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# Certainty and investment risk in a new pension arrangement: how to tailor it?

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# The outline of my presentation

- Looking at risk from a scheme member's perspective and why 'duty of care' regulation pushes this perspective
- How it looks like in a DB and DC scheme
- Opportunities in the new legal pension environment: combining certainty with pure DC
- Tailoring the building blocks: examples
- Wrap up

# Prudent Person & Duty of Care Regulation

| ...applies to...            | Prudent person  | Duty of Care   |
|-----------------------------|---|--|
| Defined Benefit scheme      | Investment policy   | Not applicable   |
| Defined Contribution scheme | <ul style="list-style-type: none"><li>• Default lifecycle(s)</li><li>• Assigning members to default risk profiles</li></ul> | Assessing and advising members who want to opt out and choose their own risk profile |

# Prudent Person & Duty of Care Regulation

- Prudent person: tailored to the interest of the members
  - risk attitude defined for collective of members
- Duty of Care: What is the member's
  - financial goal;
  - financial position;
  - knowledge and experience;
  - risk attitude
    - risk appetite (willingness to take risk)
    - risk tolerance (capacity to take risk)

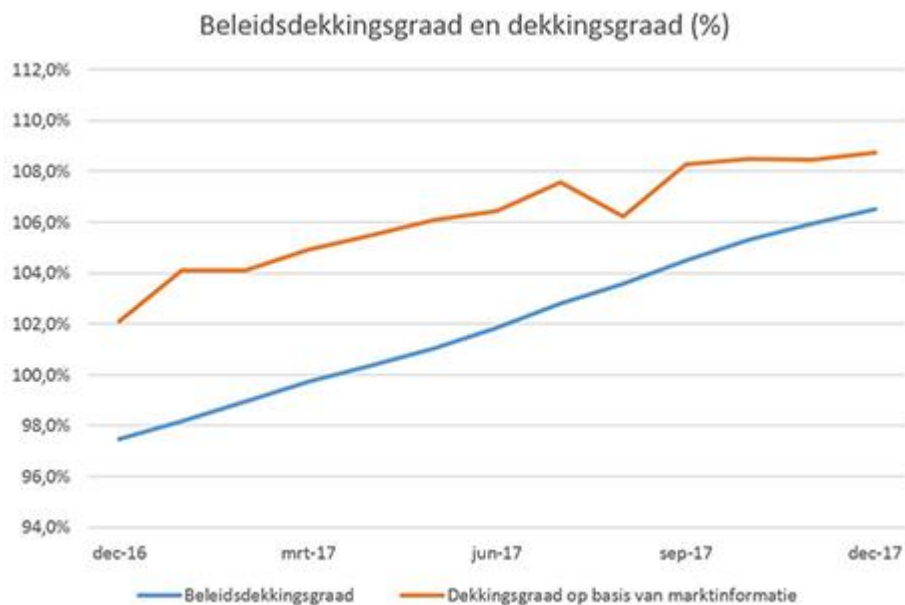
# Looking at risk from a scheme member's perspective



