



# **Reinventing Retirement: Balancing risk Private Pensions**

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**AARP, Washington, 19 July 2005**

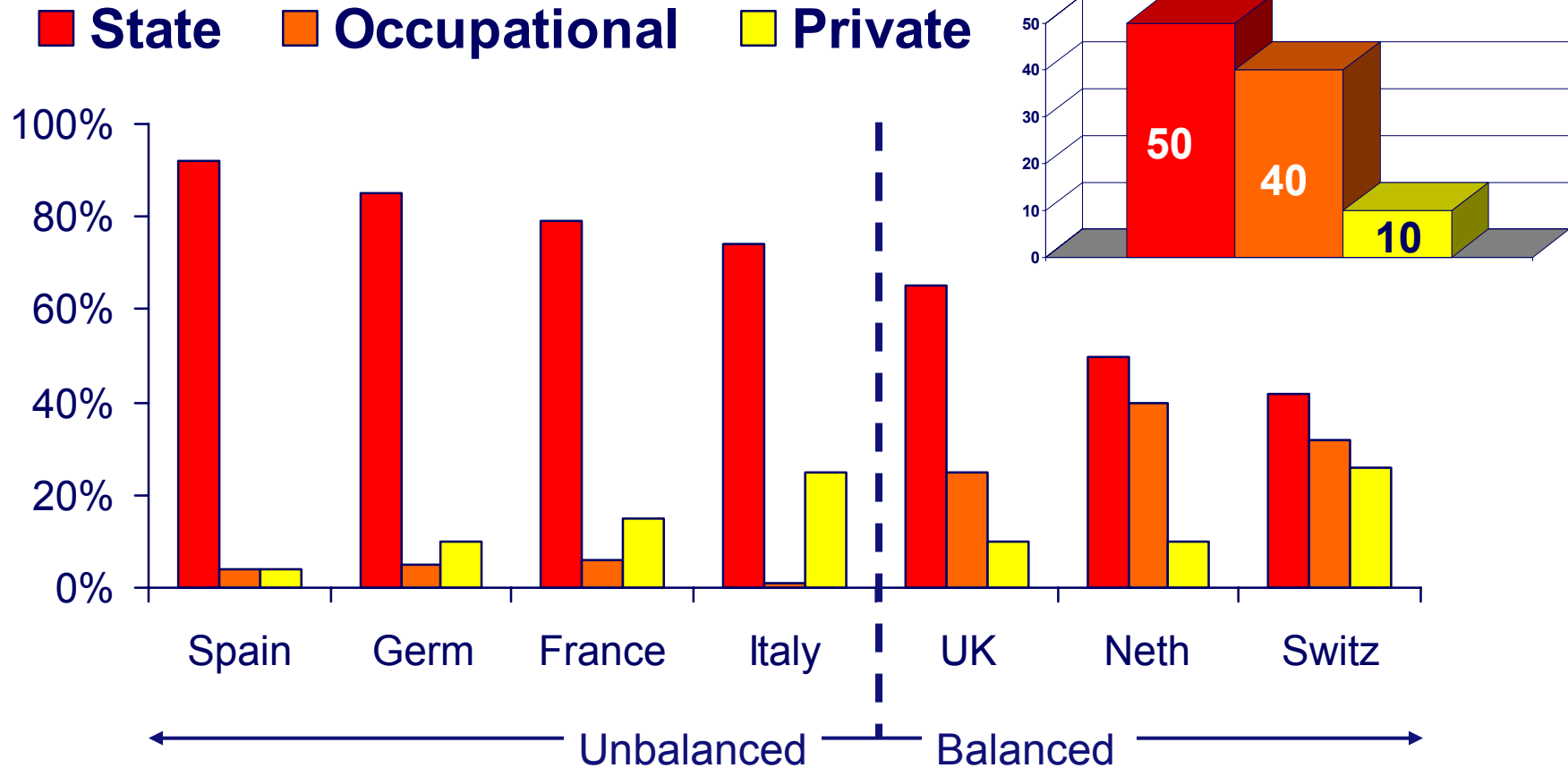
# Points to make

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- **Social security should provide an adequate safety net through a sustainable 1st pillar**
- **Employer-sponsored pension plans are the backbone of a pension system**
- **Changes to the US pension system should also encourage long-term retirement savings**
  - Employer-sponsored plans and private savings
- **Promote annuitization as a stable, long-term source of retirement income**
- **Consider flexible new work/retirement patterns**

# Employer-employee pensions are vital to the strength of the Dutch pension system

## Division of average benefit per pillar in %



(Source: Börsch-Supan, 2004)

