

EVERYTHING IN ITS OWN TIME

*To everything there is a season, and
A time for every purpose under heaven. – Ecclesiastes 3*

I. Understanding time

When people tell each other “Everything in its own time” they are usually trying to encourage a bit of patience in the other: just wait, it will be fine, everything happens at the right time.

But there is also an inverse approach: if everything happens in its own time, then what is time really? Is time something quantitative, where you can have more or less of it in shorter or longer periods?

In some sense, the answer is yes - we can even measure time. For athletes the measurement of even minor time differences is very important; while for pension funds a period of seventy years or more is relevant. At the same time, the biblical passage above suggests that each moment of time is unique: if everything has its own time, then every moment has its own quality.

In the quantitative approach to time, there are markets that may or may not come to equilibrium. In market equilibrium, all buyers and sellers can do business at prices they find acceptable. This is only possible if there is a lot of information available - preferably under the oversight of a central party that can do a quick ‘groping’ of transactions and distribute the results to everyone involved. Then, if the trade itself isn’t too costly, the market can quickly be cleared. Of course this works just fine in principle, but as we know it does not describe reality. And precisely because reality is different - with limited information, and costs associated with trade - money plays a role (Van der Lecq, 1998, H2).

Time itself is quantitative. We call this Newtonian time, or logical time. Newtonian models see the world as a very big machine; time is required in order for that machine to deliver good result. Logical time is spatial: you can move through it, going forward and backward. Thus time is reversible in these models. Everything that has been done, can be undone. Time itself flows in a way that is independent of what happens during that time. (Van der Lecq, 1998:51).

Historical time, also known as subjective or realistic time, is quite different. In this case time depends upon what is happening *within* it. Every moment has its own quality. In the world of historical time, there is no complete information. Circumstances generate knowledge and insights, and create experiences through which people are changed forever. Only rarely are expectations met - because by the time they might come to pass the world has changed and changed again. In the discipline of statistics this is referred to as **non-ergodicity**: the probability distribution of what might occur is dependent upon the initial situation. Path dependency is the consequence – that is to say, history matters. Therefore each moment is unique in terms of situation and future possibility. Historical time

is based on a developmental process. And in a world of historical time there is a significant role for money that has been hoarded (Van der Lecq, 1998, §2.4.3). Money is a resource, a store of value that can help us bridge time - from current situations we don't know everything about, to future situations of which we know even less. Life after retirement is just such a situation.

II. Pension Markets

The pension sector has many markets in which intermediary markets in the production column have their own supply and demand situations (Van der Lecq, 2009). The markets for various assets are the best-known pension markets. Put simply, pension investors, such as pension funds and insurers, are the 'demanders' and their banks and all sorts of other companies are the 'suppliers'. In these financial markets there is usually a lot of available information, meaning that past experience can tell us something about future possibilities. Economists call this risk: the probability distribution is known. Since the financial crisis, however, it is well understood that this can go in a wholly different way, leading to situations that few would ever have considered possible. Economists call this uncertainty: one has absolutely no idea which way things *can* go.

Although that sense of uncertainty seems to have thoroughly permeated the industry, there is still much work being done – and above all, calculated – with old models and with logical time. That's the time that can be reversed, remember, the time in which one can act as if something has not happened. And unfortunately, we see that people behave accordingly, particularly in the world of asset management. The 'other side of the table' is kept as ignorant as possible, bonuses are still being paid and if that is not allowed, the salaries themselves are raised. It's 'business as usual' here, with the 'usual suspects'.

In a context of transactions, that's understandable. A transaction is a short-lived thing. Both sides make the best deal and beyond that have little to do with each other. In a context of relationships, it's quite a different situation: history plays a role, and determines the possibilities for the future. A relationship can grow and flourish, but can also be broken or simply wither away.

Pension funds now have a far better realisation that they indeed have a relationship with their stakeholders, who are not just employers and unions, but also the people who will ultimately have to live off of their pensions. Recent history teaches that these people no longer trust the relationship. Things have gone irrevocably wrong, and their trust has been violated. As in any relationship, there is a great deal of understanding and empathy needed, plus a credible structural change, to save what can still be saved. Those on the other side of this relationship, in this case the participants and pensioners, must be able to see that things have been irreversibly *improved*. And this can only be done in historical time, where information is limited and grows along with circumstances and events.