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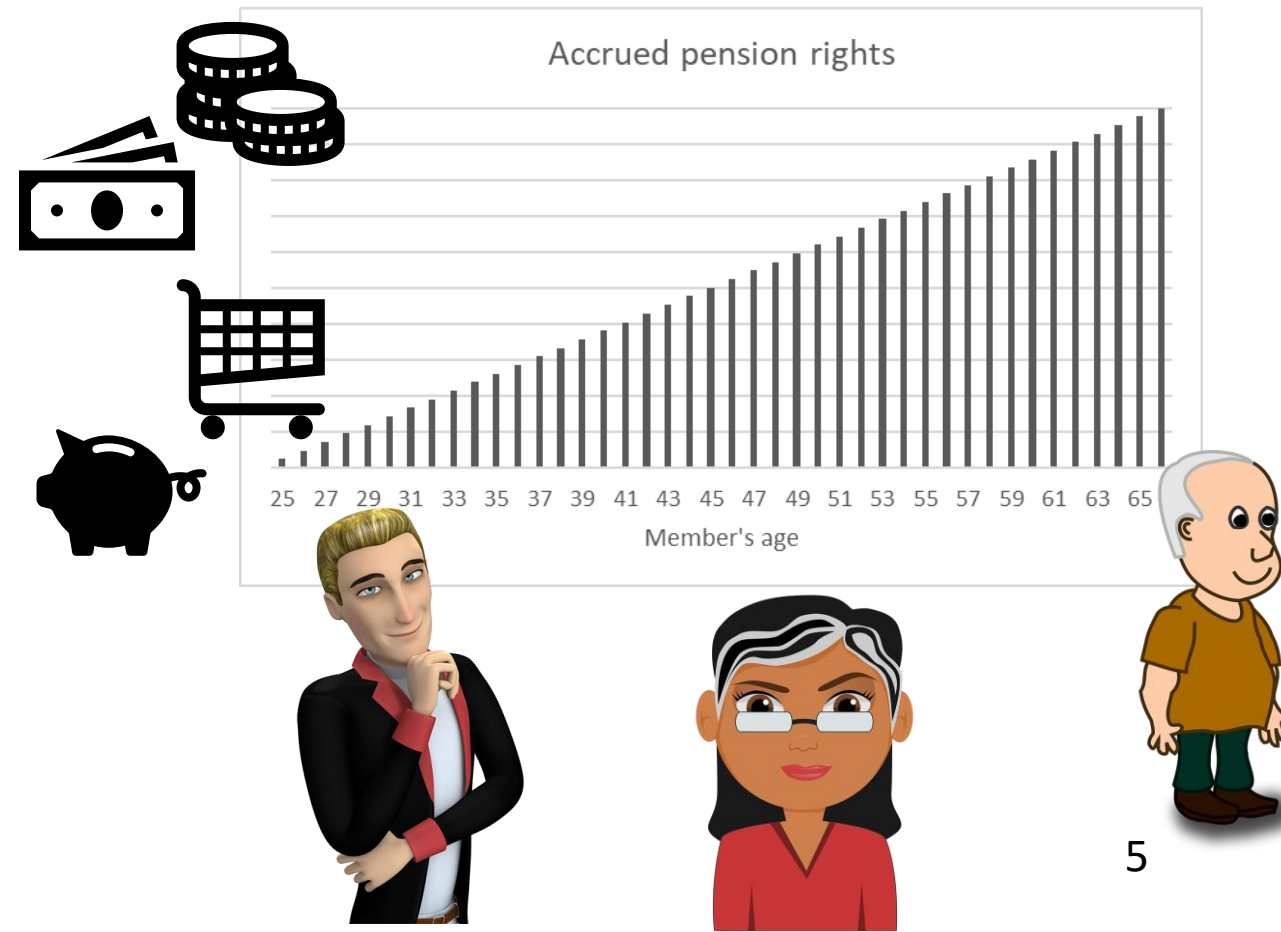
## Institutional setting

