PGIM
GLOBAL ASSET MANAGEMENT

A DUTCH LESSON ON REDEFINING RETIREMENT SOLUTIONS

How are CIOs responding to the great DB to DC shift as the rest of Europe looks on?

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- **CIOs can protect purchasing power by including inflation-linked debt and real assets.**
- **Upgrading systems to manage transition poses operational, regulatory complexities.**
- **Greater domestic investment focus driven by geopolitics, diversification.**
- **De-risking market evolving as longevity reinsurance and pension buy-outs help.**

Defined contribution (DC) schemes have seen sustained growth, while defined benefit (DB) plans have been in steady decline for years—a trend expected to persist.[1] Over the next 2.5 years, the largest pension savings system in the EU will undergo a significant shift from DB to DC.

The transition in the Netherlands brings familiar challenges faced by DC systems globally, including delivering inflation-protected income to participants, addressing the differing administrative complexities of DC versus DB, evaluating the role of illiquid alternative investments within DC structures, and mitigating tail risks, both investment-related and longevity-driven, for pension savers.

Cerulli Associates estimated that Europe's defined contribution market will record an average growth rate of 6% over the next five years, nearly twice the rate for the rest of the pension industry in the same period.[2] With nearly two trillion euros ($2.3 trillion) in accrued benefits,[3] the transition has significant implications for asset classes. We explore the emerging responses from Dutch CIOs to each of these pressing issues as we witness the transformation of the Dutch country's pension landscape in real time:

HOW CAN PENSION FUND CIOS PROTECT PURCHASING POWER IN RETIREMENT?

Balancing the preservation of inflation-adjusted purchasing power for pension beneficiaries during the decumulation phase is one of the most pressing challenges faced by CIOs globally. Therefore, retirement solutions must be innovative yet robust to meet multi-generational needs.

Inflation Protection at the Core: Inflation remains one of the most significant risks to maintaining purchasing power. Many Dutch pension funds are transitioning to inflation-indexed solutions to mitigate the erosive effects of rising costs. Funds like Pensioenfonds Loodsen (the shipping pilots' pension scheme) have prioritised full interest rate

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2. March 2022, Cerulli Associates, Europe's Defined Contribution Market Is Set to Keep Growing, https://www.cerulli.com/press-releases/europes-defined-contribution-market-is-set-to-keep-growing, Accessed March 2025
3. European Central Bank, The structural impact of the shift from defined benefits to defined contributions, https://www.ecb.europa.eu/press/economic-bulletin/focus/2021/html/ecb.ebbox202105_08~5b846b2f5a.en.html#:~:text=The%20largest%20occupational%20pension%20fund,trillion%20of%20assets%20under%20management., Accessed April 2025

hedging to safeguard member benefits against inflation spikes.[4] Using inflation-linked bonds (ILBs) forms a critical pillar of this approach, ensuring that retirees' income streams retain value amidst fluctuating price levels.

They are also exploring alternative inflation hedges such as real assets. ABP, the pension fund for Dutch government and education employees, is planning to double their investments in infrastructure and real estate by 2030.[5] These assets not only provide steady cash flows but also offer an inherent inflation hedge by linking rental or usage rates to inflation indices. So far, the allocation to more risky assets with the transition is leading to some asset classes like high yield debt being overlooked in favour of equities due to greater correlations. Furthermore, higher risk tolerance levels in liability-driven investments is prompting a broader move out of government debt.

Longevity Risk Solutions: Prolonged life expectancy among retirees adds another layer of complexity to pension fund management. Life expectancy in the Netherlands is forecast to rise to 87 years by 2050, up from 81 in 2022.[6] To counter residual longevity risk, CIOs are increasingly turning to innovative longevity-linked instruments. An example of this innovation can be seen with the Dutch pension plan for the building and the construction industry, Stichting Pensioenfonds voor de Bouw (BPF Bouw), which has integrated longevity hedges into their portfolio strategy, allowing them to lock in predictable outcomes while reducing financial strain over time.

