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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)

			Category	Q3 ‘15
Pensions & Life insurance			Pension Funds	1311
			Life insurance	139
Savings & investments	Savings & Deposits		Currency & Deposits	396
	Investments	Stocks & bond	Debt Securities	6
			Quoted Shares	31
		Fund & Other	Investment funds (NL)	28
			Foreign funds	46
	Subtotal investments			**110**
Subtotal savings & investments				506
Total Financial Assets				1956

Figure 1: Assets under management by the Dutch pension fund system, in EUR Billion
Source: DNB Mrt 2016, Deloitte Analysis

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).

Report	Report code	Frequency	Deadline	Content	Investments
Annual statements	J101 to J903	Annually	30 Jun 2016	Organization, board, provision, premium, audit statement	No
Premiums	K401 to K402	Annually	12 Feb 2016	Expected premium, required premium	No
Recovery plan	K501 to K502	Annually	01 Apr 2016	Quarterly reporting adding liabilities and payments	Partially
Regulations	K602	Annually	01 Apr 2016		No
Pension fund feasibility test	K702	Annually	30 Jun 2016		
Investments	K101 to K205	Quarterly	12 Feb 2016 17 May 2016 14 Aug 2016 11 Nov 2016	S1 until S6, VEV, holdings, coverage ratios, currencies, credit ratings, sensitivity analyses, performance	Yes
Geography & Cash flows	Geography & Cash flows	Quarterly	12 Feb 2016 17 May 2016 14 Aug 2016 11 Nov 2016	Cash flow information, used as input for K101 to K205, geographical distribution	Yes
Coverage ratio	M101	Monthly	10th working day	Overview of assets and liabilities	Partially

Table 1: The FTK reporting calendar for the year 2016
Source: DNB Dec 2015

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[1].

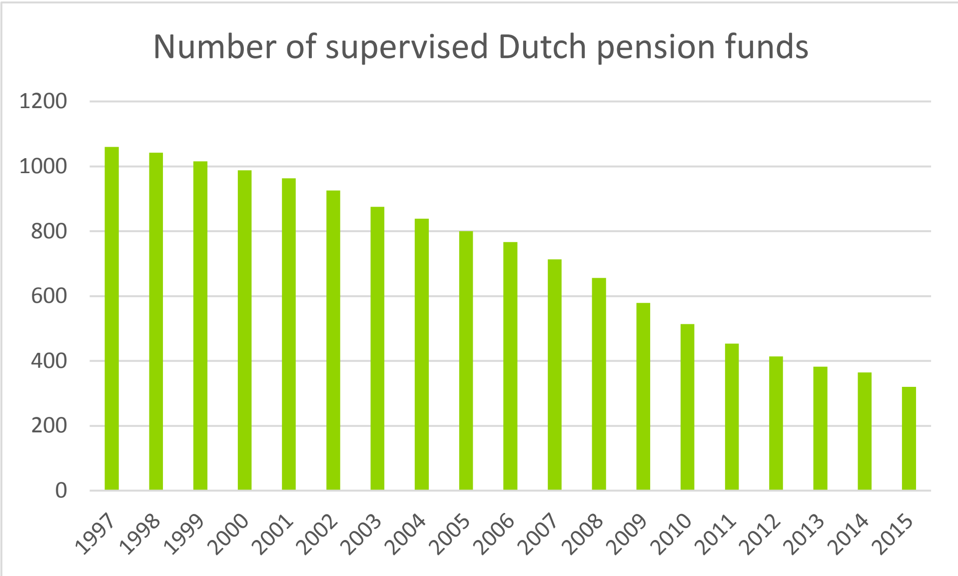

Figure 2: Number of supervised Dutch pension funds
Source: Statistics DNB (Dutch Central Bank)

Overall, at the end of Q3 2015, pension funds in the Netherlands managed an invested capital of more than €1.3 trillion.[1]