- Funding level on aggregated level



Source: DNB

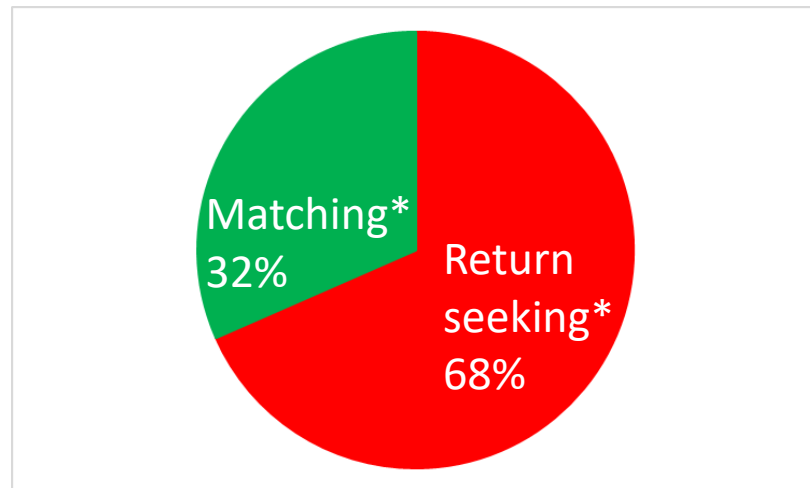
## Pension member setting



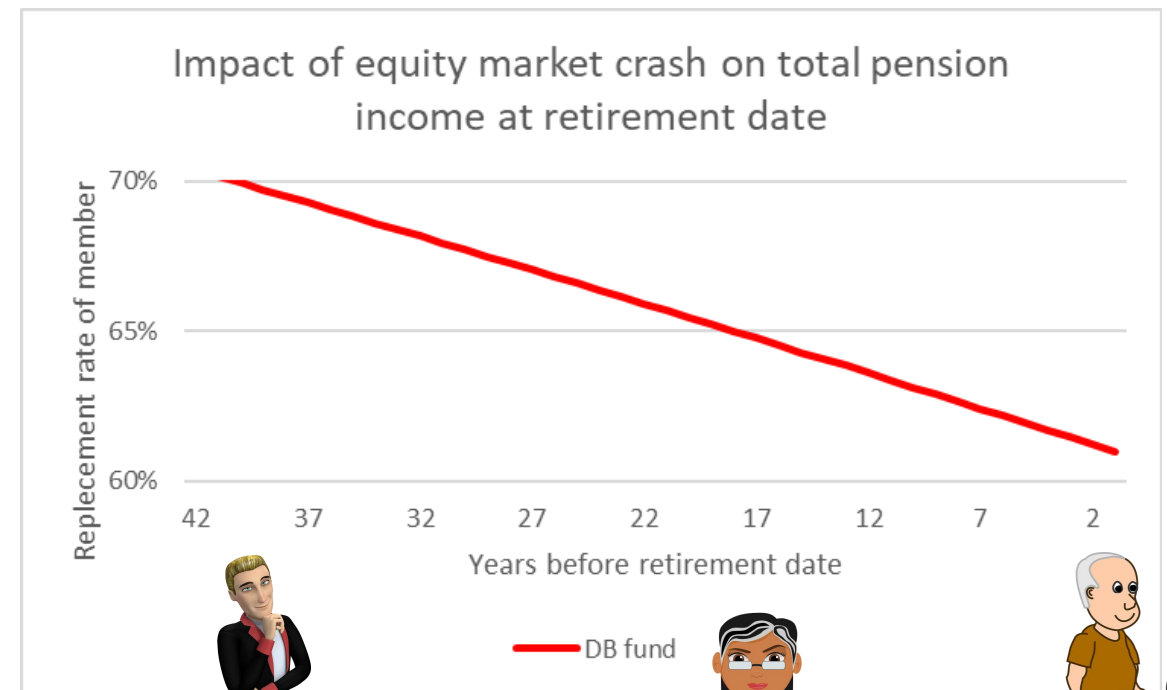
# How it looks like in a DB scheme

(average Dutch pension fund without sponsor guarantee)

