CHAPTER 7 EMPLOYMENT CONTRACTS AND PENSIONS

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A pension is intended to cover the risk of loss of income resulting from old age, in that context traditionally defined as 65 years of age. In the last few decades there has been a trend towards decreasing that predefined age by means of various early retirement systems. Since the mid 1990s that trend has turned around due to the ageing of the population, leading to a relative increase in the number of pensioners, as a result of which even the age of 65 is no longer sacrosanct.

The term 'pension' as used in this chapter refers to group pension schemes for employees, which are usually regulated by the social partners. Such schemes are known as the 'second pillar'. The Netherlands stands out at an international level due to its extremely high coverage ratio of group pension schemes, with more than 90% of all employees covered by such a scheme. Within the EU this pension system is often quoted as an example, even by the European Commission, particularly because the system is based on capital funding and is thereby relatively robust in relation to the ageing population.

The key question is the extent to which employment contracts as such remain an adequate means of regulating this type of pension. In attempting to find an answer, section 7.1 will first discuss the relationship between employment contracts and pension contracts. Sections 7.2 and 7.3 will describe the Dutch pension system from a European perspective. Section 7.4 will explain how there has been a shift in responsibilities since the mid 1990s between the parties involved: the government, the social partners, individual employers and employees, and pensioners. Section 7.5 will analyse the relative accessibility (and inaccessibility) of pension contracts for various categories of workers, whether or not they are subject to an employment contract. Finally, sections 7.6 and 7.7 will answer the key question: are employment contracts still an adequate means of regulating pensions?

7.1. PENSION CONTRACTS AND EMPLOYMENT CONTRACTS

The subject of this book is employment contracts. What is the relationship between pension contracts and employment contracts?

For years, the most important law governing group pension schemes was the Pension and Savings Funds Act (Pensioen- en Spaarfondsenwet), which used the term pensioentoezegging, generally translated as 'pension commitment'. This is linked to the term arbeidsverhouding, or 'employment relationship'. Without an employment relationship there is no possibility of making a pension commitment. Lutjens1 was thus correct in arguing that due to the contractual nature of a pension commitment it would be better to speak of a pensioenovereenkomst or 'pension contract', also under the Pension and Savings Fund Act, and it is that term which is used in the new Pensions Act (Pensioenwet), which replaced the Pension and Savings Funds Act as of 1 January 2007.² Article 1 of the Pensions Act describes a pension contract as 'the agreements that an employer and an employee have made with respect to a pension'. There is thus a close link between the employment contract and the pension contract. Under the Pension and Savings Funds Act - which, as noted above, used the term 'pension commitment' - reference was made to an 'adhesion contract', due to the close connection between the employment contract and the pension.3

In a number of respects, a pension contract is similar to an employment contract. For example, the employer may amend either contractual form if the contract in question provides for that possibility and the employer has a weighty interest in the amendment.⁴ The link between the two types of contracts is very close, but not unbreakable. An employment contract is neither a necessary condition nor a sufficient one for a pension contract. It is not a necessary condition because civil servants are also covered by the Pensions Act, and it is not a sufficient condition because although the coverage ratio of the Dutch second pillar⁵ is high, it is not complete. An important characteristic of a pension contract is that it can outlive the

¹ Lutjens, 2006.

Act of 7 December 2006 relating to the rules governing pensions (*Pensioenwet*), Stb. 2006, 705. (N.T.: Stb (*Staatsblad*): Bulletin of Acts, Orders and Decrees.)

Beltzer & Biezeveld, 2004.

⁴ Article 7:613 of the Dutch Civil Code and Article 19 of the Pensions Act.

⁵ See section 7.2.1.

employment contract, however much it may be based on and form part of the employment contract, for example with respect to the pension claims of deferred members (employees who no longer accrue pension benefits from their former employer because they have changed employers) and pensioners.

7.2. THE DUTCH PENSION SYSTEM IN A NUTSHELL

7.2.1. THE THREE PILLARS

A pension can be defined as a periodic, uniform payment that sets off the loss of income due to old age, death or disability by means of an old-age pension, a widow's/widower's and orphan's pension, a partner pension or a disability pension.⁶

The structure of the Dutch pensions system has three pillars. The first pillar is formed by the state pension system for persons who have reached the age of 65 have a right to old-age benefits under the General Old Age Pensions Act (*Algemene Ouderdomswet*). The amount of those benefits depends on the amount of time they have resided in the Netherlands between the ages of 15 and 65. As a result, many immigrants are not entitled to full old-age benefits when they reach the age of 65. Full old-age benefits for a single person amount to approximately EUR 1010 gross a month, including a holiday allowance, as of 1 January 2007. For cohabitating partners the gross monthly benefits amount to approximately EUR 692 for each partner.

The second pillar is formed by company or occupational group pension provisions. Whether an employee is entitled to a second-pillar pension will depend on whether the claimant presently works or has worked in the past at a particular company or within a particular business sector, and the existence of a pension commitment or pension contract. The coverage ratio of the second pillar now exceeds 90%. Traditionally this type of pension took the form of a defined benefit scheme based on the final pay. The premiums could vary depending on the pension fund's financial results. On average, employees paid one-third of the premiums and employers two-thirds. There have been two shifts in this respect since the mid-1990s. The vast majority of final pay schemes have now been replaced with average earnings schemes. This shift must be seen primarily against the background of the pension costs – and the

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⁶ *Cf.* Article 1 of the Pension Act.

related labour and salary costs – for the employer. The second shift is more recent and, for the time being, more limited in scale, and is based on employers' desire to place the risks related to pension accrual with the employees, in any event more than they did in the past and in some cases in full. This desire has resulted in a shift from defined benefit schemes to defined contribution schemes.

