Address by Klaas Knot, President of DNB, at the first conference of the Pension Federation on 10 November 2011

Ladies and gentlemen,
It is a special honour for me to be speaking here today. For this is the very first conference of your Federation, one whose members, moreover, are responsible for a major part of our nation's wealth. Together, the pension funds manage almost one-third of Dutch households' total assets, or well in excess of Dutch GDP. Not many nations can say as much.
In fact, the importance of pension assets is, if anything, increasing. At present, some 16 per cent of the Dutch are over 65, but in 25 years, almost one in four will be. And that generation of Dutch citizens will depend mainly on their pension savings. For many seniors today, their 'AOW' state pension is their main source of income. For the next generation, however, the reverse will be true. Thus pension funds also have an important role helping to keep the pension system affordable.
Fully funded pensions are less sensitive to population ageing than AOW pensions, which are paid for by active workers – of whom there will be fewer in a 'grey' society.
No wonder then that a leading international financial consultancy firm has once more proclaimed the Dutch system to be the best in the world. This is something to be proud of.

Yet having begun on such a high note, I fear my complacent and optimistic words have now come to an end.

Dutch pension funds today are facing stiff challenges. Not that I think we have another twenty years of crisis coming. But yes, the current crisis in Europe is indeed acute and is having momentous consequences for the pension funds.

Stock prices look cheerless and are chipping away at the pension funds' assets. Low interest rates imply the value of pension commitments is high, causing a sharp decline in funding rates.

And that is not all. For pension funds face two specific difficulties as well. Life expectancy has risen more rapidly than anticipated, meaning that future pensioners will continue to exercise their pension rights for much longer. And the upward trend may yet continue. The second difficulty is that pension funds are *more mature* than before, meaning contribution incomes as a share of total assets are lower. Stepping up contributions to strengthen the asset base is not very effective. And to cap it all, the sector turns out to have been overoptimistic about returns on investments.
In fact, the Don Committee already warned against this in 2009. As you will remember, a minority in the Committee thought at the time that both DNB and Statistics Netherlands were too pessimistic. Let's say high expectations are only human. By consequence – and in combination with incomplete contracts – funds became too generous in the 1990s.
They funded early retirement deals that weren't backed by savings, and declared contribution holidays without good reason. And now their buffers are insufficient to absorb the full impact of the current crisis. This is bad for the cement that holds our financial system together. But it is also bad for the cement that holds society together – the cement we call *trust*.

The Netherlands is rapidly changing, from a high-trust into a low-trust society. The public's trust in politicians has been so-so for many years. Next, they had to witness what the financial crisis did to large banks such as ABN AMRO and Fortis. This affected people's trust in banks. And then the debate about the pension system and the pensionable age started up – while the funding rate plummeted. Thus people's trust in pension funds was also eroded.
And to be honest: DNB lost trust as well.

Our surveys held earlier this year showed a gloomy outlook. Between March 2010 and March 2011, public confidence in the financial sector dropped back to the historically low levels of 2009. Trust in

banks is down by almost a quarter from what it was before the crisis of 2008. Trust in pension funds is even lower.
Trust in pension funds generally has fallen to as low as 43 per cent, while people’s trust in their own pension fund went down from 85 per cent before the crisis to 62 per cent now.

Pension fund members suddenly realise they run higher risks than they always thought. All at once, the inflation-proof pension they thought they had appears less secure. And apart from all the financial trouble we face, this may be the severest challenge of all: to restore people’s trust in our system.

There are several ways towards realising that goal, ways which I want to discuss with you today. In the first place, a conscious effort must be made by the social partners and the pension funds.

Contracts need to be clear – clearer than they are now – about who bears what risk. The division of risks must reflect the wishes of the funds’ membership. Funds’ investment policies must correspond to that risk profile.

This means that pension funds must find out what their members want. Are they prepared to bear more risk in exchange for lower contributions? Or, conversely, are they set on certainty and willing to pay for it? Or again, do they want contributions to stay as they are and to ‘pay’ for their certainty through a lower level of ambition?

DNB has done some research. The outcome was that members feel such a need for certainty that they are willing to make a substantial sacrifice for it. They prefer deals offering strong guarantees over deals involving high investment risks. They prefer certainty over low contributions. And they prefer assured purchasing power over fixed benefits.

Pension funds need to align their investment policies with these preferences. Invest more safely, the message appears to be. One never knows, of course, whether members will stick to their choice once they feel it in their purses, for instance because contributions go up.