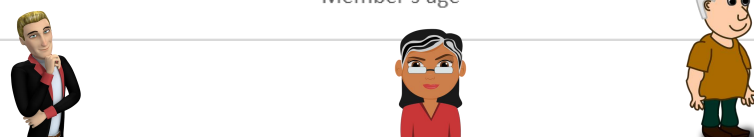
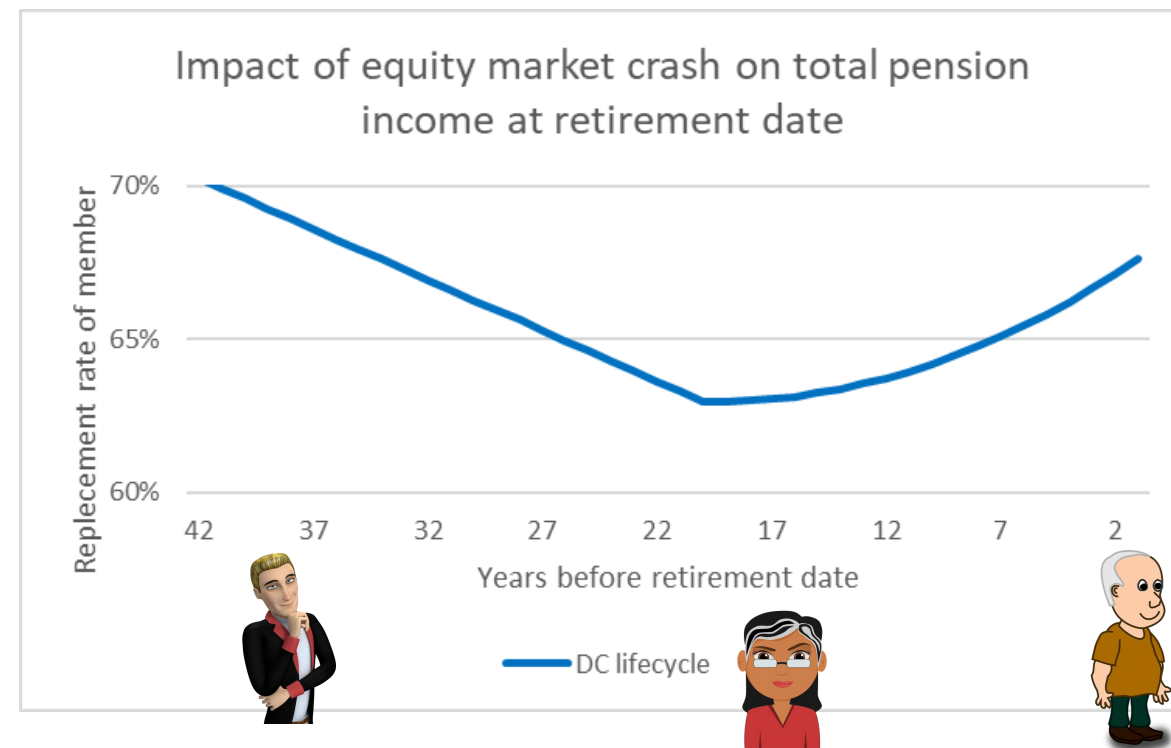
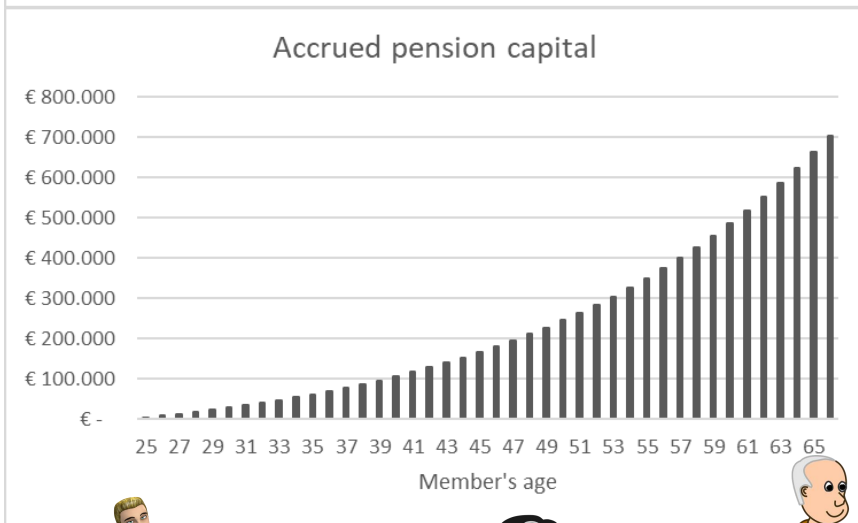
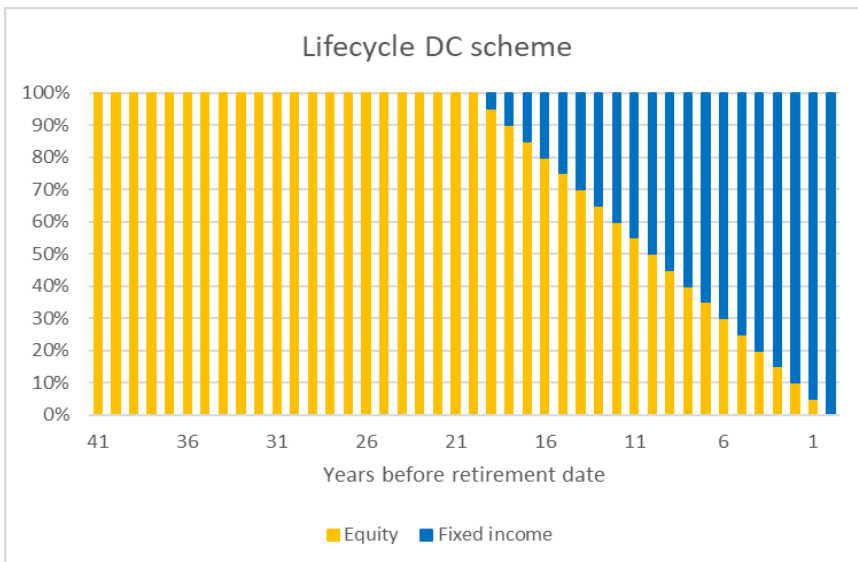
- What if a market crash of -30% occurs? (and after this average returns according to DNB scenarioset)
- Average income earner (€37K); state pension(€ 9,6K) + 2nd pillar pension (€ 16,5K in expected scenario)