Reinsurance agreements are also gaining traction, providing a way to transfer risks associated with longer lifespans to third-party providers. In 2023, NN Group, through a subsidiary, completed two transactions to transfer the full longevity risk associated with approximately €13 billion of pension liabilities to PGIM's parent company, Prudential Insurance Company of America,[7] as well as global reinsurer Swiss Re.[8]

HOW ARE CIOS NAVIGATING THE ADMINISTRATIVE BURDEN?

A key visible impact of the transition is the sharp rise in administrative expenses. A recent report by consultancy Bell said administration costs increased by 13% in 2023.[9] These costs, which now total €636 million across the ten largest Dutch pension funds, are driven by preparations for the ongoing transition. Specific expenditures include advisory fees, IT system upgrades, additional data management requirements, and increased governance expenses.

€636

Administration costs total €636 million across the ten largest Dutch pension funds.

Dutch pension funds are investing heavily in modernising their systems to manage the nuances of DC schemes, which demand enhanced transparency and adaptability. Legacy systems designed for DB models are ill-equipped to process the real-time updates and customisation options required by DC setups. For example, Pensioenfonds Loodsen amended its implementation plans multiple times under regulatory pressure to ensure equitable transitions for all member cohorts.[10] High-quality data management is another key challenge. Accurate and comprehensive datasets are crucial for modelling member benefits and running complex simulations.

The regulator's strict oversight, while necessary to safeguard members' interests, underscores the importance of governance but inadvertently magnifies costs and resource demands on pension funds. Such rising costs emphasise that modernising the pension landscape requires not just one-time investments but enduring changes that reshape operational budgets.

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7. Prudential Financial, Inc. ("PFI") of the United States is not affiliated in any manner with Prudential plc, incorporated in the United Kingdom or with Prudential Assurance Company, a subsidiary of M&G plc, incorporated in the United Kingdom.
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10. November 2024, ipe.com, First Dutch pension fund gets go-ahead for DC switch, https://www.ipe.com/news/first-dutch-pension-fund-gets-go-ahead-for-dc-switch/10076865.article, Accessed April 2025

WILL DUTCH PENSION FUNDS SWITCH TO A MORE GEOGRAPHIC INVESTING PROFILE?

At the end of 2024, Dutch pension funds managed €1.57 trillion in assets, with 82% of assets allocated in overseas markets. North America, mainly the US, accounted for a quarter of the investments, while Europe (excluding the Netherlands) held a 40% share.[11] However, investments within the Netherlands grew from 15.7% in early 2022 to 18.3% by early 2023.

European bond markets also attracted Dutch investment flows, with €294 billion flowing towards sovereign bonds, reflecting Europe's bond-dominated structure versus the equity-focused investment landscape in the US markets. The switch to a more geographic investing profile is set to accelerate in the backdrop of rising geopolitical uncertainty and growing trade tariff tensions between the US and its trading partners. For example, APG, a dedicated asset manager for Dutch pension funds, managing assets over €616 billion euros, has already invested €2 billion euros in the European defence sector and said other domestic pension funds will follow suit.[12]

The outcome will hinge on available resources and the pension fund's ability to commit to regional decision-making, as well as the portfolio's objective—whether focused on matching strategies or growth portfolios. For example, in public fixed income within growth portfolios, the majority of activity remains globally-oriented debt.

HOW ARE DUTCH CIOS MANAGING LIQUIDITY IN ALTERNATIVES?

That is the critical question. Drawing from experience in the DB landscape, it is evident that the emphasis on liquidity management is only beginning to make its mark.

