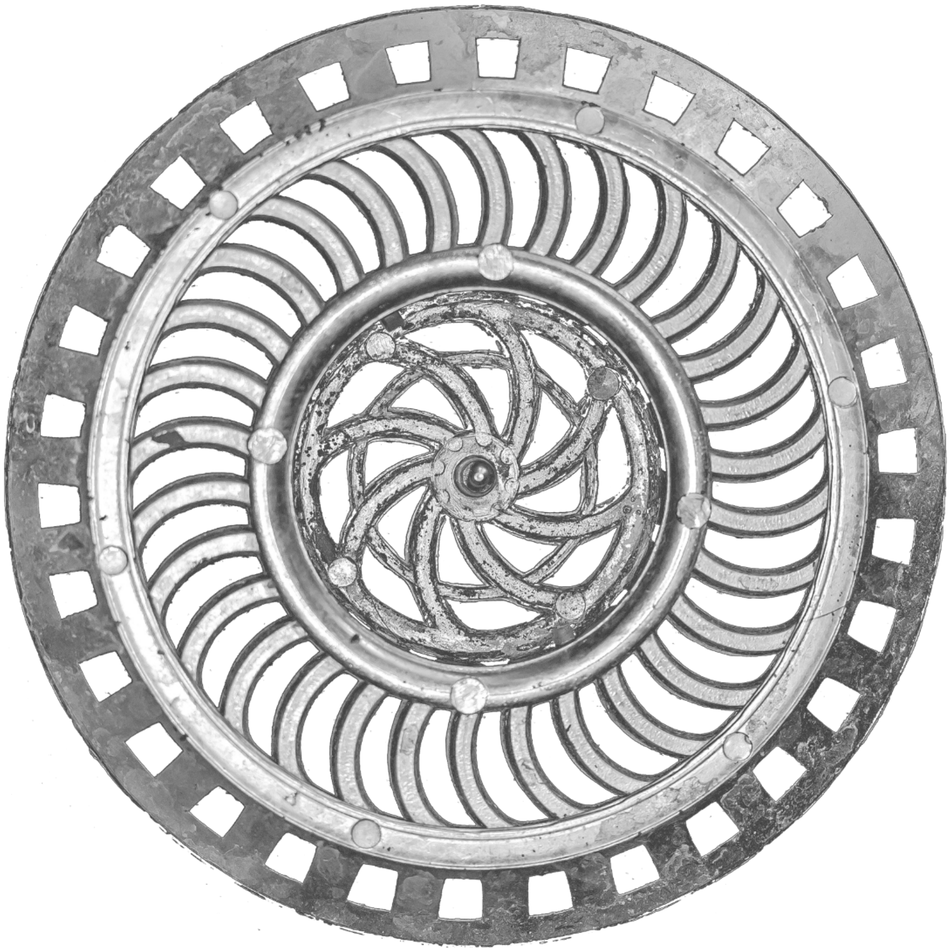
Deloitte.



Market Zoom

Dutch FTK reporting for investment funds – Regulation overview & new challenges

Setting the scene

Since the introduction of the new FTK (in Dutch “Financieel Toezichtskader” or translated “Financial Assessment Framework”) requirements, Dutch pension funds are obliged to report on investment statements. The greater transparency in reporting requirements for pension funds translates into new challenges for the investment managers. As of today, 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, which sets the statutory financial requirements for pension funds.

FTK reporting 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. In additions, it aims to assess 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 of risk exposure.

In this article, we will dive into the Dutch pension market and the indirect impacts of the FTK regulation for local and foreign investment managers.

Pension funds in context

The Dutch pension system is one of the world's most extended and comprehensive systems, containing around €2 trillion in Assets under Management. These financial assets make the Dutch market attractive for the investors, but also increase the need for a solid oversight regime.