\*DNB risk mapping methodology



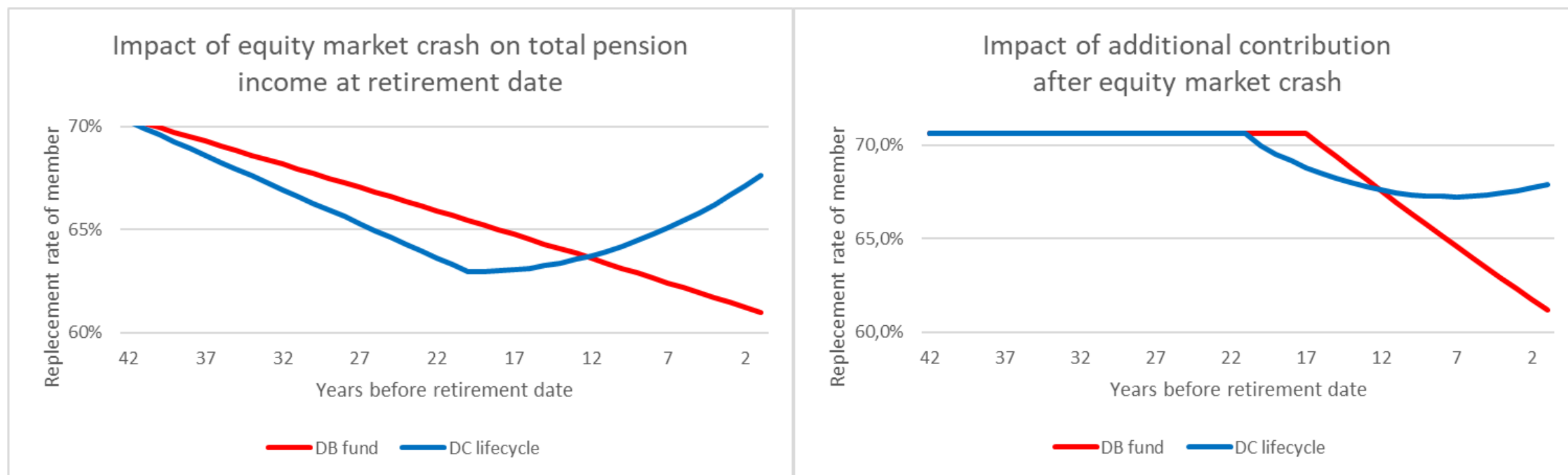
# How it looks like in a DC scheme





# Impact in DB versus DC scheme

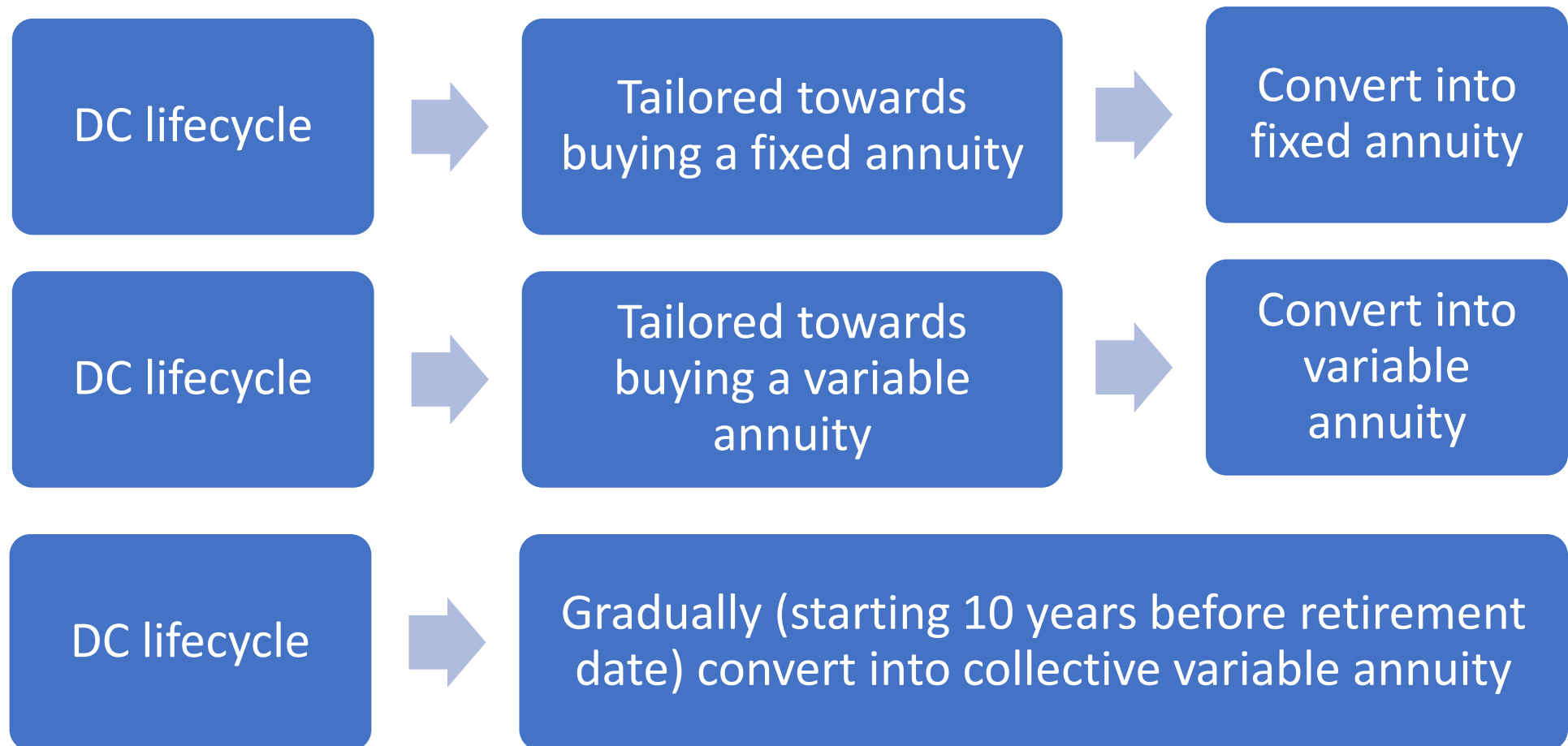
- DB: impact largest just before retirement; no time left for remediate action
- DC: impact largest about 20 years before retirement; sufficient time left to take action
  - an additional contribution up to 6% of salary is shown
- However: conversion risk (due to interest rate shocks) is still there! Impact can be -10%.