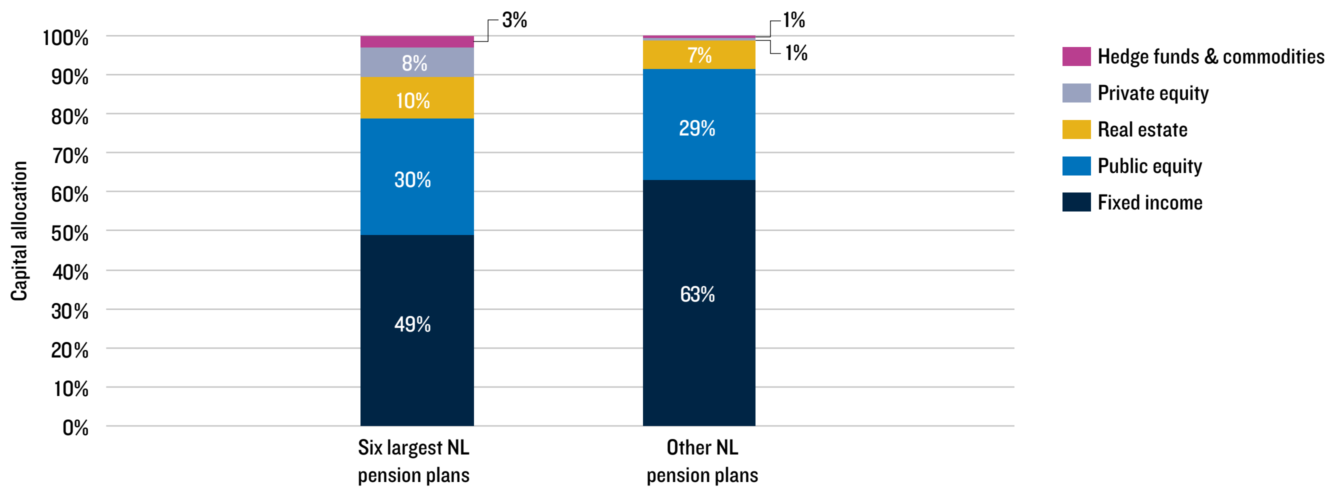
The De Nederlandsche Bank (DNB), the country's central bank, is vigilant about how pension funds manage alternatives, particularly given the lessons from the 2008 financial crisis. The regulator has introduced stringent guidelines, requiring pension funds to conduct detailed self-assessments of their portfolios.

Globally, the average allocation by one thousand plan sponsors to private equity stands at approximately 6.6% of total assets, with hedge fund allocations averaging 4.5% at the end of 2022, according to data from Willis Towers Watson.[13] While these percentages seem minor compared to the overall assets under management, the illiquid nature of alternatives can create outsized liquidity demands during market stress or periods of high redemptions.

The following chart, focused on defined benefit pension plans in the Netherlands, highlights a striking trend: larger schemes allocate a greater portion of their portfolios to private markets compared to their smaller counterparts, underscoring their strategic emphasis on these investments.[14]

The watchdog's emphasis on governance has driven funds to develop more robust monitoring frameworks. For

Larger Dutch Pension Plans Allocate More to More Complex Asset Classes



Source: 'Have scale effects on cost margins of pension fund investment portfolios disappeared?" J.Bikker & J. Meringa, DNB (2021), Table 1, PGIM calculations.

11. March 2025, European Pensions, Dutch pension funds prefer US companies over European counterparts – DNB, https://www.europeanpensions.net/ep/Dutch-pension-funds-prefer-US-companies-over-European-counterparts-DNB.php, Accessed March 2025
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13. Dec 2023, Willis Towers Watson, Overview of the 2022 Asset Allocation Study of Fortune 1000 Pension Plans, Accessed March 2025
14. November 2024, PGIM, The Scale Effect, How size shapes investment governance and allocation Institutional Advisory & Solutions, Accessed March 2025

example, some funds have reduced their hedge fund allocations to zero, citing concerns over transparency, costs, and liquidity, preferring to focus on more predictable asset classes such as private equity and infrastructure.[15]

Larger funds are leading the charge in adapting their governance structures to increase exposure to alternative assets without compromising liquidity. However, to mitigate liquidity pressures, Dutch funds are also employing innovative strategies like commitment pacing, where commitments to alternative funds are staggered over time. Some funds are adopting secondary market transactions to exit positions earlier, unlocking liquidity from investments that typically require long holding periods.

To date, allocations have primarily targeted infrastructure, private equity, and real estate. Many funds now perceive an overexposure to private equity, prompting a shift toward direct impact investments. While potential exists in private credit, liquidity constraints will be a determining factor. Notably, interest in higher-rated private credit has been on the rise.