The Dutch pension system consists of three pillars:

First Pillar or the state pension (AOW)

Second Pillar or the collective pension schemes

Third Pillar or the individual savings

Pension funds manage most of the pension money in Netherlands. Those funds can be either industry-wide pension funds or corporate pension funds - for a single company or a corporation.

Changes of the Pension Act

Between 2007 and 2009, the pension fund sector experienced 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 trend of descending interest rates and the upward readjustments of life expectancy were the main drivers for this degenerated trend.

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.

Metrics such as 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), reflect the financial position of a pension fund.

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 for indexation

Increasing minimal coverage ratios, introduction of policy coverage ration

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

Change in interest rate risk hedging, possible impact on inflation risk hedging

[1] Source: Statistics DNB (Dutch Central Bank)

In addition to these changes, there was an introduction of the new investment statements templates.

The new regulatory regime entered into force on 1 January 2015, and was last updated in 2017. In February 2018, DNB published a new version of Explanatory notes to provide instructions on the FTK Framework.

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

There are eight different reports with varying content and reporting frequency.

Report	Report code	Frequency	Content	Investments
Annual statements	J101 to J903	Annually	Organization, board, provision, premium, audit statement	No
Premiums	K401 to K402	Annually	Expected premium, required premium	No
Recovery plan	K501 to K502	Annually	Quarterly reporting adding liabilities and payments	Partially
Regulations	K602	Annually		No
Pension fund feasibility test	K702	Annually		
Investments	K101 to K205	Quarterly	S1 until S6, VEV, holdings, coverage ratios, currencies, credit ratings, sensitivity analyses, performance	Yes
Geography & Cash flows	Geography & Cash flows	Quarterly	Cash flow information, used as input for K101 to K205, geographical distribution	Yes
Coverage ratio	M101	Monthly	Overview of assets and liabilities	Partially
Liquidity (NEW)	K206	Quarterly	Overview of current and shocked liquidity position	Yes

Deloitte.

Liquidity position (K206) - new reporting requirement starting Q1 2018

In this statement, pension funds report their current liquidity position as well as the post-shock liquidity position. The shocks in question are in line with the reporting K204, and in particular:

Interest rate risk

Currency risk

Equities risk

Commodities risk

Credit risk

No correlation assumed between the various shocks, which are presented separately

Where possible, the look-through principle should be applied, and the reporting frequency is quarterly.

Impacts on asset managers

Pension funds are responsible for accurate, timely, and complete reporting to DNB. FTK reports 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 funds' investments and requires look-through approach. 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 always have sufficient information or resources to perform a look-through.

Asset managers targeting Dutch pension funds to provide the *FTK* reporting look-through and cash flows on their investment funds

FTK reporting look-through includes:

- Classification & mapping,
- Conversion of derivatives
- Credit and interest rate exposure, currency exposure
- Sensitivity analysis
- Cash flows - estimation of future cash flows of the fund
- Specific fund look-through information

Challenges & pitfalls

Data management

Producing FTK reporting requires data and information from various 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 & watch

Complexity related to the reporting, classification of assets, conversion of derivatives, application of shocks, and estimation of cash flows.

Methodology varies according to the asset class or the type of financial derivative

Analytics & cash flows calculation

Applying the regulatory-prescribed shocks to perform the sensitivity analysis and cash flow projections require appropriate quantitative pricing libraries and techniques to process financial derivative instruments, such as swaptions, options, swaps.

Scalability & delivery

Data exchange between fund managers and Dutch pension funds follows a quarterly frequency and happens within a short time frame, usually 15 business days after quarter end, adding pressure to the reporting systems.

Contacts

For assistance with the FTK reporting, please contact one of the following persons.

Xavier Zaegel
Partner | Capital Markets & Financial Risks
Deloitte Luxembourg
+352 451 452 748

xzaegel@deloitte.lu

Sylvain Crepin
Partner | Capital Markets & Financial Risks
Deloitte Luxembourg
+352 451 454 054

screpin@deloitte.lu