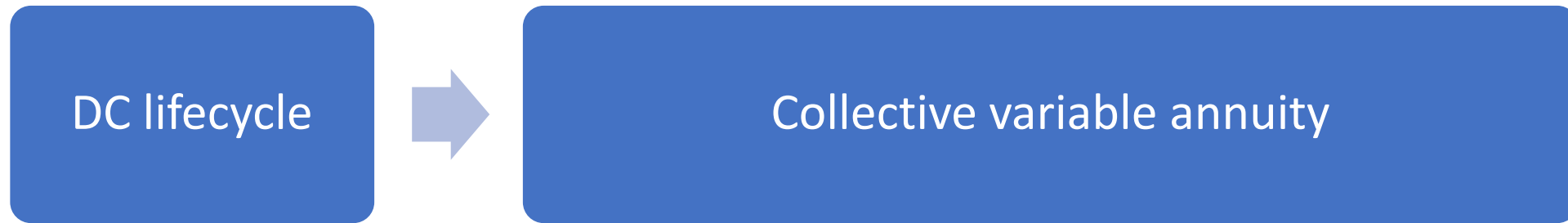
# Opportunities in the new legal pension environment

- Law on enhanced DC schemes (Wet Verbeterde Premieregeling)



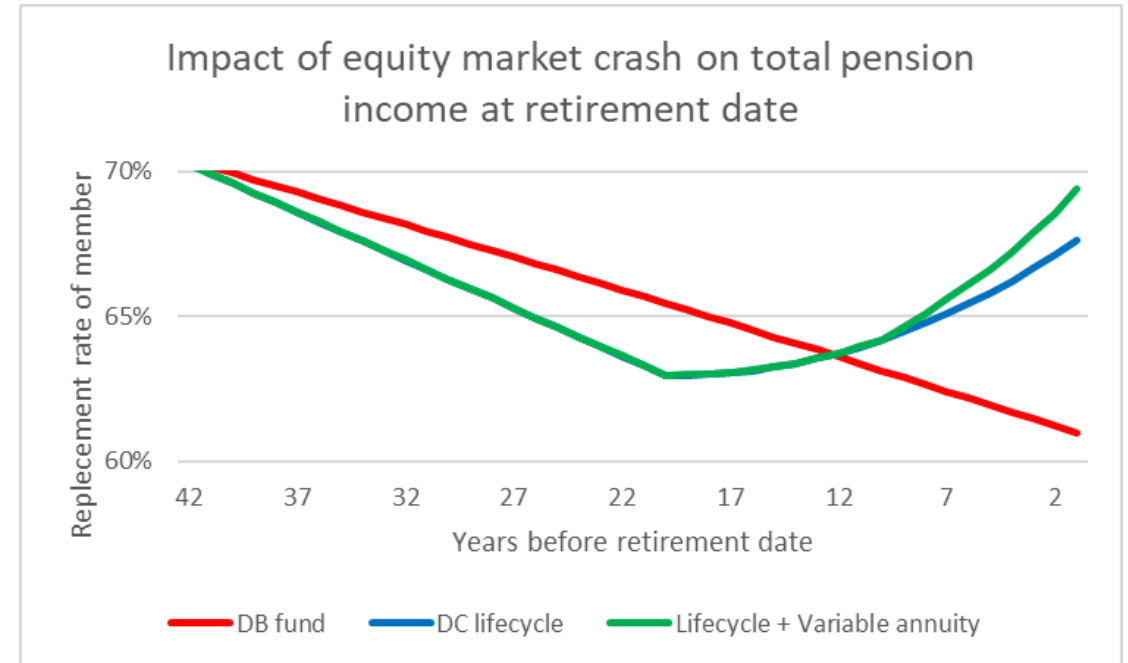
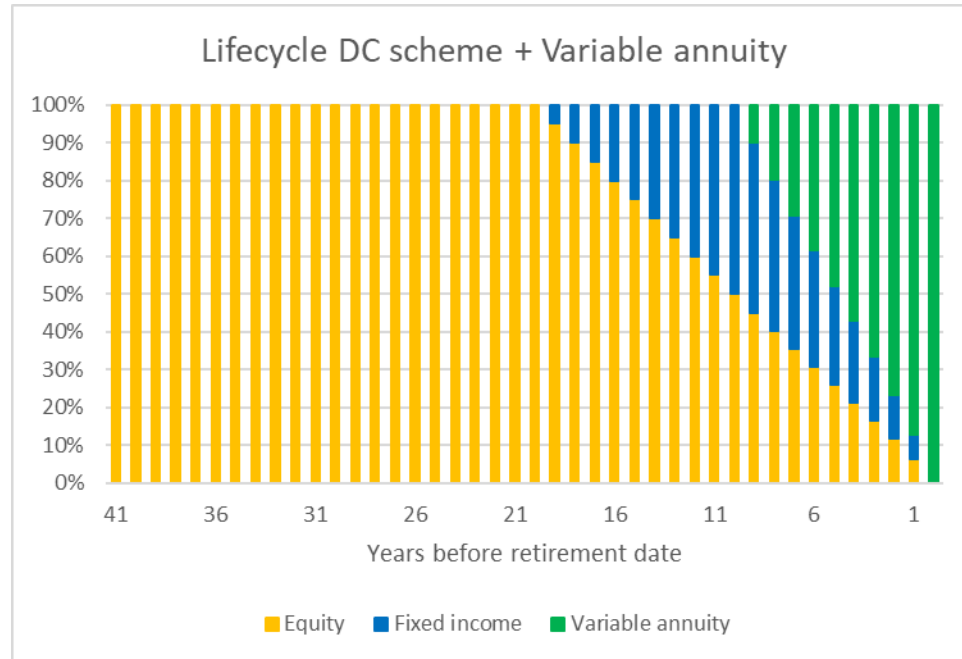
# Combining certainty with pure DC