This chapter will concentrate on the second pillar, as in practice only this pillar is related to the existence of an employment contract. In this context, emphasis will be placed primarily on old-age pensions. However, it is clear from Article 1 of the Pension Act that the second pillar consists of many different types of schemes, including widow's/widower's and orphan's pensions, partner pensions, disability pensions and unmarried person's pensions. It is apparent from this list that although the pension contract is linked to the employment contract, the related income protection is not limited to former and present employees. Orphans, widows, widowers, etc. can also be entitled to a pension that was accrued by someone other than themselves.

Finally, the third pillar is formed by individual pension schemes which are administered by private insurers. In principle, third-pillar schemes, like oldage pension benefits and other first-pillar schemes, are unrelated to the existence of an employment contract.

7.2.2. EARLY RETIREMENT SCHEMES

A large number of early retirement schemes (*vervroegde uittreding* or VUT schemes) were implemented in the early 1980s. The background to this was a high level of unemployment, which was continuing to increase at a fast pace. The purpose of early retirement was to have older (expensive) employees make way for younger (less expensive) employees. The Invalidity Insurance Act (*Wet Arbeidsongeschiktheid* or WAO) and the Unemployment Benefits Act (*Werkloosheidswet* or WW) were also used to dispense with older employees. These early retirement schemes became very popular in a short period of time. In the course of the 1990s such schemes under which older employees could retire early were gradually phased out or considerably cut back. In the mid 1990s the first policy documents began to appear proposing an increase in the participation of older individuals in the labour market.

The various measures taken have led to an increase in participation in the labour market of employees between the ages of 55 and 64, from 26.4% in 1987 to 39.7% in 2004. The greatest growth has been in the category of employees aged 55 to 59 (from 40% to 55% between 1995 and 2005).

With the introduction of the Early Retirement (Adjustment of Tax Treatment) and Life-Course Savings Scheme Act (*Wet aanpassing fiscale behandeling VUT/prepensioen en introductie levensloopregeling*) on 1 January 2006, the next major step was taken to further discourage early retirement (before age 65). As a result of that law, since 1 January 2006 the premiums that employers pay for early retirement schemes and the pay-as-you-go funded portion of pension schemes are no longer exempt from taxation; employers must now pay a 52% final levy in that respect. A lower levy applies until 2011 for existing schemes. The premiums paid by employees are no longer deductible for tax purposes, although for existing schemes until 2011 half of the premiums paid by employees will remain deductible.

Under certain conditions, employees who were age 55 or older before 1 January 2005 can still make use of the tax advantages of saving for a prepension. The person entitled to the benefits will receive higher benefits for each year in which he continues to work (*spaarvut*). This end-of-career bonus is also intended to stimulate employees to continue working longer.

7.2.3. THE LIFE-COURSE SAVINGS SCHEME

A recent new development that affects both pensions and the combination of work and care is the life-course savings scheme (*levensloopregeling*). On the basis of that facility an employee may set aside 12% of his gross salary annually until a maximum of 210% of the annual salary has been saved. That money may be used at any time to take a period of leave (for example care leave or study leave), or it may be used for early retirement. In most cases, employers must grant approval for interim leave. Employers are not required to contribute to the life-course savings scheme but they nonetheless do so in some cases; in the spring of 2006, 36% of the most important collective labour agreements (CAOs)⁷ – covering 1.9 million employees – contained agreements on employer contributions, varying from 0.4% to 3.8%. Pursuant to the relevant legislation, employers that make a contribution must do so for all

We will refer to a collective labour agreement in the Netherlands by its Dutch acronym CAO (collectieve arbeidsovereenkomst).

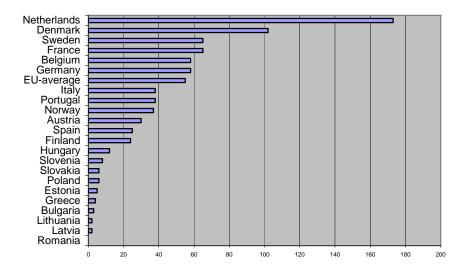
employees, including those who do not participate in the life-course savings scheme. Since its introduction there has been little inclination on the part of employees to participate in the life-course savings scheme: although agreements have been made regarding the life-course savings scheme in 70% of all CAOs, participation is still limited. Various sources mention different numbers of participants, but the highest estimates are still under 5% of all employees.

7.3. THE DUTCH SECOND PILLAR FROM A EUROPEAN PERSPECTIVE

7.3.1. COVERAGE

The Netherlands has a strongly developed second pillar compared with other EU countries. More than 90% of all employees in the Netherlands fall under a group pension scheme, and that percentage continues to increase. In 2001 the number of relevant employers who did not have a pension scheme was approximately 16%, and it appears that these were primarily smaller companies. Other countries where group occupational pension schemes are firmly rooted are Sweden, Denmark and, to a lesser extent, Norway. Table 1 shows the coverage of group pension schemes in various European countries:

Table 1: Pension provisions: second and third pillar, 2005, in percentage of GNP



Source: CBS Eurostat

As Table 1 shows, the data on occupational pension coverage differ depending on the source, not to mention problems with definitions. However, broadly speaking it appears that there is nearly full coverage in Denmark, the Netherlands and Sweden (plus the Norwegian public sector), as well as in France if that country's mandatory supplementary schemes are treated as occupational pension schemes. In Germany, Norway and the UK (plus Hungary if that country's second-pillar funds are considered occupational), approximately half of the workforce, possibly slightly more, is covered. In Belgium and Ireland the rate appears to be between one-third and one-half. Only about one-sixth of Austrian workers are covered by a scheme. In the other countries for which information is available – Finland, Greece, Italy and Spain – coverage appears to be below 10%, in some cases far below that percentage.