A look at premium incomes of international insurers suggests that the need for certainty will prove stronger than just words. And let's face it: there is no such thing as a risk-free investment. Especially if we’re talking purchasing power.
Bonds appear safe, but the Dutch Government does not issue indexed bonds. So, adjusting investment policies to the preferences of the members will by no means be easy or simple.

The second path towards restoring trust is that of transparency. Even to this day it is not easy to gain insight into your own pension rights, although things have improved on what they were, say, five years ago. Back then, funds gave little explanation – and if they did, the wording was often obscure and inaccessible. The contracts were non-transparent and difficult to explain. Thus many members had no idea they were running risks – or if they did, what risks.

And despite all the media coverage, people’s views of their pension *still* appear to be too rosy – in terms of both size and certainty. So there lies another task ahead for the funds. The pension contract must be transparent and explainable in clear terms. What’s more, it will actually have to be *explained*. Members need to know exactly what risks are involved and how these risks are shared. Pension commitments must be able to be compared objectively. The largest pension funds have now launched a publicity campaign to prepare their members for possible cuts. This is a step in the right direction.

Yet pension scheme members themselves should also show more commitment. Until recently, very few people took the trouble to get a grip on their pension rights. There were more important things in life: buying a home, for instance, or the children’s studies. ‘Pension is for later,’ people thought, ‘and what’s more: I’m saving for it, so it’s bound to be all right.’ Those days are past.

Like in so many areas of life, we ask people to accept part of the responsibility. It is important that they should be clear about their pension accumulation. That they should take the initiative to save extra money. And that they should feel involved in the choices put before them.

For many people, the financial skills this requires are beyond their grasp. That is why over 40 parties from the financial sector, government and consumer organisations have joined hands to enhance those skills, through an organisation called *Wijzer in Geldzaken* ('Guidepost to financial wisdom'). So you see there's plenty of initiative already. I should also mention the new Internet tool Mijnpensioenoverzicht.nl, and this week, of course, is national Money Week. DNB is involved in these initiatives.

Ladies and gentlemen,
We can successfully approach the goal of restoring trust from three different angles:

- clear investment policies that are attuned to members' wishes,
- transparent contracts, and
- more active involvement of the members.

The new Pension Accord makes steps in the right direction:

- It addresses longevity risk;
- it commits parties to make explicit who bears what risks;
- it focuses on future purchasing power; and
- it establishes a link between members' preferences and investment policies.

Yet we also have worries about the Accord.
The pension rights valuation and adjustment method must not incite extra risk-taking.
Shocks in the financial markets must not impact disproportionately on certain groups in society: the pain must be shared fairly by all.
Communication is now in focus. However, it is bound to prove quite a challenge to make members aware of the pension result they may expect and of the uncertainty involved.
Also, communications must counteract time-inconsistent behaviour by reporting regularly on individual pension results.

These concerns should be addressed in the elaboration of the Accord. Plenty of work still needs to be done. But it does offer opportunities to improve the system and, hence, to rebuild trust. And let us not forget one thing: the new contract is not a clean slate.
While it plots a course into the future, it still carries the ballast of the past. The shortfall has not gone away and to supplement it, separate measures are needed. And these are messages that cannot wait. We can't say stocks will go up again! Interest rates are bound to pick up!
If we fail to deal with the deficit now, we will be paying pensions to the older generation out of the purse that was meant for the young. That would put irresponsible pressure on the solidarity between generations. Later this afternoon, the issue will come up in the panel discussion – a well-chosen theme.
Intergenerational solidarity is one of the vital elements of a solid pension system.

As I said at the outset of this address: we are facing a challenging task. Still, the Dutch system is voted best in the world year after year. But as Giuseppe de Lampedusa wrote in his novel *The Leopard*: Sometimes we need to change so that everything may stay the same.
If we want our pension system to stay the best of the world, we will need to make many changes to it. The new pension Accord is a firm step forward towards this goal.
Yet it must be carefully elaborated so that the emerging new system reflects the three central concepts that DNB holds to be crucially important: sustainability, transparency and feasibility. A system that has all these three qualities will help us attain our main goal: restoring trust.

Ladies and gentlemen,
This Circus Theater is a theatre of contrasts.

By day, it is the scene of serious conferences and lofty debates. And after dark, it provides a venue for dazzling shows and spectacular musicals. Today's conference itself, however, also harbours a remarkable contrast. Tonight's programme announces the musical *Wicked*, whose subtitle claims that *Nothing is what it seems*. And we, this afternoon, are discussing the exact contrary of that.
Pension funds are not *wicked*. And if they have acquired that odium, they are working hard to get rid of it again. Pension rights need to be clear and unequivocal. They need to be deals in which things are *exactly* what they seem.

Thank you!