## Two building blocks



- DC lifecycle: Return seeking assets (equity and credits)
- Collective variabele annuity (“collectiviteitskring”) invested in low risk fixed income assets, duration matched to nominal pension rights of members

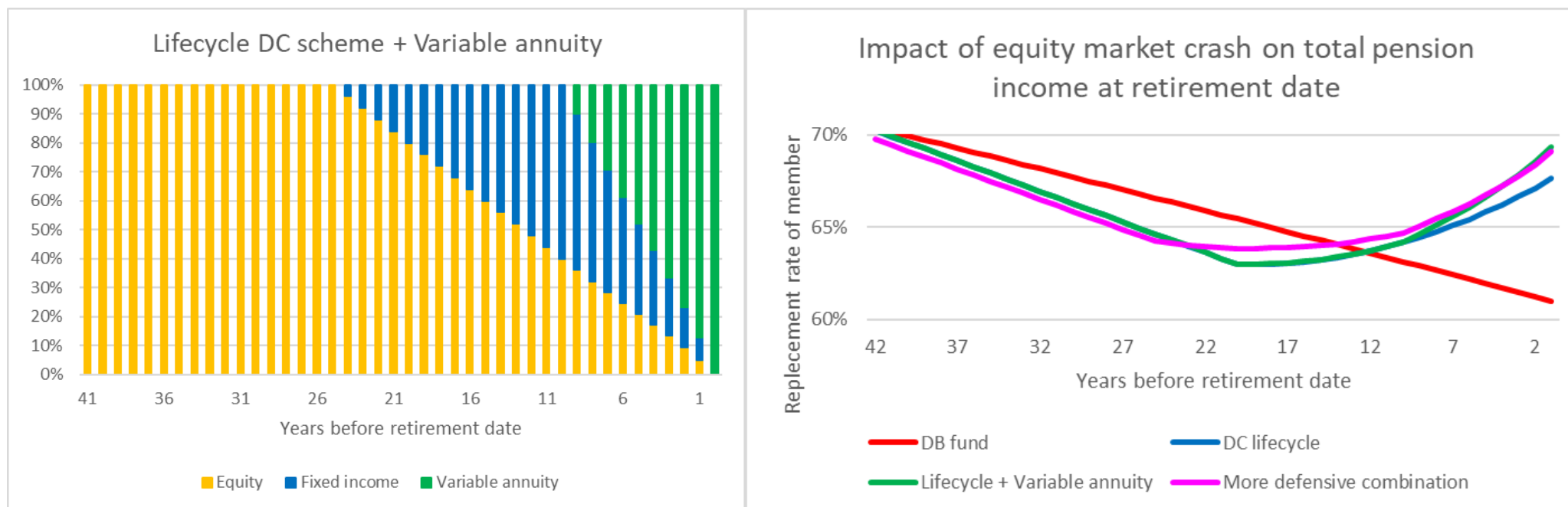
# Tailoring the building blocks: An example