Hence in many EU countries the first pillar is still dominant. Since that pillar is generally financed by a cost-allocation or 'pay-as-you-go' scheme (the current employees pay the premiums for the pensioners), those systems are under increasing pressure due to an ageing population. Many countries have

therefore begun implementing reforms, in some cases substantial, which have often been subject to considerable resistance from employees and trade unions. Significant examples are Austria, France, Belgium, Germany, Italy and Greece.

7.3.2. GROUP SCHEMES

The terms 'pension commitment' and 'pension contract' introduced in section 7.1 suggest a large degree of individual contractual freedom for employers and employees. However, in practice that freedom is as good as non-existent. The provisions governing pension schemes in the second pillar are fully or predominantly determined in collective negotiations between employers (or employer representatives for industrial schemes) and employee representatives. Many enact schemes in the form of a CAO. Most early retirement schemes also take this form.

In the Netherlands, industrial pension funds dominate the second pillar. Such funds are the result of the Industrial Pension Fund (Obligatory Participation) Act (*Wet betreffende verplichte deelneming in een bedrijfstakpensioenfonds* or Bpf) from 26 March 1949.8 An important reason for enacting that law was the need for clear legislation. The existing provisions, in particular the Labour Relations Decree (*Buitengewoon Besluit Arbeidsverhoudingen*), were not considered to be sufficiently clear. A more direct reason was the intention in the agricultural sector to create a pension scheme for the entire sector.9 It is worth noting that the regulation was drafted to include the self-employed in addition to sector employees. In the end, it was not done. An important argument for creating a scheme at the sectoral level was to contribute to the equalisation of employment conditions. That was also the reason for obliging the self-employed to participate: to eliminate factors that affect the mutual factors relating to competition in an industrial sector. The Industrial Pension Fund (Obligatory Participation) Act was not intended to ensure that all

Incidentally, industrial pension funds existed before that law was enacted. The first Dutch industrial pension fund was created in 1917 in the province of Friesland by the *Coöperatief Verzekeringsfonds* (Cooperative Insurance Fund) in Leeuwarden. The province of Limburg followed in 1918 with the formation of the *Algemeen Mijnwerkersfonds* (General Mineworkers' Fund). Four more funds were set up in 1929. A government decree passed in 1908 can be considered the first relevant legal regulation, albeit indirectly. That decree was based on Article 1637s of the old Dutch Civil Code (now Article 7:631 of the Dutch Civil Code), which contained a prohibition against compulsory sourcing. The decree excepted pension fund schemes from that prohibition.

⁹ *Cf.* Lutjens, 1999.

employees had a pension. Whether to create a facility was left to the business sector itself. If there was a need for a facility, the law offered the possibility of imposing mandatory participation as pursuant to the Industrial Pension Fund (Obligatory Participation) Act. The Minister of Social Affairs and Employment can make a pension scheme that applies to an industrial sector generally applicable if the organised business sector requests it and the scheme already applies to a significant majority of the employees working in that sector. In such cases, participation in a pension scheme is based on the employer's statutory obligation rather than on a collective contract or commitment. Employers that have their own pension scheme may be exempted from compulsory participation provided they have already applied a pension scheme that is equal or better for a minimum period of six months.

The first industrial pension fund – for the agricultural sector – was created on the very day the Industrial Pension Fund (Obligatory Participation) Act was enacted, after which the number of funds increased relatively quickly. The Netherlands has a large number of company pension funds, in addition to industrial pension funds, primarily at larger companies. In 2006 the total amount of approximately EUR 980 billion in pension reserves was administered by:

- 103 industrial pension funds (of which 78 were compulsory and 25 noncompulsory), which together administer approximately three-fourths of the total amount;
- 676 company pension funds;
- 12 pension funds for professionals;
- 67 life insurance companies with registered offices in the Netherlands.

As a result of mergers and acquisitions there is a downward trend in the number of funds, from 1,000 in 1999 to approximately 800 in 2005. An important characteristic of company pension funds (and other pension funds) is their financial independence from employers. Such funds are prohibited from holding shares in their 'own' company.

7.3.3. DIFFERENT TYPES OF SCHEMES WITHIN THE SECOND PILLAR

A given scheme – regardless of whether it is incorporated into an industrial sector or into a company pension fund – can take many different forms. The first differentiation to be made is the distinction between defined benefit schemes and defined contribution schemes. In defined benefit schemes, the

end result – the amount of the pension – is determined in advance. However, that does not hold true of the premiums to be paid, which can vary in the course of time. In defined contribution schemes the amount of the premiums is predetermined but the end result depends on the investment performance of the premiums that are paid. The vast majority of pension schemes in the Netherlands take the form of defined benefit schemes, but the number of participants in defined contribution schemes is increasing. In 2004 there were approximately 5.8 million participants in some form of defined benefit scheme and just under 200,000 participants in some form of defined contribution scheme.

Within the category of defined benefits schemes a differentiation can be made between final pay schemes and average earnings schemes (as well as various hybrid types). In the last few decades, most final pay schemes have been replaced with average pay schemes for reasons of cost containment.

On average, employers pay two-thirds of the premiums and employees pay one-third. There are notable exceptions to this general rule. For example, in the ABN-AMRO 2005 CAO the parties agreed that for the time being the pensions would remain non-contributory for employees.