# Dutch Pillar I: state pension (AOW)

- Started in 1957, mandatory, pay-as-you go
- All residents insured between 15-65
- Build up 2% entitlement for every insured year
- Premiums included in tax rate
  - Nearly 18% of income up to EUR 29,000
  - Savings funds created through accelerated redemption of public debt to counter aging effects
- No relation to economic activity (work)
- Provides basic standard of living
  - Benefit is flat rate, based on statutory minimum wage
  - 50% of net minimum wage for person living with partner
  - 70% of net minimum wage for single person
- Pay out starts at 65
  - No possibilities for earlier or deferred benefits



The world's oldest:  
Mrs Van Andel

- She just turned 115
- Enjoyed AOW for 48 years without paying for it

# Dutch Pillar II - Occupational pensions

- **No obligation for employers to provide pensions, but most do**
  - **95% of all workers covered**
    - **90% via company and industry-wide pension funds**
    - **10% via direct insurance**
- **2/3 based on final pay; 1/3 based on career-average pay**
- **About 630 company and 80 branch pension funds**
- **Contributions tax deductible, benefits charged as income**
  - **Employer pays on average 65% and employee 35% of contributions**
- **Aim of most plans: provide 70% of final (or average) salary after 35-40 years of contributions**
  - **Pillar I benefit is included (franchise) in reaching this 70% level**
- **Obligation to pay in annuities, lump sums not allowed**
- **Obligation to fund outside the company**
- **Portability**



# Dutch Pillar III: private pensions

- **Additional voluntary individual arrangements**
- **Premium tax-deductible up to limit**
  - Limit is higher when person does not have sufficient arrangements to provide an old-age umbrella of 70% of final pay
- **Benefits are taxed**
- **Tax-deductible products; benefits taxable**
  - Endowment with annuity clause, unit-linked with annuity clause, deferred annuity, immediate annuity
  - Single premium
- **Not tax-deductible products, benefits tax free**
  - Life insurance, also combined with mortgage (investment in bricks/property)
  - Individual savings plans (mutual funds), banking and insurance
  - Savings accounts
  - Property



# Winds of change blow in the Netherlands

- **Abolishment/discouragement of early retirement to encourage participation of older workers**
- **Introduction of Life time account as flexible savings instrument as of 2006**
- **Changes to occupational pensions via collective labor agreements**
  - Netherlands is still DB country, but careful shift towards introduction of DC and search for alternatives
    - Combination of DB (to basic level) and DC (on top of basic level)
    - Collective DC
  - Raising of retirement age
- **New insurance system for medicare/long-term care in 2006**
  - Introduction of mandatory basic medical insurance for everyone
  - Voluntary individual arrangements on top of that



# Levensloop: life time savings account

- **Name is almost the same as US LSA, but character is different in several respects:**
    - Emphasis in Dutch system is on saving time
    - Not competition or substitute for employer-sponsored or individual pension plans
    - Employer can choose to contribute
    - Maximum savings amount is 12% of gross salary per year
    - Maximum savings balance is 210% of gross salary
    - Savings are tax-exempt, pay-out is taxed
  - **Dutch LSA is flexible savings instrument**
    - Early retirement
    - Sabbatical leave
    - Extended maternity leave
    - Study time
  - **Positive expectations, but jury is still out**
  - **Response of workforce**
    - 50+ : will use it for early retirement
    - <30: will they use it at all and if so, for which purposes?
    - 30-50: will they use it as a flexible instrument?
- ING welcomes initiatives that stimulate flexible retirement solutions, but is opposed to initiatives that could discourage people from making stable long-term retirement savings**



# Comparison US - Europe



- **President Bush shows strong personal commitment to reform the US pension system**
  - Present plans in 60 cities within 60 days
  - Though experts agree the US pension system is not in crisis, early action will help to keep it sustainable
- **European leaders continue to disagree on many issues, including pensions**
- **President Bush' plans to reform social security meet criticism, including from AARP**
  - Unwise to drain money out of social security

## ING's view:

- **We support efforts to help strengthen solvency of social security**
- **Changes in the system should also encourage long-term retirement savings**
  - Employer-sponsored plans
  - Private savings
- **We support incentives that encourage annuitization of pay-out options**

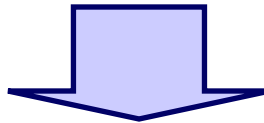
# Points to share from the Dutch system

- **Maintain sustainable 1st pillar as social safety net**
  - Explore funding alternatives to absorb effects of aging population
    - Netherlands: fund formed from early redemption of government debt
    - US: Changes to social security should not discourage Americans from maximizing long-term retirement savings
      - Employer-sponsored plans and private savings
- **Continue to stimulate voluntary savings in pillars II and III**
  - Occupational pensions are the backbone of the pension system
  - Stimulate 401K plans as vital part of US retirement savings
    - Promote annuities as vehicle for stable long-term income stream
  - Alternative solutions such as hybrid DB/DC, collective DC are being developed
- **Consider flexible new work/retirement patterns in response to social trends**
  - Add flexible savings instrument for extended maternity leave, sabbatical, early retirement, but leave existing long-term retirement savings intact
  - Part-time pension
  - Tax support is key to success

