  - Dutch system
  - TIAA-CREF
  - Ontario Teacher's Fund
  - US Multi-employer
  - Church Plans
  - New UK Structure