7.3.4. THE DUTCH SYSTEM AS MODEL?

The European Commission considers the Dutch system to be a model that should be emulated. Compared with the pay-as-you-go systems used in other EU countries, the Dutch capital funding system can certainly be considered robust. In the years that have passed since 2001, the Dutch system has shown itself to be somewhat vulnerable though. The low level of interest rates combined with sharply dropping share prices resulted in serious financial problems for the vast majority of pension funds. Employees were confronted with considerable increases in their premiums, 10 and pensioners were confronted with cessation of indexation. The most significant problems now appear to be behind us, as most pension funds have recovered. In 2005 the value of the investments of all Dutch pension funds increased by EUR 100 billion to EUR 635 billion, in which respect the coverage ratio increased to 130%. 11 However, according to the estimates of the Dutch Central Bank, in

^{10.} In 2003 the premiums for industrial pension funds increased by an average of 17%, although there were wide variations. The largest increase was 167%.

¹¹ Figures of 12 March 2006 from the Dutch Central Bureau of Statistics.

2006 pension funds were lacking between 5% and 15% of the assets needed to pay out *inflation-proof* pensions.

7.4. SHIFTS IN THE DISTRIBUTION OF RESPONSIBILITIES AND THE RISKS AND REWARDS

As noted in section 7.3 above, in many EU countries the pension systems are being reformed to strengthen the second pillar. Once of the consequences of those reforms is a shift in the positions of the various parties involved: the role of the social partners is increasing compared with the role of the government. The relative scope of the various pillars in the Netherlands has been fairly stable for some time now, although this does not mean that there have not been any shifts in the distribution of responsibilities between the various parties.

Traditionally, pension funds are the exclusive domain of employers and employees, and they are administered by their representatives. ¹² For industrial pension funds, those parties are employers' organisations and trade unions (*cf.* Article 99 of the Pensions Act), and for company pension funds they are generally the employer and the persons designated by the company's Works Council. If the pension scheme is administered by an insurance company, the Works Council has the right to approve any changes to be made to the pension scheme. Pensioners are considered to be represented by the representatives of the employees who are still active (the trade unions or Works Councils). The following subsections will discuss the relationship between the government and the social partners (7.4.1), individual employers and employees (7.4.2), employees and pensioners (7.4.3), and – with a view to the future – the current and future generations (7.4.4).

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^{12.} Incidentally, at various ministries many different proposals are circulating with respect to a reform of the system. The background relates to EU measures governing the liberalisation of financial services, which could constitute a threat to compulsory participation in industrial pension schemes. This caused the Dutch Ministry of Social Affairs and Employment to propose that pension funds be obliged to contract out their asset management and bookkeeping to private parties. That has already been done at some funds but not at the largest ones, ABP and PGGM. In April 2006 the Dutch Ministry of Finance went considerably farther when it proposed limiting social partners' role in pension funds to making agreements on a compulsory pension scheme and being held accountable in that respect.

7.4.1. GOVERNMENT AND SOCIAL PARTNERS

Both employers' organisations and trade unions have traditionally regarded supplementary pension schemes for employees - in addition to basic government benefits and with the exception of private pension schemes without any employer involvement - as falling under the relevant terms of employment and therefore within their domain. While acknowledging that the government has a role to play, they prefer to see that role restricted to those instances in which intervention is absolutely necessary in the public interest. In an opinion given in 1990,13 the Dutch Social and Economic Council (Sociaal-Economische Raad or SER) - the national advisory body in which both the social partners and independent members participate defined the problem of the division of responsibilities between the government and social partners in this respect. In the view of the Social and Economic Council, the tasks and responsibilities regarding pensions are divided between the government and social partners on the basis of 'mutual obligations'. On one hand, employers' and employees' organisations should accept the government's significant role in this respect, as well as its task of laying down minimum conditions on the ground of public interest. On the other hand, government intervention should always be 'proportional' and should acknowledge the social partners' primary responsibility for the content, accessibility, implementation and cost of supplementary pensions as an element of the terms and conditions of employment.

The basic assumption that supplementary pension schemes should be dealt with within the context of the consultations between the social partners has long determined the extent of the government's intervention in this respect. Since the 1990s, however, the role of the government has increased substantially. More than 20 bills to amend the Pension and Savings Funds Act were passed by the Upper and Lower Houses of the Dutch Parliament in the 1990s. One example of this increasingly substantive government involvement is the introduction of increased flexibility of facilities for dependant's pensions. As a result of these amendments to the relevant legislation, supplementary pension funds that offer such facilities (which are not standard in all schemes) are now obliged to offer participants a choice between a dependant's pension and an increase in their own pension. This addresses the complaint often raised by single people that the level of solidarity required of them by such provisions has become unreasonable, especially in view of the fact that not only married persons but also unmarried cohabitating partners

¹³ Sociaal-Economische Raad, 1990.

are eligible for a dependant's pension. The latter development was set in motion by equal-treatment case law handed down by the administrative courts. Hence the issue was ultimately placed on the agenda and handled by the legislature rather than by the social partners.

A second example of government intervention is the pressure that has been placed on the social partners to convert existing early retirement schemes into pre-pension schemes, which are more flexible and less expensive. There are two reasons for this. First there is the affordability of the schemes: the costs of the early retirement schemes were considered prohibitive and were increasingly seen as incompatible with a restrained development of labour and wage costs. The second reason for the government to put pressure on the social partners is based on the goal of stimulating participation of older employees in the labour market. The government's position ultimately resulted in an agreement between the three parties involved, which was predominantly intended to curb cost increases of pension schemes. The existing tax incentives for early retirement were phased out or cancelled in order to stimulate, or even force, older employees to continue working.