III. Evolution

Will the pension sector be able to make the step from logical time to historical time? In other words, do the parties involved accept responsibility for what has happened in the past, and will they stay the

course, trustworthy and credible, as they move forward in a whole new manner. While there are certainly innovations to be seen, they don't go nearly deep enough. The pension sector must innovate further. I will explain that by drawing an analogy with the theory of evolution [3]. In a highly simplified version of the evolutionary mechanism, there are three distinct aspects:

1. Generating mutations

Innovations are needed in order to be able to respond better to changing circumstances. And because in historic time we don't know just what the future might look like, there is great importance in having various types of innovation. Research in which the outcome is known from the beginning is not very promising in generating mutations that do well in situations of which we are not yet aware. Fundamental research must therefore be free of predetermined results. Research funding is, more often than desirable, forcibly directed towards certain limited and concrete questions - preferably those already fitted up with directions to solutions. True innovation requires that financiers recognise that there are fundamental structural changes needed which cannot be seen or predicted in advance. This problem is not exclusive to the pension sector (Mazzucato, 2014).

2. Leaving a legacy for future generations

Successful innovations must survive, so the knowledge associated with them must be captured. First of all, it is necessary to look carefully at *what* is successful; and subsequently, at what is *causing* that success. There must be great care taken in recording what is being innovated, and how that innovation works. This can be partially documented in procedures. But a part of it is also resides in the minds of people: tacit knowledge. It is via relationships, then, that success can be passed on. Relationships work outstandingly well within historical time; a time concept in which knowledge can grow and be transmitted from person to person.

3. Selection

This mechanism determines which variant survives and which does not. Successful variants survive in changing circumstances, while unsuccessful variants die out. That extinction occurs on two levels: the level of the individual and the level of the species.

At the individual level, it's about how some live long enough to reproduce, while others do not; their genetic combinations therefore die out with them. This is what we call 'survival of the fittest'. In economic terms, some companies conquer market share, while others go bankrupt or are taken over by other companies. Further it is not just market share, but also good relationships with stakeholders which enables some firms to survive better than their competitors. Consider the example of banks or suppliers who willingly help clients during difficult times, on the basis of a good relationship. In a broader sense, then, survival is a matter of adapting to the situation – in other words, those that best fit will be the most 'fit'.

This selection process requires that losers disappear from the market: "Winners need their losers." In pension funds, we see this happening via the consolidation process, in which many funds that can no longer cope with the diverse challenges of the current situation seek affiliation with a larger industry-wide fund, a general pension fund or an insurer. As independent entities disappear from the market their 'uniqueness' will no longer be passed on.

The second selection mechanism concerns the survival of the species, the so-called 'struggle for survival'. It's about the fitness of a species to survive in changing circumstances. In this evolutionary process, species die out if they don't adapt quickly enough - and the extinction of species cannot be undone. Time is not reversible.

This is exactly what I think is happening in the pension sector in the Netherlands: if the industry does not adapt quickly enough, the sector will disappear. The need for change is urgent.

IV. Evolutionary mechanisms in the pension sector

Right now we see the struggle for survival in full force among pension funds. As a species, they are under great evolutionary pressure to survive. And that's not just about reducing operating costs, known as 'static efficiency'; it is mostly about the funds responding to changes in their environment, the so-called 'dynamic efficiency'.

In the pension sector these last changes are going slowly. Industry experts Boot and Drijber wrote their reports in 2007, and it's been quite a while – namely 2010 - since the reports of the Frijns and Goudswaard commissions appeared. Especially in those latter reports, the urgency of change was clearly signaled via the "sinking giants" (Frijns et al, 2010:20) and the graphical image of the fundamental exchange, in which the misunderstandings between the funds and some stakeholders are clearly defined (Goudswaard et al., 2010: 53 Figure 5.1). However, it was still necessary to have a SER (Sociaal Economische Raad or Social and Economic Council of the Netherlands) recommendation in 2015 before the willingness arose to at least reflect on a new sort of pension scheme (SER, 2015). Even after the scheme was drafted in prototype (SER, 2016), it still wasn't clear to everyone that an innovation had been proposed that might indeed increase the survival rate of the species - Dutch pension funds.

For after all, the world keeps changing – and to survive in these changing circumstances, mutations are necessary. There are at least four irreversible developments or 'changed circumstances' to be observed:

1. The demographic transition: There are fewer young people in our population, and more and more old people who are only getting older. This imbalance will be slightly offset by gradually increasing the state pension eligibility age (and retirement age), but there are (political) parties, hoping for logical time, who want to reverse this measure. Without lowering pension entitlements, this is unaffordable; the funds aren't in the same shape they used to be in, and they no longer have the same opportunities they had in the past.

2. The labour market transition: The labour market is changing. Workers are sometimes employed and sometimes self-employed. Sometimes they work full-time, sometimes part-time, sometimes not at all; or they may work abroad for a while. Here too, there are (political) parties who keep hoping for logical time, and trying to reverse this development in the labour market by reintroducing the 'indefinite period' employment contract as the norm. For pension funds, that will not provide a sufficient ground to be able to maintain the uniform contribution and accrual system. Most industries will not be returning to the old-time model of a lifetime career with the same employer, or within the same sector.

