Market Zoom

Dutch FTK reporting for investment funds: a new struggle
The greater transparency in reporting requirements for pension funds means that investment managers face new challenges by the time they need to report the holdings of the investment fund.
1. **A few words for context…**

Since the introduction of the new FTK (in Dutch “Financieel Toezichtskader” or translated “Financial Assessment Framework”) requirements on assets and liability reporting, Dutch pension funds are obliged to report on investment statements. The greater transparency in reporting requirements for pension funds means that investment managers have been facing new challenges by the time they needed to report the holdings of the investment fund. As of today, one year later, many different asset managers are still facing the challenge on timely and correctly reporting.

The FTK is the part of the Pensions Act in the Netherlands, in which the statutory financial requirements for pension funds are laid down. It is built around the principles of market valuation, risk-based requirements, and financial transparency. The aim of the FTK is to improve the insight of both the supervised institution and the supervisory authority into the institution’s financial position as well as its possible developments over the short and medium term. The determination of the required capital is risk-based, meaning the requirements increase or decrease with the degree to which the fund is exposed to risks.

In this article, the Dutch pension market and the indirect impacts of the FTK regulation for local and foreign investment managers are put into perspective, one year after the FTK amendments.

2. **Context of Pension funds**

The Dutch pension system is one of the world’s most extended and comprehensive systems, containing around €2 trillion in Assets under Management (see figure 1 below). These financial assets put the Dutch market into an interesting position for investors, but also increase the awareness for a solid oversight regime. The Dutch pension system consists of three pillars:

1. First Pillar or the state pension (AOW)
2. Second Pillar or the collective pension schemes
3. Third Pillar or the individual savings

Most of the pension money in the Netherlands is managed by pension funds. There exist two types of pension funds, depending on the category of its members:

- Industry-wide pension funds (for an entire sector, or professions such as medical specialists or dentists)
- Corporate pension funds (for a single company or a corporation)
3. Regulatory context of pension funds

The Dutch government monitors the business conducted by pension administrators and is the oversight regime for financial pension assets. This task is entrusted to two regulators—the Dutch Authority for the Financial Markets (AFM) and De Nederlandsche Bank (DNB).

The AFM keeps track of the behavior of pension funds, especially their obligation to provide information to its members, whereas DNB has the statutory duty of exercising prudential and material supervision over pension funds. Prudential supervision entails assessing the financial position of pension funds, in light of ensuring that pension funds are able to fulfil their future obligations. Material supervision focuses on the assessment of the constitutions and rules of pension funds and governance structures.

Financial Assessment Framework (FTK)

The FTK, which is part of the Pensions Act, sets out the requirements for the financial position of a pension fund. The financial position of a pension fund is reflected by its coverage ratio, which expresses the relationship between the fund’s assets and the pensions that the fund need to pay in the future (i.e. pension liabilities).

All pension funds are required to report statements on their financial undertakings, however the relevant set of statements can differ from fund to fund.

The statements can be subdivided into eight different reports with varying content and reporting frequency (monthly, quarterly, and yearly).
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4. Motives for the changes in the Pension Act

Between 2007 and 2009, the pension fund sector was faced with the severe consequences of the financial crisis. The average coverage ratio had dropped to 92 percent in 2009 (in comparison to 150 percent in September 2008)\(^1\) as the pension assets decreased to 130 billion and the liabilities rose to 145 billion. The descending interest rates and the upward readjustments of life expectancy were the main drivers for this degenerated trend. As of today, with the continuing decreasing interest rates, the funds are facing an even larger challenge for the coming years.