7.4.2. INDIVIDUAL EMPLOYERS AND EMPLOYEES

A second significant shift in the distribution of responsibilities is that from the group to the individual and from employer to employee. In many cases these shifts occur together as a result of the replacement of defined benefit schemes with defined contribution schemes. Defined benefit schemes have always been standard in the Netherlands. The 'golden standard' was the final pay scheme, which, together with government old-age benefits, led to an income equal to 70% of the most recently earned salary after a working life of 40 years. In almost all cases the final pay scheme has been replaced with some form of average earnings scheme.

In spite of this shift, defined benefits schemes continue to dominate, although defined contribution schemes are quickly becoming more popular, in particular at listed companies that have a company pension fund (as well as others with a company pension fund). This is motivated by the desire of companies to no longer be responsible for the uncertain expenses that arise from the existing guaranteed pension commitments to date (defined benefit schemes). This desire has boosted as a result of the implementation of the International Financial Reporting Standards (IFRS), which compel companies to provide more information about their financial risks, including any pension

obligations. An investigation conducted by KPMG in January 2006 shows that more than 400 companies want to convert to a defined contribution scheme within one to five years. Once example is Akzo, which in 2005 agreed with the trade unions to fully convert to a defined contribution scheme for its 12,000 employees. It took approximately two years of negotiations with the trade unions to reach that agreement.

As a result of that agreement, since 2006 the Akzo group no longer runs any pension risks. In exchange, the company has transferred an extra EUR 150 million into the pension fund's cash resources. In addition, Akzo granted the pension fund a EUR 100 million subordinated loan. In the next five years Akzo will pay a premium equal to 20% of the pensionable earnings (*i.e.* the pensionable salary minus the government old-age benefits). In 2006 Akzo employees paid 4% of the same pensionable earnings (it is currently 5%). Those premiums are deposited in a fund for price indexation of employees' pensions. Indexation for pensioners depends on the pension fund's financial position. This led the lobby association for Akzo's pensioners to take the matter to court, demanding that the company guarantee the indexation in the event of pension fund deficits. The court rejected the claim in January 2007. 14 (See subsection 7.4.3 regarding the position of pensioners.)

The extent to which listed companies that are affiliated with an industrial pension fund are being 'inconvenienced' by the new rules for annual reporting is not entirely clear. A conflict has arisen in that respect between the Dutch Association of Industry-Wide Pension Funds (*Vereniging van Bedrijfstakpensioenfondsen*) and a number of companies affiliated with that association on the one hand and the Royal Dutch Institute of Register Accountants (*Koninklijk Nederlands Instituut van Registeraccountants* or NIvRA) on the other.

There are also various gradations of individual and group schemes within the defined contribution category. In the event of a fully individualised defined contribution scheme, the employee bears the full rate risk *and* the investment risk on the retirement date. For group-defined contribution schemes, the employer's share of the premium is fixed and employees run less of a risk than they would in the event of a strictly individual variant even though they do not have any 'firm' entitlements. The new Pensions Act sets limits on the ability of individual employees to choose investments in defined contributions schemes; such limitations are intended to protect the employees. The pension

¹⁴ District Court of Arnhem, the Netherlands, 29 January 2007, LJN AZ7916.

administrator is required to intervene if, given an employee's age, the chosen portfolio is too aggressive according to the criteria set by the pension administrator, in which case the portfolio's risk profile must be adjusted downwards. This obligation to intervene does not apply to collectively-defined contribution schemes.

The shift from defined benefit schemes to defined contribution schemes is also occurring – to an event greater extent – in the United Kingdom and Ireland. Defined contribution schemes are also being used extensively in countries that have just begun to set up collective pension schemes, like Poland and Hungary.

7.4.3. THE POSITION OF THE PENSIONERS

For years, pensioners have been complaining that they have insufficient say on pension funds. The power rests with the fund administrator or management body, comprising an equal share of employers' and employees' representatives. Although there is an option to reserve seats for pensioners and/or to establish a membership board representing them, pensioners' representatives claim that this provides insufficient guarantees that their interests will be adequately protected. The immediate cause for the increased involvement of pensioners was primarily financial in nature, *i.e.* the lower indexation of their pensions and in some cases the complete cancellation of that indexation.

On 1 July 2004, Aart Jan de Geus, the former Minister of Social Affairs and Employment, forcefully argued in favour of a code of conduct for pension funds comparable to the *Tabaksblat* corporate governance code for listed companies. The Minister had two objectives: an improvement in the quality of management and a stronger position for pensioners. He threatened to revoke tax allowances and possibly end compulsory participation in schemes if funds failed to take suitable measures.

In 2005 the Dutch Joint Industrial Labour Council (*Stichting van de Arbeid*), a bipartisan private-law body consisting of employers' representatives and employees' organisations, published a code of conduct entitled *Principes voor goed pensioenfondsbestuur* ('Principles for Proper Pension Fund Governance'), which applies to both pension funds and the schemes that are administered by insurance companies. The Minister of Social Affairs and Employment considers those principles to be a good starting point for the

development of governance within pension funds. The umbrella organisations for the industrial and company pension funds also reacted positively. In July 2006 the Minister of Social Affairs and Employment nonetheless announced that he wanted to legally regulate the representation of pensioners. This was implemented for company pension funds in Articles 100 and 101 of the Pensions Act, enacted on 1 January 2007. In industrial pension funds, pensioners are represented only if the fund's articles provide for such representation (Article 99 of the Pensions Act).