WHAT IS THE OUTLOOK FOR THE DUTCH DE-RISKING MARKETS?

The Dutch de-risking market is undergoing a significant transformation as demand for pension buy-outs grows and longevity reinsurance gain prominence under Solvency II guidelines. Solvency II guidelines require Dutch insurers to hold substantial capital buffers to hedge against a potential 20% mortality rate reduction. This stringent requirement strains capital resources and forces insurers to seek best-in-class solutions.

As a result, longevity reinsurance, via tools like indemnity swaps and shock absorbers, offers a viable path forward. These strategies transfer extreme longevity risks to reinsurers, enabling insurers to optimise capital and streamline operations. By absorbing tail-end risks, they improve the solvency positions of insurers, facilitating regulatory compliance while keeping costs manageable. This collaboration ensures that pension funds engaging in buyouts can receive competitive pricing without eroding the insurers' capital buffers.

WHAT WILL THE INVESTMENT POLICY LOOK FOR IN THE SOLIDARITY RESERVE COMPONENT OF A DUTCH PENSION FUND?

In a solidarity scheme, pension assets are the "collective property" of the participants, with a portion assigned to each age group. However, there is a portion of the collective property that is not assigned to any group but remains a "collective asset" shared by all participants. This part of the collective assets is called the Solidarity Reserve.[16] Dutch law caps the solidarity reserve at 15% of a pension fund's total assets.

The solidarity reserve is funded, initially, from contributions from employers (which could be from any funding surplus from the transitioning DB plan), and, thereafter, through a portion of any positive excess return. The reserve is structured to balance risks across contributing cohorts using pre-defined allocation rules. For instance, younger participants who can tolerate higher risks may later benefit from returns accrued through the solidarity reserve during periods of economic downturn. Conversely, retirees gain stability from the buffer, which cushions market volatility's impact on their benefits.

Managing risk-sharing mechanisms within the reserve requires deep connections between pension fund administrators and asset managers. The reserve must adapt to cohort-specific risk tolerances while maintaining sufficient liquidity to address short-term funding requirements.

Crucially, investment strategies for the solidarity reserve must emphasise diversification, sustainability, and alignment with the long-term nature of pension liabilities. These approaches often incorporate diversified portfolios combining government bonds, equities, and sustainable investment vehicles like green bonds, supporting both return potential and ESG objectives.

Incorporating low-volatility assets alongside growth-oriented investments, such as infrastructure projects or real estate, ensures a consistent risk-return profile. Pension funds are also leveraging lifecycle investing tailored by cohort to align exposure levels with participant age profiles.

15. May 2021, ipe.com, ABP exits hedge fund investments, https://www.ipe.com/abp-exits-hedge-fund-investments/10052948.article, Accessed April 2025
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THE BOTTOM LINE: LESSONS FOR EMEA

In the EU, the working-age-to-pensioner ratio is set to drop from nearly 3:1 to less than 2:1 over the next 50 years, with similar trends seen in the UK accelerating the shift from Defined Benefit (DB) to Defined Contribution (DC) pension schemes.[17] This has raised questions on a variety of fronts for existing pension systems in Europe. The ongoing Dutch transition offers responses to some of these questions. Flexibility is key to meeting diverse retiree needs, and Dutch CIOs are revisiting rigid annuity models in favour of hybrid solutions. Products like variable annuities can combine lifetime income guarantees with investment-adjusted growth potential, striking a balance between stability and opportunity.

Economies of scale are critical to navigate rising costs and stricter regulations as larger funds can negotiate better deals with asset managers. The UK's Pensions and Lifetime Savings Association (PLSA) noted that as AUM reaches £20 billion ($26 billion) schemes can start to co-invest in private markets; above this, schemes can invest directly and are able to use in-house investment capabilities.[18]

Finally, larger funds demonstrate a pronounced interest in private markets, drawn by the potential for enhanced returns and the added diversification offered by what is seen as a specialised asset class.

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