Country Report

The Netherlands

Current pension system: first assessment of reform outcomes and output

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THE NETHERLANDS

The Institutional Architecture

The protection offered by the Dutch pension system against the risks of poverty and social exclusion in old age is one of the most encompassing in the world. The system underwent since the 1980s incremental but steady modernization and, at the same time, maintained its dual Beveridgean-Bismarckian character: a basic universal scheme based on residence, the *Algemene Ouderdoms Wet* (AOW), topped up by quasi-mandatory pre-funded privately-managed occupational schemes. With the help of external constraints (EU equal treatment law and the 1990 Barber judgement by the ECJ) the Dutch government eliminated the breadwinner bias in the system; and through subsequent legislation it expanded its coverage to less privileged working categories (part-time, fixed-term and other atypical jobs). However, gaps in coverage persist and despite being Dutch pensions among the most efficient in the world, the system underwent since the 1990s three reform trends: i) individualization of occupational pensions; ii) lifelong labour market participation through the abolishment of pre-retirement arrangements; iii) implicit privatization of the public tier due to incomplete indexation and increases in the pensionable age (as lower benefits will have to be supplanted via other savings arrangements).

The **first (state and mandatory) pillar** has a single tier. The AOW is a PAYG basic pension covering all residents from the age of 65 (during 2009 it was raised to 66 by 2020 and 67 by 2025). Early retirement is disallowed, as is deferral. It is, however, possible to combine pensions and work.

Whereas until the mid-1990s the AOW was self-balancing (expenditures and revenues had to match), now it can run deficits and is financed through three different channels. Individual income-related contributions apply for all taxable income up to EUR 31,122 as of 2008. The current contribution rate is 17.9% (and the maximum is set at 18.25%). The rest constitutes income dedicated to occupational pensions. Deficits are covered by general taxation. In 1998 a Reserve Fund was established, which should finance any AOW shortfalls after 2020 (the projected amount of assets in the Fund, accumulated through annual government deposits will be is EUR 126 billion).

The benefit is flat rate and is conditional on the number of years of residence in the country (between 15 and 65). The full AOW is earned after 50 years, each missing year entails a deduction of 2%. People who live alone are entitled to an AOW pension based on 70% of the net minimum wage (EUR 1,048.09 gross in January 2009, slightly less than 30% of gross wages). People who are married or living with a partner are both entitled to a pension based on 50% of the net minimum wage (EUR 730.64 gross in January 2009). There is a supplementary allowance for partners under 65 topping up the AOW pension, amounting to circa 30% of the minimum net wage (this should be discontinued after 2015). There is a holiday allowance and a small government top-up. The AOW is taxed unless one is entitled to a (generous) tax credit.

The AOW is indexed alongside the net minimum wage, which is uprated biannually. Hence, there is a small discrepancy between gross wage growth and the AOW, which is slowly eroding its replacement rate with respect to earnings. The Indexing Conditions Suspension Act permits Parliament to suspend indexation if the ratio of inactive to active persons of employable age falls below 82.6:100. Since 1996 the AOW has been fully indexed.

The AOW hence is an insurance against poverty for the majority of the Dutch population. However, partial AOW benefits, when not coupled with a second pillar pension represent a threat to social inclusion during old age. Partial AOW benefits are on the rise due to increased immigrants working in the Netherlands and residents working abroad. In December 2008, 464 thousand people did not receive full AOW, i.e. 17% of the total. This is a threefold increase in two decades. As for Dutch people abroad, these are in abetter position than immigrants, as they can insure themselves with the Social Insurance Bank (*Sociale Verzekeringsbank*, SVB) when working outside Netherlands. Almost 34 thousand people over 65 claimed income support, which is roughly 70% of those that are actually eligible. Local-level governments provide such social assistance.

The **second pillar** consists of quasi-mandatory supplementary occupational schemes. They are regulated by the Pension Savings Act (*Pensioen en Sparfondsen Wet, PSF*). The Law on Mandatory Participation in Sectoral Pension Funds (*Wet Betreffende de Verplichte Deelneming in een Bedrijfspensioenfonds*) permits the Ministry of Social Affairs to require an entire sector to participate in the same pension fund once the social partners set up one pension arrangement in that sector. Hence, some 91% of wage earners are covered by occupational schemes.

By the end of 2008 there were 567 pension funds in the Netherlands, divided among three types: sectoral pension funds (*Bedrijftakspensioenfonds,* BPF), company pension funds (*Ondernemingpensioenfonds*, OPF) and pension funds for the self-employed. By Q3 of 2009 they collected assets worth almost 126% of projected 2009 GDP.