7.4.4. CURRENT AND FUTURE GENERATIONS

Various forms of intragenerational and intergenerational solidarity are built into the second pillar. Solidarity within generations is achieved through flatrate premiums for which no differentiation is made on the basis of age. These premiums are obligatory for industrial pension funds that are subject to those mandatory provisions. Redistribution and risk sharing *between* generations is implemented in various ways, primarily through extra contributions from actives when the coverage ratio exceeds certain values, and more generally by building up asset buffers. Full indexation has an impact on the assets during a long period in which returns on investments are low. The investment policy also contains redistribution elements. The underlying principle of investing in shares is that they will yield more in the long term. However, the investment horizon for a younger employee is fundamentally different from that of a pensioner, as the latter will want to have certainty on the indexation of his pension in the coming years.

A subject that has led to much discussion in the Netherlands, especially since the beginning of this century, is the long-term distribution of risks and rewards between older and younger people or – from a broader perspective – between the current and future generations. This discussion reveals an underlying fear that younger generations will be burdened with the costs of an ageing population (particularly with respect to pensions and health care). In 2005 the Bureau for Economic Policy Analysis (*Centraal Planbureau* or CPB), an independent advisory body of the Dutch government, calculated that the next government would have to cut an extra EUR 15 billion in order to maintain public finances and thereby achieve a budget surplus of 3% of the

¹⁵ Wetenschappelijke Raad voor het Regereingsbeleid, 2002.

gross domestic product in 2010. ¹⁶ That surplus would make it possible to distribute the risks and rewards fairly among current and future organisations.

Critics argue that the younger generations are still bearing an unfair proportion of the risks. An example that is often put forward is the transitional scheme for early retirement and pre-pension. Critics argue that young people must contribute to the transitional schemes, but only older people profit from them. Criticism has also focussed primarily on trade unions. In 2005 the government rejected proposals to separate younger and older generations by making a 'generation account' for all employees born in a given year.¹⁷

7.5. PENSION SCHEMES: ACCESSIBILITY, INCLUSION AND EXCLUSION

7.5.1. EMPLOYMENT CONTRACTS AND PENSION CONTRACTS

Section 7.1 discussed the close, but not seamless, relation between employment contracts and pension contracts. The status of *employment contracts* as a mechanism for inclusion and exclusion is the primary focus of this book. This is not the same as inclusion in and exclusion from a pension contract. This issue can be viewed schematically as follows:

	Pension contract	No pension contract
Employment contract	I	II
No employment contract	Ш	IV

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¹⁶ See http://www.cpb.nl/nl/pub/cpbreeksen/bijzonder/61/bijz61.pdf.

¹⁷ Economist Coen Teulings in *Het Financieele Dagblad* of 3 December 2004.

As explained in sections 7.2 and 7.3, the vast majority (more than 90%) of Dutch employees who are employed subject to an employment contract have a pension contract (I), and a small percentage (10%) do not (II). The latter group has been shrinking steadily in recent years due to a wide range of measures, and it appears that this process will continue. Section 7.5.2 contains an overview of those measures.

The terms 'inclusion' and 'exclusion' as used in this book relate primarily to III and especially IV. To what extent are workers who lack an employment contract excluded from group pension schemes, and to what extent is this justified?

First, it is worth noting that some workers who lack an employment contract are covered by group pension schemes (III), so for them the employment contract does not work as an exclusion mechanism. That category will be discussed in section 7.5.3. As for IV, when the Dutch pension system was set up inclusion of this category was considered (see *e.g.* the example of the industrial pension fund for the agricultural sector discussed above in section 7.3.2), but that step was never taken. For this employee category, it is the institution of the CAO which is more relevant than the individual employment contract. The discussion regarding 'inclusion' of this category was recently raised again in relation to the implementation of the life-course savings scheme (see section 7.5.4).

7.5.2. THE 'WHITE SPOT'

Those employees in the Netherlands who have employment contracts but who are not covered by any group pension scheme are referred to as the 'white spot'. There could be several reasons for this situation:

- the employer did not make any pension commitment;
- certain categories (such as flexible workers) are excluded;
- barriers to participation.

The 'white spot' is concentrated at smaller companies and companies that have existed less than four years. Companies in certain sectors are also overrepresented: professional services and the cultural, recreation and other services sectors. The scope of the 'white spot' decreased considerably between 1985 and 1996, from 17.9% of employees between the ages of 25 and 65 in 1985 to 9.2% in 1996. A significant reason for this is the fact that the accessibility of pension schemes has increased for certain categories of

employees since the mid 1980s. In 1985 it was still impossible for 8% of employees to participate in a pension scheme due to their being a woman (married or unmarried), or to the small number of hours that they worked. Legislation and case law have now removed the most significant barriers to participation for women. Because in many cases discrimination against part-time employees is put on a par with direct or indirect discrimination based on sex, the equal-treatment legislation for men and women (and the related case law) has also had a favourable effect on the pension situation for part-time employees. In 1994 a prohibition against making a direct differentiation on the basis of working hours was included in Article 2a of the Pension and Savings Funds Act (now Article 8 of the Pensions Act). In addition, since 1996 pursuant to the Equal Treatment (Working Hours) Act (*Wet onderscheid arbeidsduur*) there is a prohibition against making any differentiation on the basis of working hours.

The use of waiting periods has also decreased; the vast majority of funds (representing 96.7% of active participants) do not have any waiting period. However, for persons who have had many different short-term jobs the waiting period can constitute a problem. Waiting periods are utilised primarily in the professional services sector.

The new Pensions Act contains a provision pursuant to which accrual begins at the age of 21,¹⁸ or the date on which the employment commences if the employee has already reached age 21. A higher age limit would be disadvantageous for those who start working at a young age and stop working (temporarily or permanently) at a later age, or who start working part-time. In 1996, 4% of the 'white spot' could be traced to the imposition of an age limit by a specific pension fund. Since 1996, the number of pension funds that impose an age limit (as well as the number of active participants subject to an age limit) has decreased.