# Create awareness and cooperate to find solutions

## Research of ING among US citizens reveals:

- **2/3 of Americans don't know how much income they need for retirement**
- **Most Americans do not understand financial risks related to retirement plans**
  - Investment, inflation, longevity
- **Most Americans do not have an adequate plan for retirement**
- **More than 60% lack confidence in social security to help fund their retirement income**



- **Increase awareness of need to make retirement savings**
  - Employer-sponsored plans and private savings
- **Joint task of government, social partners, financial sector and individuals**
- **ING calls for public/private partnership in finding retirement solutions**
- **Organizations such as AARP are vital partners in this process!**

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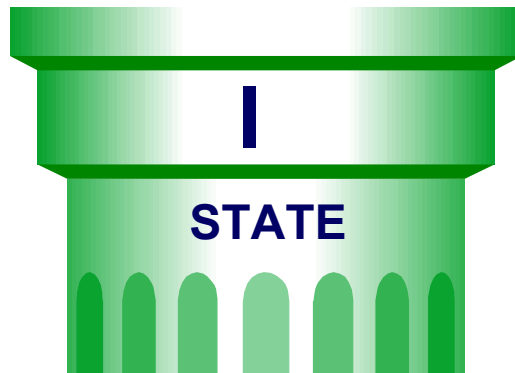
# ADDITIONAL INFORMATION

# Balanced 3-pillar pension system in Netherlands

Pay as you go  
Independent of  
income

Secures minimum  
standard of living

Provides 70% of legal  
minimum wage



Arranged between  
employers and employees

On mandatory basis

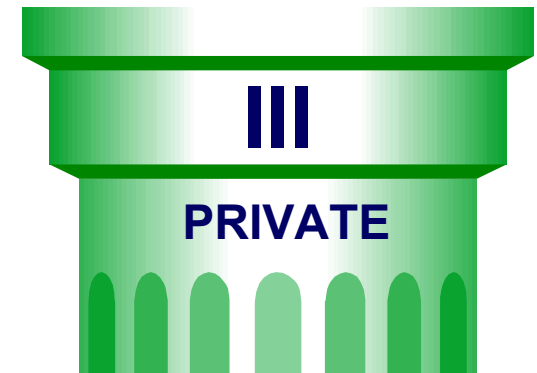
Defined benefit or defined  
contribution plan

Aims to provide, together  
with Pillar I, 70% of salary  
(final or average pay)



Voluntary,  
tailor-made  
supplementary  
arrangements  
supported by  
tax incentives

Provides additional  
benefits for earlier or  
higher pension



Employer-related pension assets totalled EUR 456 bn in 2003 (102% of GDP)  
In addition, insurers held EUR 251 bn Pillar II + III assets (56% of GDP)

# Combination of DB and DC

+ Socially secure

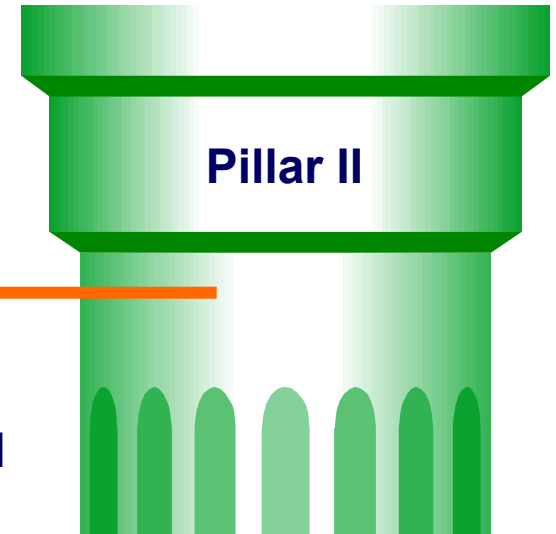
+ Risk shared  
between provider  
and individual