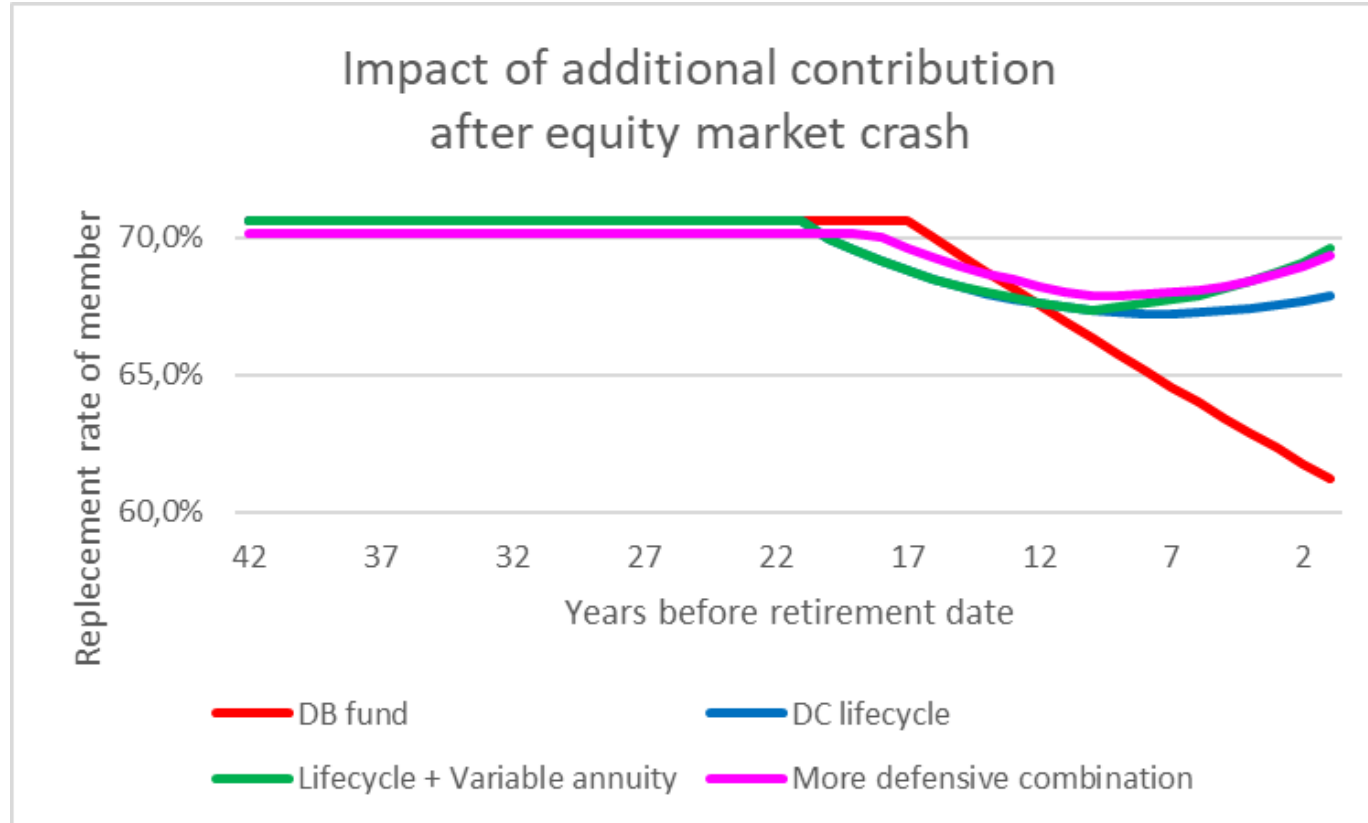
- Less exposure to market risk in the years near retirement
- Conversion risk near retirement date has been eliminated!

# Example 2

- A more defensive combination
  - Start derisking at age 42 (instead of 47)



# Looking again at the impact of additional contributions



## Wrap up

- Assess risk not only on pension fund level but also on individual members' level
- Regulation pushes this perspective
- DC can be combined with certainty in such a way that it is much better tailored to members' risk tolerance
- We do not need new regulation to build this new pension arrangement



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