Another measure worth noting is the implementation of Directive 2001/23/EC on transfers of undertaking. That directive has been incorporated into Articles 7:662 *et seq.* of the Dutch Civil Code. The underlying principle is that the rights and obligations under the transferor's individual employment contract and CAO are transferred to the transferee. Group pensions were

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^{18.} In the original proposal it was age 18, but the age limit was raised after criticism of the Council of State. Business owners also objected to the age limit of 18 years, partly because the obligation would then apply to some holiday workers too. More generally, the lower age limit would lead to a significant increase in administrative obligations for business owners.

excluded from the legislation until 2003. In declaring that the rules also applied to pensions, the legislature intended to further decrease the 'white spot'. In addition, Article 9 of the new Pensions Act states in so many words that if the transferee has a pension scheme and the transferor does not, the transferee will be deemed to have made the transferor's employees an offer to conclude a pension agreement as of the time of the transfer. One of the consequences of the implementation of the Flexibility and Security Act (Wet Flexibiliteit en Zekerheid) in 1998 was that temps could now also fall within the category covered by group pension schemes. In 1999 an industrial pension fund was created within the framework of the CAO for temps working for employers are affiliated with ABU (the Dutch association of temporary employment agencies). On 13 December 2003, pension schemes were made obligatory for all employment agencies despite objections of the NBBU (the Dutch association of intermediary organisations and temporary employment agencies) and a number of industrial pension funds. In order to participate in the scheme, the temp must have worked at least 26 weeks for the same employment agency and must be at least 21 years of age.

A comparison with other countries shows that the barriers to participation still vary considerably. For example, in some countries (including Spain) it is impossible for part-timers who work relatively few hours to participate in pension schemes. In some countries there are also age limits for participation in pension schemes, and in many countries temps fall outside the second pillar.

7.5.3. THE EMPLOYMENT CONTRACT AS A DEVICE FOR INCLUSION OR EXCLUSION

In principle, in the Netherlands most freelancers and self-employed persons with no staff fall outside the second pillar. Thus, at first glance the employment contract would appear to function as a mechanism to exclude this category of workers from the employment condition of pensions. However, most schemes are open to the self-employed on a voluntary basis insofar as they are members of the sector. In a number of cases participation has been made compulsory by the Minister of Social Affairs and Employment, for example for the self-employed in the construction, wood, metal and painting industries. ¹⁹

¹⁹ *Cf.* also Schoukens, 2000: 203.

Some of the related issues have also been codified in the new Pensions Act, which was enacted on 1 January 2007. Its Article 3(2) provides that the act also applies to self-employed persons who fall within the scope of a pension scheme administered by a mandatory industrial pension fund. The only exception to that applicability is in the event of a transfer of undertaking.

Some countries with a lower coverage ratio for group pension schemes than the Netherlands have unexpectedly broad conditions for inclusion. For example, in Italy there is a facility that also allows self-employed persons with no staff to participate. In Greece, where occupational pension funds were introduced as recently as 2002, the law provides that funds can be set up to cover specific occupations on the initiative of self-employed persons, freelancers and agricultural workers (or their occupation-based organisations).

In the Netherlands, for some independent professions, such as medical specialists, GPs, pharmacists and veterinarians, participation in a pension scheme is compulsory on the ground of the Occupational Pension Scheme (Obligatory Participation) Act (*Wet verplichte deelneming in beroepspensioenregeling*). In 2005 the Lower House of the Dutch Parliament passed a legislative proposal to amend that act. One of the purposes of that amendment was to promote mobility between salaried employment and self-employment by also allowing self-employed persons to transfer accrued pension benefits.

A pension contract is linked to the employment contract. The consequences of termination of the employment contract must therefore also be discussed briefly. First and foremost, pension entitlements that have already been accrued remain intact. In many cases it is possible to transfer the pension if an employee switches employers. The new Pensions Act contains many provisions in this respect. A transfer of undertaking can lead to a transfer of the pension scheme and to the right to participate in a scheme in the event that the transferor does not have one and the transferee does.

If after being ill for two years (in which context the employment contract continues; see Chapter 4 in this respect) an employee is deemed legally disabled for work, the pension accrual will end. The same holds true in the event of unemployment.

If an employee loses his status as an employee because he becomes selfemployed, possibly under pressure from the employer, whether he will continue to fall under the second pillar will depend on the relevant CAO and the arrangements – if any – made in the respective sector.

One last point worth mentioning is that if an employee switches employers, any rights to early retirement that have been accrued may lapse insofar as they are employer-specific. This issue will gradually become more relevant as early retirement schemes are phased out.

7.5.4. INCLUSION AND EXCLUSION: EARLY RETIREMENT SCHEMES AND LIFE-COURSE SAVINGS SCHEMES

As noted above, the Dutch legislature has taken a number of measures – partly on the basis of European directives regarding equal treatment – in order to further increase the coverage of group pension schemes, however without implementing a legal pension *obligation*. At the same time, countless measures have recently been enacted aimed at decreasing access to *early* retirement schemes, in the sense that the retirement age has been raised. This has resulted in complicated transitional issues, for which reason certain categories of employees may suddenly find themselves excluded from a particular pension scheme. On the other hand, many CAOs, including those for the metalworking and electrical industries and Corus, have largely remedied the consequences of the tax measures implemented by the government that place barriers to early retirement.