In the aftermath of the financial crisis, a critical reassessment of the FTK regulation for pension funds seemed to be appropriate in order to future-proof the Dutch pension scheme. This translated into a series of recommendations in the area of investment policy and risk management and an amendment of the FTK regulation. The changes include:

- Higher solvency buffers
- Stricter funding rules will apply for indexation
- Increasing minimal coverage ratios
- More dependency on market developments (curves more linked to the market rate than fixed rates)
- Recovery plans (fixed income returns) matched to market expectations
- Incentive to transfer risks to a more defensive asset mix, as the period to gain is decreased
- Interest rate risk hedging is changed under the new FTK regulation (hedging will result in a more stable return)
- Possible impact on inflation risk hedging
- Introduction of policy coverage ratio

\(^1\) Source: Statistics DNB (Dutch Central Bank)
In addition to these changes, new templates for the investments statements have been introduced. The new regulatory regime has entered into force on 1 January 2015.

5. Statistics of pension funds in the Netherlands

More than 90 percent of employees have a pension scheme with their employer, and three-quarters of all employees are with an industry-wide pension fund. The size of the pension funds vary considerably, relative to the number of members as well as the accrued capital. The largest fund has more than 1 million active members and an invested capital higher than €150 billion. At the end of Q3 2015 there were about 320 supervised pension funds in the Netherlands.

Overall, at the end of Q3 2015, pension funds in the Netherlands managed an invested capital of more than €1.3 trillion.
At the end of the third quarter in the year 2015, the gross investments comprised mainly of fixed-income instruments (ca. 55 percent), equities (ca. 29 percent) and real estate investments (ca. 9 percent).\textsuperscript{1}

![Investment spectrum Q3 2015 by Dutch pension funds](image)

**Figure 4: Investment spectrum Q3 2015 by Dutch pension funds**

Source: Statistics DNB (Dutch Central Bank)

### 6. Impact of the FTK reporting for Asset Managers

Pension funds are responsible for accurate, timely, and complete reporting to DNB. DNB explains that the FTK Quarterly States should provide a detailed picture of the investments so that the complexity of the balance sheet and any changes over time can be grasped.

The FTK Quarterly States put more emphasis on a detailed reporting of the fund’s investments and requires look-through on investment funds. For this, a large amount of data needs to be collected at line level of the portfolio, including OTC derivatives. This requires a lot of time, money, and attention from the pension fund. Therefore, Dutch pension funds will need assistance from their asset managers as they do not necessarily have enough information or resources to perform a look-through on their own. Asset managers targeting Dutch pension funds will then be very likely to be requested to provide the so-called FTK reporting look-through and cash flows on their investment funds, including:

- Classification, mapping, conversion of derivatives, currency exposure, credit and interest rate exposure, sensitivity analysis
- Cash-flows: estimation of future cash flows of the fund
- Specific fund look through information
7. FTK Reporting: Challenges + Pitfalls

Challenges of FTK reporting for asset managers can be regrouped in four categories:

- Data management: producing FTK reporting requires data and information from a lot of different sources with heterogeneous content and format. Data harmonization, cleansing, and enrichment of all securities are necessary to perform regulatory classifications and allow for the calculation of analytics and shocks.

- Regulatory expertise and watch: understanding the FTK regulatory requirements related to FTK reporting, classification of assets, conversion of derivatives, application of shocks, and estimation of cash-flow are complex and differ according to the asset class or type of financial derivative instrument.

- Calculation of analytics and cash flows: applying the regulatory shocks to perform the required sensitivity analysis and cash flow projections require appropriate quantitative pricing libraries and techniques to process financial derivative instruments (swaptions, options, swaps).

- Scalability and delivery: data and analytic exchanges between fund managers and Dutch pension funds are expected with a quarterly frequency and within a short time frame, usually 15 business days after quarter end, adding pressure to the reporting systems.
8. Appendix

Illustration of K202 reporting

Illustration of K203 reporting

Illustration of K204 reporting
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Illustration of K205 reporting

Illustration of Cash-Flows reporting

Source:
http://www.pensioenfederatie.nl/services/themas/Pages/Financieel_Toetsingskader_FTK_31.aspx#Huidige_stand_van_zaken

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2 The K205 reporting is mainly provided by the pension fund itself.
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