There is no statutory requirement for entry ages for occupational plans, but any discrimination against women has been abolished. More than half of all schemes do not have an entry age, the rest between ages 16 and 25. Retirement happens at 65 and can be either coupled with work or extended. In 2005, the tax-favoured status of separate early retirement programmes (*Vervroegde Uittreding*, VUT) and which led to pre-pension benefits between ages 60 and 65 was abolished to stimulate labour-market participation of older workers.

As for the benefit formulae, of the 567 funds, 76.5% offer defined benefit schemes (of these, 14.5% final salary schemes and 56.4% average salary schemes), 7.1% defined contributions schemes and 13.1% mixed schemes. Most final salary schemes have an accrual rate of 1.75% for each year of service, implying a replacement rate of 70% after a complete 40-year career. In most average-salary schemes the accrual rate varies from 1.75% up to 2.2% per year of service.

Second pillar contributions are set in collective wage agreements, and are typically shared between employers and employees. Employers usually pay a higher share: in 1998, employers paid 6.7% of their wage bill into second pillar schemes, while employees paid 2.3% of their wages. Due to the financial crises the figures are now much higher, easily totaling 15% of taxable income. Due to tight coupling between the AOW and occupational pensions, contributions to the second pillar are paid only on the salary above a level called the franchise. However, this level has been slowly decoupled from the AOW to increase the coverage and magnitude of occupational pensions.

Valorization and indexation are not legally required and not predetermined, but rather subject to tripartite negotiations. With respect to valorization, for approximately 75% of the participants in average wage schemes, past earnings are valorized in line with growth of average earnings while for 8% the rate of inflation is used. The problem of insufficient indexation for non-active members (those who have changed jobs and whose assets remained in the former employer's scheme) has been eliminated by legally enforcing the full portability of pension rights.

Until recently most schemes were using wage indexing but in the wake of the two financial crises (2001-2002 and 2008-2009) had to cancel or freeze it. In 2008, 70.9% of total funds did adopt a predetermined standard of indexation, which is, however, conditional upon the pension funds' performance. The rules differ substantially and range from overall wage movements (11.8%) to overall price movements (33.9%) passing through a series of nuances.

As mentioned in the introduction, the main problem of the otherwise very encompassing

Dutch second pillar are persisting 'white gaps', which happen for self-employed, people working in informal sectors, in non-covered sectors and, until recently, to those working part-time. Additionally, the system treats social risks differently: unemployment, childcare and early retirement lead to cuts in pension entitlements; disability and divorce to hikes. All of these are being only slowly tackled.

As for the gaps in coverage, the part-time problem (affecting most women, as the Netherlands is the only OECD country where there are more women working part-time than full-time) has been very effectively solved by a pro-rata reduction of the franchise for occupational schemes, which means that most people working part-time will obtain an occupational pension. For the self-employed, who are not automatically covered, their contributions can be reinvested in the firm (tax-free up to a ceiling) and then converted into an annuity; however, it is very unlikely that this may happen at a larger scale.

With regards to the differential treatment of social risks, unemployment, childcare as well as early exit (now abolished) did not give any right to accrue assets in occupational pensions. Disability does. Voluntary insurance during childcare is permitted. There is usually redistribution towards women, if they divorce. In fact, the pensions accrued during marriage are split between the couple and divorced women continue receiving benefits even if they remarry.

Finally, the **third pillar** consists of voluntary, supplementary pension schemes, which enjoy high tax subsidies in those cases when the combined value of the AOW and occupational schemes' benefits do not guarantee a final replacement rate of 70%. Most 'white gaps' are partially compensated with tax exemptions for additional savings. Ultimately, there is a life-course savings arrangement exists due to abolition of pre-retirement rules. Unfortunately, most authors question whether voluntary savings are enough to cover the (small) gaps of the Dutch occupational pensions and lower benefit levels that will be brought by the massive switch to average salary schemes from final ones.

Information needs

Communication is taken rather seriously in the Netherlands. The SVB sends an annual statement every January or February, which shows the total amount of the AOW pension that one received during the past year, as well as any deductions made for tax and national insurance contributions. Together with the annual statement, the beneficiary receives a statement of the monthly pension for January (pension statement) and SVB's magazine. Additionally, the insured can view their annual statement online during the first week of January.

As for the occupational funds, a major issue was to increase their transparency in the wake of the two financial crises. First, each fund has to provide members with an annual statement on assets, investment strategy, accrual rates. Second, the regulator's solvency rules toughened substantially. Funding requirements are stringent (there is a the solvency test and minimum funding test) and pension funds, which are underfunded have to produce very clear short- and long-term recovery plans to the Dutch Central Bank.

