COUNTRY REPORT
NETHERLANDS

Dutch funds to assess member risk appetite

RISK TOLERANCE
TJIBBE HOEKSTRA

In measuring their members' risk appetite as required by new laws, pension funds should not overlook desired pension outcome

KEY POINTS

There are two types of risk to measure – the risk of ending up with too low a replacement ratio at retirement and the risk of losing money along the way

It is therefore important to measure risk appetite in combination with the desired pension outcome

Measuring members' risk appetite has most added value when it comes to determining individual risk profiles

Once the new Dutch pension law comes into force, schemes will be required to measure the risk appetite of their members at least once every five years. Not everyone is convinced that this is an achievable exercise in practice.

The new law, which is still in a consultation phase, has already triggered interest among pension funds to measure the risk appetite of their members. "I've noticed an enormous uptick in interest from pension funds in doing a risk-appetite survey since the publication of the draft law in December," says Koen Vaassen of Achmea Pensioenservices, one of the Netherlands's largest pension administrators. "We are now talking to seven funds at a time, some of which have never before really measured their member's risk appetite."

Measure the right risk

How useful is measuring the risk appetite of a fund's membership, is a matter for debate (see panel). "It's a laudable effort by the legislator to involve members, but it's a hell of a challenge in practice to define the real risk preference of your participants, let alone to measure it," says Stefan Lundbergh from consultancy Cardano.

The main challenge is in drafting the questions. Lundbergh says: "There are a lot of behavioural traps involved, and you need to know what risk you are measuring: is it the risk to end up with too low a replacement rate at retirement because you invested too conservatively, or is the volatility of the investment portfolio the risk you are measuring?"

"If you ask people how much risk they want to take with their pension, almost all of them will say they want as little risk as possible," says Gosse Alserda, who has been researching the topic for nine years and even devoted his PhD thesis to it. "But if you show them what more risk means in terms of expected pension outcome, this changes." says Alserda,

According to Alserda, who works for Aegon Asset Management alongside his work at Groningen University, the most reliable way to measure the risk appetite of pension savers is to make them choose between two scenarios: one high-risk and one low-risk. "For both options, we show them a good weather and a bad weather pension outcome. Their choices tell us how they trade a higher expected pension outcome against more risk. This we arrive at their risk appetite," he says.

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Gosse Alserda

Achmea uses a proprietary model to measure risk appetite called Pension Builder, based on a model developed by pension think tank Netspar. Achmea's model also aims to strike a balance between acceptable risk and desired return. "We ask participants to move a slide from left to right, whereby the lowest possible investment risk is on the left-hand side while the highest possible risk is on the right. We combine this with attaching probabilities to a variety of pension outcomes," Vaassen says.

Vaassen conducted a survey for seven pension funds in 2020 and says that the survey, which takes 10 minutes to fill in, usually has a response rate between 15% and 20%. He says this is sufficient to get a representative sample. "For sector schemes, participation is usually a bit lower than for company schemes but we've never gone below 12%."

Not a panacea

But the question then is how useful such a survey is in practice and whether the results will affect a pension fund's asset allocation.

A risk-appetite survey is not a panacea, says Vaassen. "It doesn't give you a ready-made life cycle that perfectly suits your average member's risk preference, but it always provides useful food for thought to a pension fund, which could help them in the decision-making process."

The Dutch pension reform sets out two different types of contracts that pension funds can choose from. Most funds, especially the large sector schemes, will likely opt for the so-called 'new contract' which involves one collective investment mix with returns being attributed differently to members based on their age. The other option is a more individual one, whereby each member can choose between a number of different life-cycle options.

Doing a member survey can help pension funds to make the choice between the two contract types, says Vaassen. "If you find big differences in risk appetite between members, it may be better to choose the option with the different life cycles."

Risk appetite surveys are especially useful to determine individual risk profiles, says Alserda. "Variables such as age, education, sex and wage level are helpful to determine a fund's collective risk profile, but they don't tell you very much about an individual's risk appetite. All these variables together only explain about 6% of the variation. The rest comes down to the individual."

Focus groups

If a pension fund chooses the 'new contract' option, which most of the large sector schemes are expected to do because of its strong collective elements, surveying a fund's entire membership might have less added value. In such a case, a fund may choose to determine the collective risk appetite of its membership in a different way.

"A fund could establish focus groups or use an organ that already exists, such as the accountability body, to determine the collective risk profile," says Lundbergh. "I would make it as concrete as possible and, for example, organise a workshop to set up a discussion between trustees and the accountability body or another representative group of members. I would then discuss a number of different scenarios with them, talk them through the trade-offs involved and explain the consequences of going for more or less risk in the portfolio. This provides a foundation for the risk appetite of different groups in the collective."

The advantage of this approach compared with anonymous surveys, Lundbergh adds, is that it allows you to make sure members do understand the consequences of all of the options that are on the table when making their decision.

Vaassen notes, however, that, in practice, accountability bodies are usually not representative of a pension fund's total membership. "The typical member of such an organ tends to be rather risk-averse, and as a result relying on such groups may result in choosing too conservative an investment strategy."

The role of the benevolent dictator

Measuring risk appetite of the members of a collective pension scheme is "largely a technical exercise", says Prof David Blake, the director of the Pension Institute at City University in London. In the end, it is not going to make a meaningful difference to the fund's asset allocation, he says.

"The standard life cycle model, where risk is gradually being reduced as one grows older, always overrules an individual's own risk preferences," he says. "Taking account of scheme members' risk preferences could change a fund's asset allocation by a few percentages points at most."

And if a survey of member risk attitudes suggests a radically different asset allocation – typically one which is more conservative – it would probably not be in the interest of members to follow through. "Because designing a pension plan is so complex, you need a benevolent dictator approach. It's good to empower people, but to put them in charge completely is something else." Blake likens participation in a pension scheme to an airline journey. "The airline simply wants to get the passengers to a destination in the most optimal way. You don't let them choose the engines of the airplane, only their seat and their meals. The airline takes care of everything else."

Membership surveys could be more influential when it comes to, for example, preferences for sustainable investing. "If your members are strongly averse to, say, fossil fuels, then so long as they are aware there will be consequences in terms of financial returns, this is something pension funds can implement. Such surveys are far more likely to cause significant deviations in asset allocation than risk-preference studies."

What's on the fiduciary landscape

FIDUCIARY

TJIBBE HOEKSTRA

The popularity of all-inclusive fiduciary management deals is likely to continue

KEY POINTS

- The trend towards all-inclusive fiduciary management has made it harder for foreign players to win new clients
- The transition to a new, defined contribution-based pensions system is not expected to bring meaningful change to the fiduciary landscape in the short term
- Switch to DC may work in favour of specialised foreign managers

The Netherlands has seen a strong trend towards an all-inclusive relationship between pension funds and their fiduciary managers, mostly to the benefit of established local players. The impending pension changes may change the balance in favour of foreign managers but room for new entrants is limited.

Foreign fiduciary managers active in the Netherlands have lost market share over the past decade. That is because many pension schemes have trended towards all-in-one fiduciary management offerings. These concentrate investment advice, manager selection, risk management and the management of liability-driven investment (LDI) portfolios with just one manager.

Some foreign players, including Allianz Global Investors, Lombard Odier and SEI, have withdrawn their fiduciary management offering altogether as they had been struggling to attain sufficient scale. One local player, Rotterdam-based Robeco, also quit the fiduciary business last year after it lost its biggest client Vervoer (the pension fund for the transport sector).

Karin Roeloffs, head of fiduciary management at Aegon Asset Manage-