The *life-course savings scheme* has not yet been made available to the self-employed. Questions have been raised in the Lower House of the Dutch Parliament regarding this issue, in which respect the legislature has been requested to implement a facility for this category of workers, for example by means of tax incentives.²⁰ However, the Minister of Social Affairs and Employment considers such a facility to be impractical. The life-course savings scheme is a facility to give employees an opportunity to take leave. Leave forms part of the employment contract between employer and employee. Such a facility would also be difficult to monitor or enforce. In addition, the Minister argued that there is no need for such a facility, also for old-age benefits, because the self-employed already have their own tax incentives.²¹ The Minister did agree to investigate the various options for self-employed persons.²² Incidentally, it appears from an investigation among the self-employed that this group does in fact wish to be able to take advantage of

²⁰ Kamerstukken (Parliamentary Documents) II 2005-2006, 30 300 XV, no. 4.

²¹ Kamerstukken II 2005-2006, 30 300 XV, no. 66.

²² Kamerstukken II 2005-2006, 30 300 XV, no. 78. Cf. also Aerts, 2007: 294-295.

such a facility, not necessarily to ensure adequate old-age benefits but rather to enable them to stop working for a period of time.²³

7.6. EFFECT OF THE CHANGES ON EMPLOYMENT CONTRACTS

Early on, pensions were clear-cut and were usually built up at the same job if for no other reason than to avoid the loss of pension rights owing to job changes. Then came the rise and fall of early retirement schemes and their replacement with more flexible pre-pension schemes. Gradually, significant cutbacks were made.

The nature of pension schemes and contracts is subject to change insofar as pension *certainty* seems to be subject to some degree of erosion, particularly when defined contribution schemes are introduced, as such schemes treat deferred salary as deferred *variable* salary. An employee can generally exert considerably less influence on that variable deferred salary than on variable salary, which in most cases constitutes only a small part of the ultimate salary. Whereas 'classic' pension schemes give a right to predetermined benefits, in some cases pension schemes are now taking on the character of individual investment funds. This is not in line with the protective nature of most of the provisions contained in employment contracts.

7.7. THE ADEQUACY OF EMPLOYMENT CONTRACTS FOR THE REGULATION OF PENSIONS

7.7.1. INCLUSION AND EXCLUSION: DIVISION OF RISK

The Dutch pension system, or in any event the second pillar, is highly respected throughout Europe. Although recently there have been major financial problems within the second pillar, the system as such has not really been called into discussion. With the expansion of the category of persons subject to employment contracts, temps can now also take advantage of group pension schemes. The most significant category to remain excluded is the self-employed with no staff and certain categories of flexible workers. The shift

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²³ EIM, 2006.

towards defined contribution schemes calls into question the extent to which the group character of the scheme continues to exist and the transfer of risks to certain employees (or categories of employees) can be justified. The more fundamental question is whether employment contracts are the most suitable instrument to regulate pensions. The fact that the second pillar is being reinforced in many EU countries is an indication that this question must be answered in the affirmative. On the other hand, there are also systems in which the link between the pension and the employment contract has been dropped, in any event to a certain degree – in Italy, Hungary and Poland.

7.7.2. TOP HEAVY?

Insofar as existing schemes are being abolished or cut back, it appears that, unlike cases involving work and illness, employment contracts are actually becoming a bit 'lighter'. That effect is partially cancelled out by the introduction of the life-course savings scheme, which confronts employers with new duties.

A problem that could be classified under the category 'financially top-heavy' is double taxation. Employees pay for both fully-funded pension schemes and for the pay-as-you-go early retirement schemes (or in any event for the related transitional scheme). The latter is primarily or exclusively for the benefit of employees who have already retired early and the category of employees that is still entitled to retire early on the ground of the transitional schemes. There is no certainty that any of the other employee categories will receive benefits under the scheme at some point in the future - on the contrary, it is practically a certainty that they will not be able to take advantage of early retirement schemes. It can thus be concluded that, unlike issues such as illness and health care, with respect to pensions employment contracts appear to have become 'lighter' for employers in terms of their rights and duties. This is certainly the case when it comes to the replacement of defined benefits schemes with defined contribution schemes. At the same time, the burden for employees is all the heavier. Experiences in countries like the United Kingdom on the transfer of pension risks to employees raises the question of whether employees are able to properly judge the consequences of that transfer of risk.

7.7.3. VULNERABILITY OF THE SYSTEM

The future affordability and sustainability of the pension systems in the EU is under significant pressure due to an ageing population. The Netherlands' substantial system of group pensions places it in a relatively favourable position to deal with those problems. However, the system certainly is not invulnerable, as was clear in the period between 2001 and 2004. The sensitivity to sharply dropping share prices should not be underestimated, particularly in a period when long-term interest rates are low. Sensitivity to developments outside the Netherlands should not be underestimated either. Irregular public finances in other member states leads to inflation and increased interest rates. High inflation – which will be imported in full or in part – leads to an erosion of the value of the pension savings.

7.7.4. FINAL WORD

Like the other topics of this book, employment contracts are an 'admission ticket', in this case to group pension schemes. This is not always the case, but the excluded employee categories continue to decrease, and in principle there appear to be sufficient measures in place to repair the remaining 'white spots' in the system. However, as long as pension contracts are based on an employment relationship the one category that formally remains outside the system is that of the self-employed. In this respect, the Dutch system is less expansive than that of other EU countries.

The most significant development to have been set in motion in recent years is the transfer of pension risks from employer to employee. Although it must be said that the vast majority of employees are still entitled to a guaranteed pension, the employee category that bears a risk in this respect is increasing. If this process continues – and little can be said about that at present – the nature of pension contracts will gradually change. In that case, it will no longer be the employee who is primarily protected against the possibility of reaching old age without an adequate income: the employer will be the one protected from unexpected expenses in connection with his employees' pensions.