The Role of Large Pension Funds in the Economy

Evidence and thoughts from the Netherlands

OECD/IOPS – Global Forum (Berlin, 30 October 2015)

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Key points

- Netherlands represent 1 percent of world economy. Dutch pension funds invest 15 percent of AUM @home

- The AUM distribution across pension funds is heavily skewed. 50 percent AUM is owned by 3 pension funds

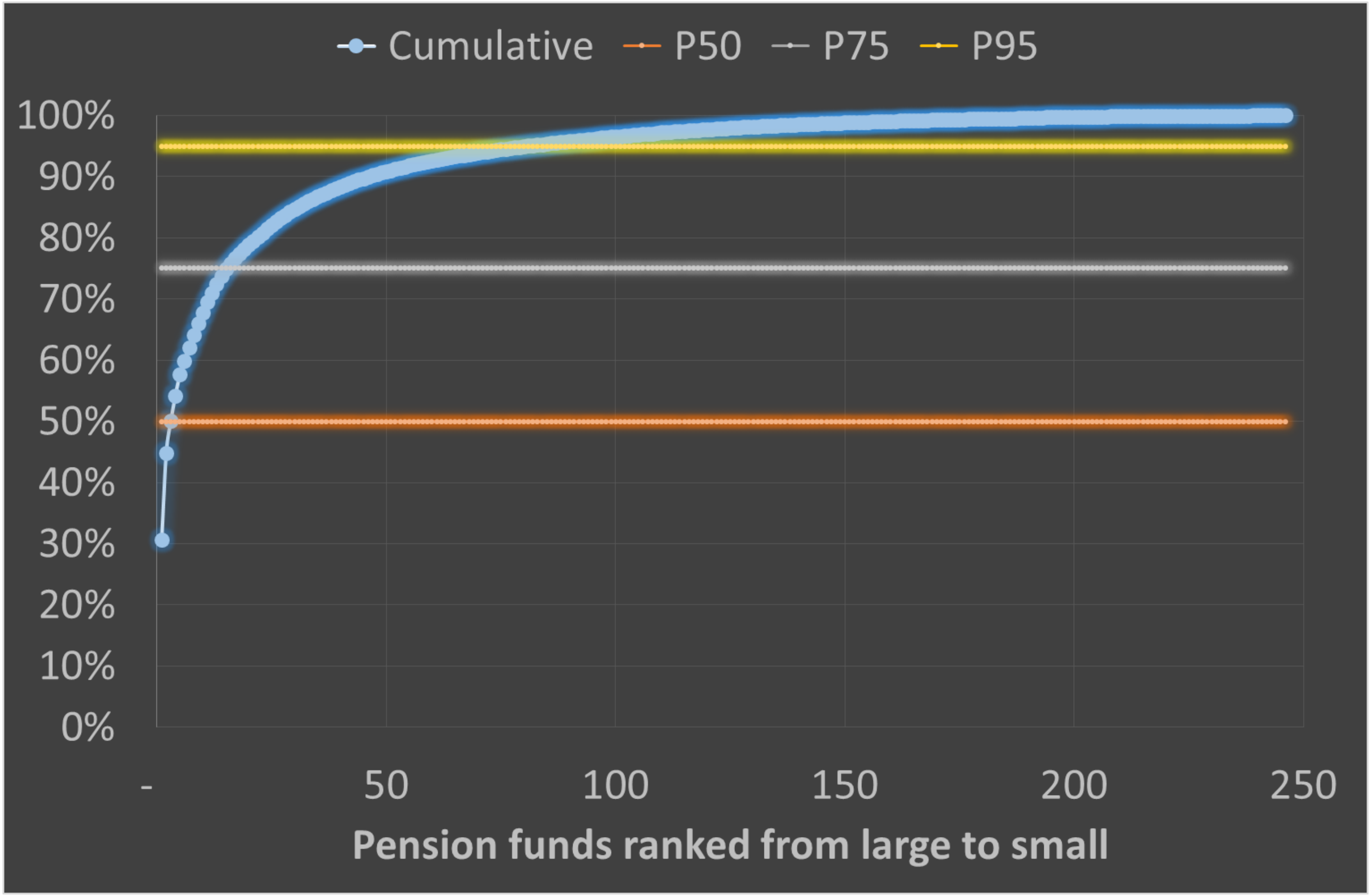
- Empirical studies show that pension funds follow a ‘buy low, sell high’ rebalancing strategy

Dutch pension funds invest 15 percent of AUM @home

Investment @home per asset class	Pension funds %	Insurance cies %
Government bonds	16*	37
Credits	12	46
Equities	3	37
Real estate	23	100
Mortgages	54	100
Cash	64	89
Total	**15**	**53**

**Example*: Dutch pension funds allocate EUR370bn to government bonds of which 16 percent, or EUR59bn, is invested in Dutch government bonds. Total Dutch government debt is EUR474bn

The AUM distribution across pension funds is heavily skewed



The 3 largest pension funds own 50 percent of AUM
The 15 largest pension funds own 75 percent of AUM
The 75 largest pension funds own 95 percent of AUM

Empirical studies show that Dutch pension funds follow a 'buy low, sell high' rebalancing strategy

Bikker, Broeders and de Dreu (IJCB, 2010)	• 1999-2006 • Each quarter, pension funds rebalance 39 percent of excess equity returns. The remaining in subsequent quarters
De Haan and Kakes (JBF, 2011)	• 1999-2005 • Pension funds showed contrarian behavior in the most turbulent years implying that they have a stabilizing impact
Gorter and Bikker (AE, 2013)	• 1995-2009 • Pension funds rebalance 40 percent of market price movements in both bull and bear markets

Supervisory issues for large pension funds

- The pension system, and therefore large pension funds, should contribute to economic stability

- Optimal risk management, stable contributions and gradual absorptions of financial shocks in benefits create the least economic damage

- If a pension system amplifies the economic cycle, the fulfillment of pension commitments is more difficult

Supervisory issues for large pension funds (*cont.*)

- Large pension funds with highly standardized pension contracts benefit from economies of scale but there might be a trade-off with
  - Need for more tailor made pension arrangements (life cycle)
  - Organizational complexity
  - Liquidity constraints
- Benefits of intergenerational risk sharing for large, mandatory funds no longer outweigh disadvantages
  - Governance gap
  - Discontinuity risk
  - Ageing