The Administrative Structure

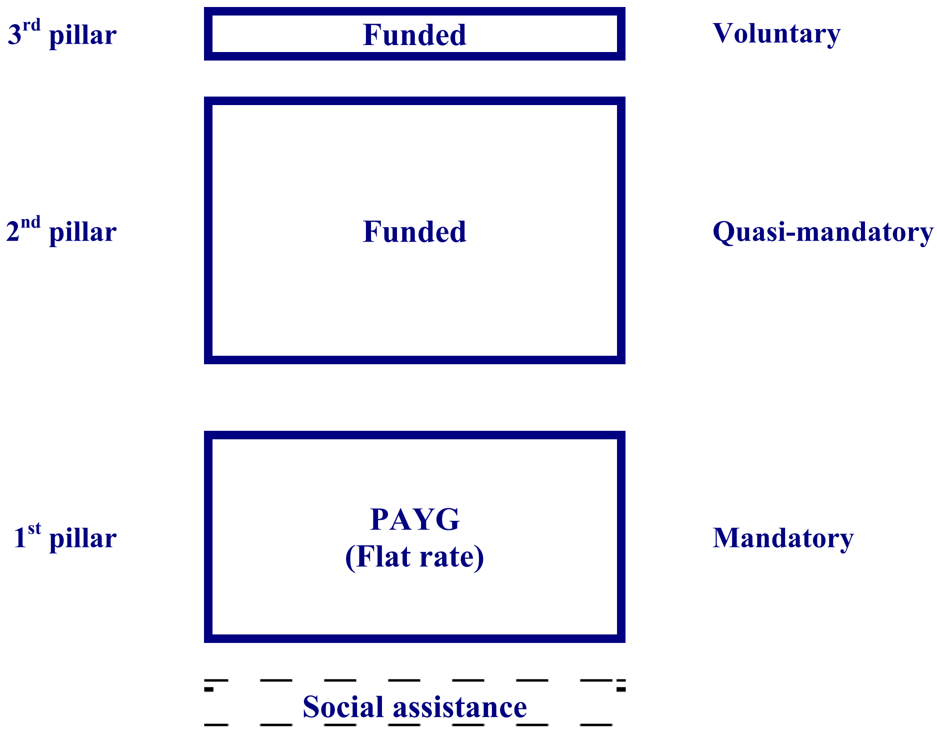
The social safety net for citizens consists of a social assistance programme called social minimum. This social assistance programme is managed by municipal agencies. The AOW is administered by the Social Insurance Bank (*Sociale Verzekeringsbank*, SVB), a state bureaucratic structure that leaves little room to corporatist bodies.

As for occupational schemes, until 2004, the Pension and Insurance Authority (*Pensioen en Verzekeringskamer*, PVK) was the supervisory body charged with oversight. In 2004 the PVK merged with the Dutch Central Bank (*De Nederlandsche Bank*, DNB) and is now called the Pension Chamber (*Pensioenkamer*). Details of pension plans are negotiated in collective agreements, while the Ministry for Social Affairs defines the general framework for operations and governance.

Assessment and Future Challenges

The Dutch pension system, which combines Beveridgean and Bismarckian features, is very suitable to guarantee social adequacy for most of the resident population. However, the system should prepare for future challenges, not least increasing costs in both the first and second pillars (through tax exemptions).
Looking at the system's social adequacy, incomplete residency is a problem: the increasing number of immigrants gets only partial AOW benefits and could hence be socially excluded. With respect to the occupational pensions, coverage and protection should improve. Irregular work histories imply that people may not accrue rights, e.g. during care, unemployment, childrearing etc. Labour mobility can be a source of trouble for final salary schemes, as new employers do not cover the whole back service and this deficit is not automatically supplanted by tax deductions. There are 'white gaps', which are only partially compensated with tax exemptions for additional savings. The self-employed are not covered by second pillar arrangements and the tax deductions they enjoy are not devoid of problems.

Figure 1 The Main Pillars in the Dutch Pension System



1st Pillar, universal coverage (residence-based);
2nd Pillar, occupational schemes;
3rd Pillar, individual programmes.

Annex 1

Key Data about the Pension System in the Netherlands

Contribution rates	2009	Max
Total (1st pillar)	17.9%	18.25%

Supplementary schemes	
Contribution rates	Shared between the employer and employee, they vary across and within schemes
Coverage (of employees)	91%
Assets in EUR bln (2009)	722
Taxation	Exempt Exempt Taxed
Investment principles	Prudent Person Principle

Theoretical replacement rates	Gross			Net
	1st pillar	2nd pillar	Total	Total
2005	29.6%	41.1%	70.6%	92.0%
2050	29.6%	39.3%	68.9%	90.1%

SILC income 2004	Total	Male	Female
Relative income of 65+	0.879	0.882	0.879
Aggregate rep. ratio	0.426	0.475	0.517

Eligibility retirement age	
Old age	65 (66 in 2020 and 67 in 2025)
Early retirement	Disallowed
Deferred retirement	Disallowed (but pensions can be combined with work)

Indexation	Minimum net wage

Public pension spending (as % of GDP)	2004	2020	2050
	12.4	14.8	20.0

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