3. Developments in financial markets: Developments in the financial markets still seem to be behaving according to 'logical time'. But anyone who takes a longer look into history will see that not all swinging pendulums return to the middle. What that middle is, moreover, depends upon which period one is looking back at. The return of interest rates to equilibrium levels, the so-called 'regression to the mean', is after all an 'investment belief' – a conviction, in other words, but not a fact. Other financial prices and indicators can sometimes remain very different to what we've been accustomed to, and for a very long time. This is not only due to the functioning of financial markets, but also through various developments that influence the productivity of labour and capital. Some argue that distribution issues also play a part here (Mason, 2015). Issues of growth and distribution have been tackled with varying degrees of success, as history shows. Trust between social partners comes and goes.

4. Developments in society: Finally, there are many irreversible developments in society. Often reference is made to individualisation, which is indeed perceptible. But we also see a government that withdraws, and no longer delivers what her citizens count on. Citizens have to figure things out for themselves, and have become customers. So it's no wonder that they claim their rights and 'vote with their feet'. That creates a sort of tension we are also seeing in pension funds. Participants in a pension scheme can't leave, after all, and are therefore not really customers. The more pension funds approach participants as customers, the more tension arises with mandatory participation. Resistance to authority is an understandable response, especially if those authorities have failed to live up to their previous promises. Individualisation of pension claims can make the relationship more transparent, but not really better, as long as the "exit mechanism" is not replaced by a "voice mechanism" (Hirschman, 1970). This is not a matter of control over investment policy, but really about the earnest fulfillment of the pension sector's representative roles.

Do participants still feel represented by the unions? Can they vote for the accountability body? That varies by fund and by sector. Is their pension scheme delivering what they had expected? This demands courageous communication, especially about what *cannot* be promised. Such fearless communication is desperately needed. Trust is diminished, and credible and structural change is necessary. Making pension claims more transparent by means of individual, so-called 'pension pots' can contribute to trust, but it's not enough. There also has to be more trust in those who carry the fiduciary responsibility for other people's pension capital.

In short, there are four major trends that are exerting evolutionary pressure on the pension sector, especially on pension funds. To survive as a species, structural adjustments must take place. More attention to innovation is therefore proposed.

There are certainly some innovations to report now, for example the introduction of the general pension fund (APF) a full ten years after European regulations made it mandatory. It hasn't been speedy; but now the APF is finally here, and it offers many opportunities for 'solidarity circles' so that its implementation can be managed cooperatively. Unfortunately, the route to the APF is still closed to various types of retirement collectives; that threatens to limit the implementation of this innovation, just as we saw previously with the PPI and the multi-OPF. A bit of speed in the expansion of legal opportunities to capitalise on new pension vehicles would help these innovations to make it through the 'struggle for survival'.

However, the initiative for innovations rests not with legislators alone; the pension sector itself must take timely action in order to stay 'fit for purpose'. Scholars may help.

V. What can science contribute?

Sadly enough, things aren't going too briskly in the interchange between the pension academics and the pension practitioners. Of course Netspar plays an important role in bringing both groups together, and in generating and disseminating knowledge. The changes demanded are getting started very slowly, however; and more are needed. Can science make a contribution here? How does pension practice relate to pension science? And *is* there actually something like 'pension science'?

Let's start with that last question: pensions are, in my opinion, a multi-disciplinary field. Insights taken from a variety of scientific disciplines are of importance for pensions. Think of macroeconomics and financial economics, for instance, but also behavioural economics and economic psychology, law and institutional economics. Other relevant fields are certainly conceivable. The subject demands multiple perspectives.

The multidisciplinary nature of pensions, however, is exactly what makes the subject so difficult to get published in scientific journals. This seems the least problematic for asset management research, in which the goal of capital building is not always relevant. Research on macroeconomic pension models is also published in the journals, but they largely reduce pensions to intertemporal savings. Pension-specific issues are often at the intersection of academic disciplines, making it tougher to publish. If scientists are measured by their academic publications, they are forced to drastically reduce their socially relevant research questions into research issues that will lead to publishable articles. This 'publishability' of pension-specific research is further hampered by the fact that pension systems in various countries are vastly different, while many scientific journals take the US system as a starting point, or aim for a universal perspective. This is also why academic articles can be difficult to apply in practice.

Even where it is possible, the pension sector seems to be struggling to apply scientific insights. Here are four examples:

1. In the financial economy, the benefits of life-cycle investments are known. Yet, many pension funds still invest uniformly and cultivate an average accrual. The SER-developed prototype of a new life-cycle investment scheme is still getting a lot of resistance. It sometimes appears that the maintenance of the mandatory participation - as an end in itself - prevails over the roughly-better results anticipated from life-cycle investments.