+ Limited risk in  
investment return

- More complicated

DC above basic  
level

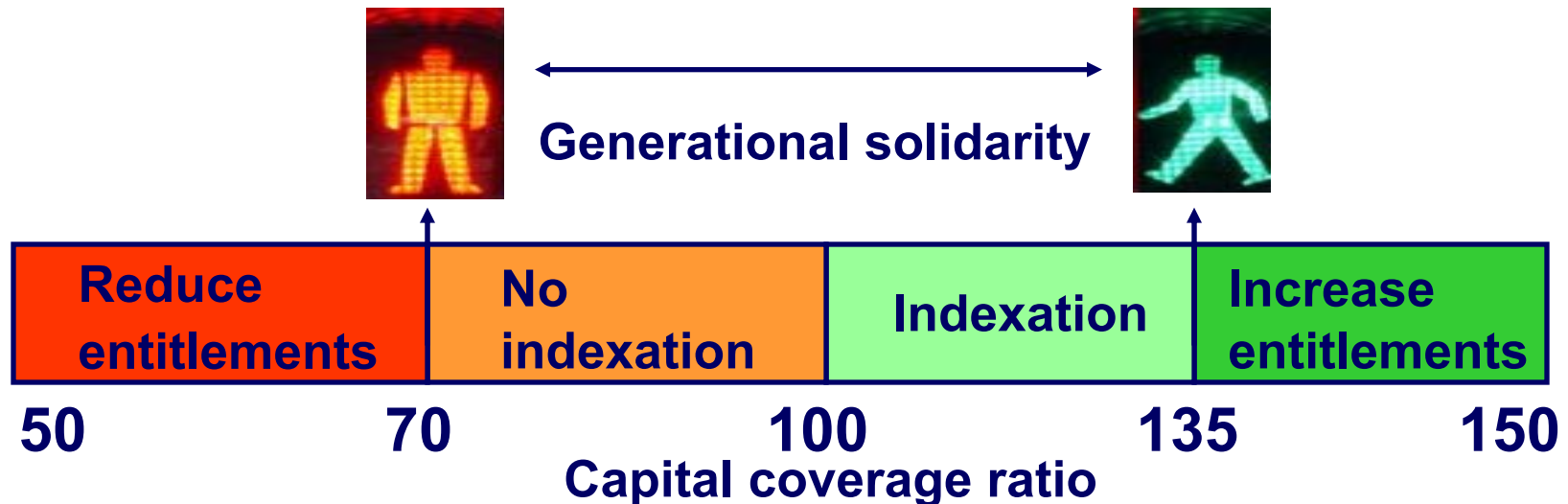
DB up to  
a basic income level



Combine collective solidarity with individual flexibility

# Innovative idea: Collective Defined Contribution

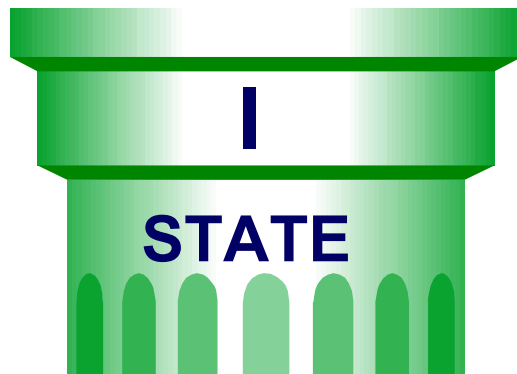
- **Collective risk sharing reduces price of pension product**
  - Research shows that collective pension offers significantly higher proceeds than individual pension
- **Feasible solution: Collective DC**
  - Set top and bottom limit for capital coverage ratio
  - Increase or reduction of pension entitlements if these limits are exceeded
  - Fair sharing of pleasure and pain
  - Role for insurers, pension funds, employers and employees



# Interdependence of pension and care systems

- **Set up and funding should be similar**

**Basic  
minimum/social  
safety net:  
basic health  
insurance  
long-term care**



**Benefits/care above  
social minimum  
to be arranged by  
employers and  
employees**



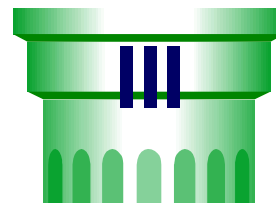
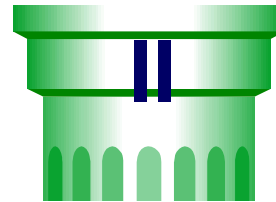
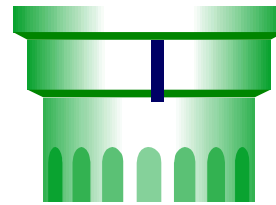
**Additional  
individual  
supplementary  
provisions via  
private insurance**



# Current and future set up of care system in the Netherlands

## Current set up

|  |  |
|--|--|
| <p><b>AWBZ</b><br/>Mandatory social insurance for long-term care</p>         |  |
| <p>Mandatory insurance for employees with annual income below EUR 33,000</p> | <p>Voluntary insurance for employees with annual income above EUR 33,000</p> |
| <p>Supplementary Voluntary insurance</p>                                     |  |



## Future set up

|  |
|--|
| <p>AWBZ (reduced in scope)<br/>Mandatory social insurance for long-term care</p>       |
| <p>Basic insurance curative care</p> <p>Mandatory insurance for all Dutch citizens</p> |
| <p>Supplementary Voluntary insurance</p>   |