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# Dutch regulator blamed for pensions losses

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The Netherlands' regulator is killing the country's pensions system by imposing liability matching rules that have cost it €120bn, according to a Dutch consultant and pensions guru.

Anton van Nunen, owner and founder of Van Nunen & Partners, told delegates at the OECD-WPC World Pensions and Investments Forum in Paris last week that the approach to investment that aims to match assets to liabilities required by Dutch regulator, the DNB, had lost the country's pensions industry 15% of its assets.

Liability matching was widely adopted as a strategy following the market crash at the beginning of the last decade when regulators felt that pension funds had sustained substantial losses by focusing more on assets and less on liabilities. In practise, the regulator required pension funds to hedge the risks arising from their liabilities by buying bonds.

Van Nunen said: "The problem is not the liability matching requirement per se but the way the DNB requires it to be calculated using swap rates."

Dutch pension funds have long complained that because they are forced to use a swap curve when calculating pension liabilities, the funding ratio is skewed. The swap curve which Dutch pension funds are forced to use to measure liabilities has decreased markedly, especially when compared to AAA corporate bond yields used under IFRS, and this has increased liabilities.

Van Nunen added: "It is a terrible method. The swap market is not deep enough. Pension funds buy a 30-year swap in a tight market. This has the effect of pushing up liabilities making it worse for the next pension fund that follows suit. Consequently they are caught up in an asset-destroying circle.

"The Dutch regulator said the €120bn was the value with which the financial health of the Dutch pension system declined during the 2008-09 credit crisis and added that half the amount was due to regulation, that is as a consequence of rising liabilities, and the other half as a result of declining asset prices. But this division is not correct as pension funds, confronted with declining swap rates and thus with rising liabilities, de-risk, sell equities and thus create their own losses also from this side of their balance sheet. So, much more than 50% of the €120bn loss is caused by the influence of regulation."

He said: "Investments have to be liability-aware not necessarily liability driven. However, in practice, pension funds are to a large degree forced into hedging liabilities by the regulator."

Van Nunen added that pension funds should not strive for certainty; it was simply too expensive, but they should instead be guided by the duration of liabilities, the period over which they would have to pay pensions. And he said that the reality was that interest rate risk had become regulatory risk, with the method of regulation being the problematic issue.

Van Nunen went on to say: "Banks and other providers made excellent use of this regulatory risk: many pension funds entered LDI structures at a price and without an exit at a fair price. So exaggerated regulatory risk has benefited banks and asset managers and impoverished institutional investors."

He said the Implication of the DNB's criticism of pension funds for taking too much investment risk and failing to hedge liabilities was that they should be insurers. But he noted that "Risk, not money, is the only 'asset' a pension fund has at its disposal," highlighting that pension schemes have to invest in risky assets like equities that over the long term will generate better returns than low-risk assets such as bonds. "The simple fact is that non-risky assets do not guarantee the returns required for nominal pensions. Risk will show its ugly face regularly but that is exactly the reason why risk premiums exist."

He said the regulator, although motivated by the best of intentions, punished decent risk taking by introducing short-term considerations that determine investment policy.

Meanwhile the DNB reported that at end-September 2010 Dutch pension funds had more than €300bn invested in bonds. With pension funds having total investments of more than €675bn, bonds were the largest asset class, followed by €216bn in equities.