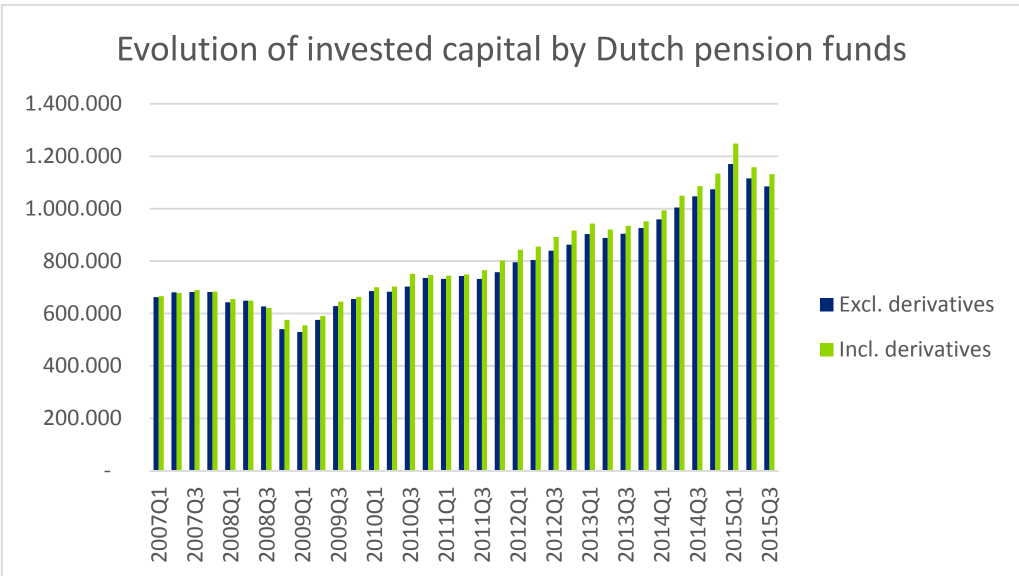

Figure 3: Evolution of invested capital by Dutch pension funds
Source: Statistics DNB (Dutch Central Bank)

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. 9percent).[1]

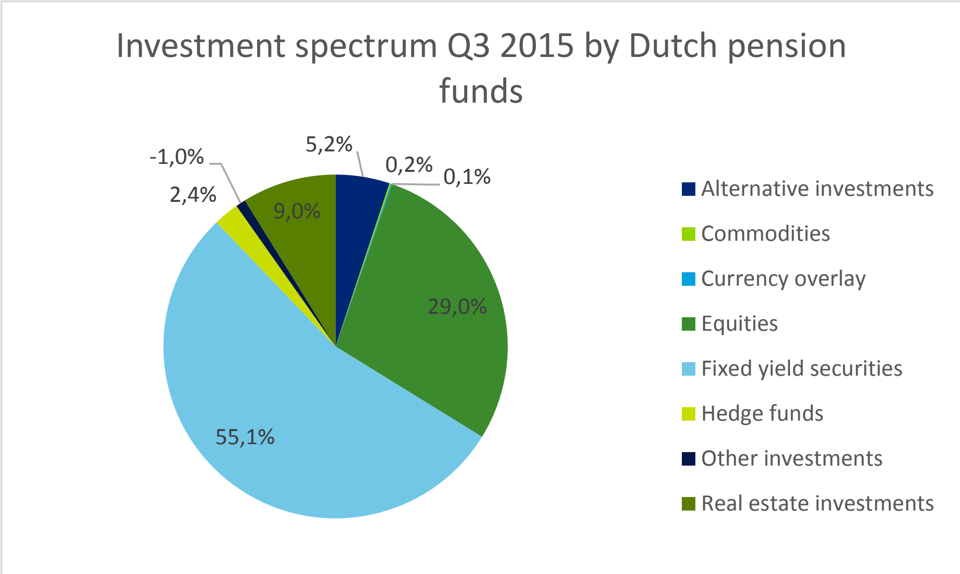

Figure 4: Investment spectrum Q3 2015 by Dutch pension funds
Source: Statistics DNB (Dutch Central Bank)

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

c02			c_01	c_02	c_03	c_04	c_05	c_06
			Euro	US $	UK £	¥en	Other	Total
			01	02	03	04	05	06
		Market value, excluding derivatives						
r_1_1	1.1	Property	0	0	0	0	0	0
r_1_2	1.2	Equities	0	0	0	0	0	0
r_1_3	1.3	Alternative investments	0	0	0	0	0	0
r_1_4	1.4	Fixed-income securities	850.000.000	35.000.000	33.000.000	0	0	918.000.000
r_1_5	1.5	Hedge funds	0	0	0	0	0	0
r_1_6	1.6	Commodities	0	0	0	0	0	0
r_1_7	1.7	Other	0	0	0	0	0	0
r_1		1 Total fund investments (excl. derivatives)	850.000.000	35.000.000	33.000.000	0	0	918.000.000

c03			c_01	c_02	c_03	c_04	c_05	c_06
				US $	UK £	¥en	Other	Total
				02	03	04	05	06
		Investments sensitive to exchange rate fluctuations						
r_2		2 Currency overlay (notionals)		36.000.000	30.000.000	0	0	66.000.000
r_3		3 Investments sensitive to exchange rate fluctuations		-1.000.000	3.000.000	0	0	2.000.000
r_4_1	4.1	Actual hedging percentage		102,9%	90,9%	0,0%	0,0%	97,1%
r_4_2	4.2	Strategic hedging percentage						