2. Meso-economic research repeatedly shows that the economies of scale for pension funds are enormous. This applies to both asset management and pension administration, including the IT infrastructure. Nevertheless, many funds are holding on to their unique identity and are committed to sacrifice substantial pension results.

3. From behavioural economics and economic psychology we know that people are limited in their ability to deal with freedom of choice. Recently too, the Netherlands Scientific Council for Government Policy presented a compelling study focused on the limited self management of citizens (WRR, 2017). This insight is important not only in cases where the government withdraws, but also in the situation in which the pension funds finally, honestly reveal that pension results are uncertain. Of course, it is good to provide people with operational perspectives and to teach them about personal financial planning based on various capital sources, including the fifth pension pillar of human capital; but scholars have long known that this will not be sufficient. After all, a double-digit percentage of the population is unable to understand or work with percentages, is not equipped to manage its own budget, and has great difficulty in assessing long-term decisions.

As long as the pension sector, including social partners, is not responding adequately to this situation, it should be able to communicate in a realistic way about what the second pillar has to offer and, in the meantime, should be working harder on making pension schemes as future-proof as possible. The urgency of this is being taken on in varying degrees. I see some initiatives to simplify pension contracts. In my opinion, the prototype developed by the SER in 2016 is more transparent than the current, highly complex CDC arrangements, without having to compromise on the **pension results**. The often-used criterion of 'explainability' has as much to do with comprehensibility as with acceptance. Therefore, there is also an ethical side to the simplification of pension schemes: the better people understand it, the more likely they are to trust it. Simplification is thus an example of a structural and credible change that can lead to restoration of trust. There are opportunities for innovation here, as well.

4. Academic research into diversity is not always solid when it comes to proving causality, but the correlations of diversity and results for organisations are quite strong. In the pension sector, the importance of diversity is also linked to the heterogeneity of stakeholders, and the need for support for the results of an even balance of interests. Nevertheless, and despite a code for pension funds and an associated monitoring committee, diversity is sadly still scarce in the industry.

In short, to the extent that it is possible for scientists to publish research on issues relevant to pensions, it is up to the pension sector to take the results and get to work. Unfortunately quite a different approach can be observed: the selective 'shopping' from scientific insights, professors set on the

sidelines as study scholars if those insights do not tie in with the pension sector's own interests - and resuming 'the order of the day' after a lecture at one of the (too) many pension congresses is finished. Given the big evolutionary pressure on the sector, this is a risky attitude. Survival demands innovations.

When it comes to the necessary innovations, we in the pension sector aren't just talking about the schemes, but about implementation too. As mentioned, the implementation of the first IORP directive lasted ten years; but now the Pan European Pension Plan and the Pan European Occupational Pension Plan come our way. Europe offers opportunities, for example pension industry employment opportunities for the highly-qualified. These opportunities will increase if Dutch pension delivery organisations are enabled to implement the new schemes. This calls for an evolutionary perspective from their shareholders, who are, as mentioned earlier, under evolutionary pressure themselves.

In addition to 'big data', which is now being tackled by Netspar, the interaction between technology and money matters is another innovation area. We already know 'fintech' and 'regtech', but what's going on with 'pensiontech'? When the fund managers dig into the 'future-proofing' implications of these new opportunities for themselves, they might decide to appoint IT experts to their boards, just as is now occurring in supervisory boards.

There is also a good deal of research into the possibilities for sustainable investment of pension assets. Researchers and investors are considering how they can add value by choosing for the long term. In this context, the global initiative Focusing Capital on the Long Term (FCLT) is particularly encouraging [4]. Undoubtedly there are still other subject areas and fields in which pension practice can benefit from scientific insights.

VI. Conclusion

Since the financial crisis, the world has changed irreversibly. Many financial institutions have been forced to create structural and credible improvements, so that they can survive individually and as a species. In addition to technological changes, ethics are increasingly used as a competitive parameter. The pension sector is also under evolutionary pressure. Four major trends are driving us towards innovation, if the funds as a species are going to survive. Time is running out.

Fieke van der Lecq

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[1] This article is a shortened version of my inaugural address of the same name dated June 15, 2017. The Dutch language version of this shortened article first appeared as Van der Lecq (2017). .

[2] A stochastic system is called ergodic if it tends to be a probability to a limiting form that is independent of the initial conditions. Breakdown of ergodicity gives rise to path dependence. When path dependence occurs, "history matters". (Palgrave [via http://horst.qfl-berlin.de/sites/files/u2/Palgrave.pdf](http://horst.qfl-berlin.de/sites/files/u2/Palgrave.pdf) dated 21-05-2017)

[3] For a more extensive discussion of this analogy, see Van der Lecq, 2009:7-9.

[4] See <http://www.fcltglobal.org/> and the Dutch initiative www.shiftto.org