c04			c_01

Illustration of K202 reporting

c02			c_01	c_02	c_03	c_04	c_05	c_06	c_07
			AAA	AA	A	BBB	lower than BBB	no rating	Total
			01	02	03	04	05	06	07
		Fixed-income securities, excluding derivatives							
r_1_1	1.1	Government bonds, non-index-linked	22.000.000	10.000.000	0	0	0	0	32.000.000
r_1_1_1	1.1.1	of which: government bonds, mature markets, non-index-linked	22.000.000	0	0	0	0	0	22.000.000
r_1_1_2	1.1.2	of which: government bonds, emerging markets, non-index-linked	0	10.000.000	0	0	0	0	10.000.000
r_1_2	1.2	Index-linked bonds	0	0	0	0	0	0	0
r_1_3	1.3	Mortgage loans	0	0	0	0	3.000.000	0	3.000.000
r_1_3_1	1.3.1	of which: mortgages, residential (direct)	0	0	0	0	0	0	0
r_1_3_2	1.3.2	of which: mortgages, commercial (direct)	0	0	0	0	3.000.000	0	3.000.000
r_1_3_3	1.3.3	of which: residential mortgage-backed securities (RMBS)	0	0	0	0	0	0	0
r_1_3_4	1.3.4	of which: commercial mortgage-backed securities (CMBS)	0	0	0	0	0	0	0
r_1_4	1.4	Credits	1.200.000	40.000.000	335.000.000	360.000.000	94.000.000	46.400.000	876.600.000
r_1_4_1	1.4.1	of which: corporates and financials	1.200.000	40.000.000	300.000.000	240.000.000	54.000.000	45.000.000	680.200.000
r_1_4_2	1.4.2	of which: subordinated loans / bonds	0	0	35.000.000	120.000.000	40.000.000	1.400.000	196.400.000
r_1_4_3	1.4.3	of which: covered bonds	0	0	0	0	0	0	0
r_1_4_4	1.4.4	of which: convertibles	0	0	0	0	0	0	0
r_1_4_5	1.4.5	of which: CDO: Collateralised debt obligations (CLO, CMO, CSO)	0	0	0	0	0	0	0
r_1_4_6	1.4.6	of which: other asset-backed securities (ABS) and securitisations	0	0	0	0	0	0	0
r_1_4_7	1.4.7	of which: private loans	0	0	0	0	0	0	0
r_1_4_8	1.4.8	of which: syndicated loans	0	0	0	0	0	0	0
r_1_4_9	1.4.9	of which: bank loans	0	0	0	0	0	0	0
r_1_5	1.5	Short-term receivables and liquid assets	0	6.400.000	0	0	0	0	6.400.000
r_1_5_1	1.5.1	of which: short-term receivables (< 1 year)	0	-600.000	0	0	0	0	-600.000
r_1_5_2	1.5.2	of which: liquid assets (cash)	0	7.000.000	0	0	0	0	7.000.000
r_1		1 Total fixed-income securities	23.200.000	56.400.000	335.000.000	360.000.000	97.000.000	46.400.000	918.000.000

Illustration of K203 reporting

		Market value	Market value (MV) after standard shock	Notional long positions	Notional short positions	Market value after shock 1	Market value after shock 2	Market value after shock 3	Market value after shock 4
		01	02	03	04	05	06	07	08
2.0	**Interest rate derivatives**					-1,0%	-0,5%	0,5%	1,0%
2.1	Futures contracts, exchange-traded	-650.000	-600.000	32.000.000	25.000.000	2.000.000	500.000	-1.800.000	-3.000.000
2.2	Futures contracts, OTC	0	0	0	0	0	0	0	0
2.3	Swaps	0	0	0	0	0	0	0	0
2.4	Put options	0	0	0	0	0	0	0	0
2.5	Call options	0	0	0	0	0	0	0	0
2.6	Inflation contracts	0	0	0	0	0	0	0	0
2.7	Other instruments	0	0	0	0	0	0	0	0
2.8	Total interest rate derivatives	-650.000	-600.000	32.000.000	25.000.000	2.000.000	500.000	-1.800.000	-3.000.000
3.0	**Equities contracts**					-25,0%	-12,5%	12,5%	25,0%
3.1	Futures contracts, exchange-traded	0	0	0	0	0	0	0	0
3.2	Futures contracts, OTC	0							
3.3	Put options	0	0	0	0	0	0	0	0
3.4	Call options	0	0	0	0	0	0	0	0
3.5	Other instruments	0	0	0	0	0	0	0	0
3.6	Total equities contracts	0	0	0	0	0	0	0	0
4.0	**Currency contracts**					-25,0%	-12,5%	12,5%	25,0%
4.1	Futures contracts or equivalents	1.800.000	12.600.000	2.300.000	74.000.000	14.400.000	7.200.000	-7.200.000	-16.200.000
4.2	Put options	0	0	0	0	0	0	0	0
4.3	Call options	0	0	0	0	0	0	0	0
4.4	Other instruments								
4.5	Total currency contracts	1.800.000	12.600.000	2.300.000	74.000.000	14.400.000	7.200.000	-7.200.000	-16.200.000

Illustration of K204 reporting

Return on investments for the fund's risk

c01			c_01	c_02	c_03	c_04
			Quarter		Year-to-date	
			Actual TWR (%)	Benchmark return (%)	Actual TWR (%)	Benchmark return (%)
			01	02	03	04
		Performance				
r_1_1	1.1	Property	1,0%	1,0%	1,0%	1,0%
r_1_2	1.2	Equities	1,0%	1,0%	1,0%	1,0%
r_1_3	1.3	Alternative investments	1,0%	1,0%	1,0%	1,0%
r_1_4	1.4	Fixed-income securities	1,0%	1,0%	1,0%	1,0%
r_1_5	1.5	Hedge funds	1,0%	1,0%	1,0%	1,0%
r_1_6	1.6	Commodities	1,0%	1,0%	1,0%	1,0%
r_1_7	1.7	Other investments	1,0%	1,0%	1,0%	1,0%
r_1	1	Total return on investments (incl. currency overlay)	1,0%	1,0%	1,0%	1,0%
r_2	2	Interest rate hedging return (contribution)	1,0%	1,0%	1,0%	1,0%

Investment return for the fund's risk

c02			c_01	c_02	c_03	c_04	c_05	c_06
			Quarter			Year-to-date		
			Actual TWR (%) incl. overlay	Actual TWR mandate (%)	Benchmark return mandate (%)	Actual TWR (%) incl. overlay	Actual TWR mandate (%)	Benchmark return mandate (%)
			01	02	03	04	05	06
		Performance						
r_1_1a	1.1	Property	1,0%	1,0%	1,0%	1,0%	1,0%	1,0%
r_1_2a	1.2	Equities	1,0%	1,0%	1,0%	1,0%	1,0%	1,0%
r_1_3a	1.3	Alternative investments	1,0%	1,0%	1,0%	1,0%	1,0%	1,0%
r_1_4a	1.4	Fixed-income securities	1,0%	1,0%	1,0%	1,0%	1,0%	1,0%
r_1_5a	1.5	Hedge funds	1,0%	1,0%	1,0%	1,0%	1,0%	1,0%
r_1_6a	1.6	Commodities	1,0%	1,0%	1,0%	1,0%	1,0%	1,0%
r_1_7a	1.7	Other investments	1,0%	1,0%	1,0%	1,0%	1,0%	1,0%
r_1a	1	Total return on investments, incl. currency overlay	1,0%	1,0%	1,0%	1,0%	1,0%	1,0%
r_2a	2	Interest rate hedging return (contribution)	1,0%	1,0%	1,0%	1,0%	1,0%	1,0%

Illustration of K205 reporting[2]

Year	Cashflow	
2015	€	-
2016	€	155.000.000,00
2017	€	85.000.000,00
2018	€	120.000.000,00
2019	€	80.000.000,00
2020	€	90.000.000,00
2021	€	105.000.000,00
2022	€	73.000.000,00
2023	€	75.000.000,00
2024	€	30.000.000,00
2025	€	70.000.000,00
2026	€	26.000.000,00
2027	€	20.000.000,00
2028	€	12.000.000,00
2029	€	6.300.000,00
2030	€	8.200.000,00
2031	€	5.000.000,00
2032	€	4.500.000,00
2033	€	6.000.000,00
2034	€	6.200.000,00
2035	€	7.300.000,00
2036	€	2.400.000,00
2037	€	2.400.000,00
2038	€	2.400.000,00
2039	€	2.400.000,00
2040	€	2.400.000,00

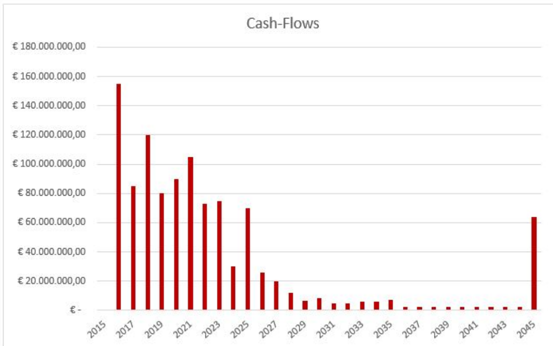

Illustration of Cash-Flows reporting

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

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

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