Investing in Dutch Residential Mortgages and Dutch Pension Reforms: The Value of Liquidity

Achmea Mortgages

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- Mortgages remain an attractive investment under the Future Pensions Act (Wtp), but liquidity and valuations require increased attention.
- The transition to the Wtp framework is an ideal moment to reassess your mortgage investment strategy, with a focus on liquidity needs.
- Making mortgages eligible for collateralisation can lead to a more efficient liability hedging portfolio and higher expected returns.

Wtp Requires a New Perspective on Mortgage Investments

The transition to the Future Pensions Act (Wtp) is the perfect opportunity for pension funds to critically review their investment strategies. Mortgages remain an attractive asset class under the new framework, offering a favourable risk-return profile compared to other fixed-income investments. However, the requirements for liquidity, rebalancing capabilities, the speed of ramping up investments post-transition, and portfolio construction are evolving. Achmea Mortgages' innovations align well with these changes, ensuring institutional investors continue to benefit from the enhanced returns that mortgages offer.

Liquidity as a Critical Factor

The shift from the previous regulatory framework (FTK) to the Wtp makes liquidity even more crucial. The transition from a defined benefits system to a defined contribution system with individual pension accounts, collective investment portfolios and assigned returns necessitates flexibility. Achmea's mortgage investment fund (PHF) offers this flexibility and a high free cash flow, enabling the fund to generate substantial liquidity in the short term. This makes it easier for investors to rebalance the investment portfolio when necessary.

The larger the mortgage portfolio within a fund, the greater the free cash flow generated from interest payments and repayments. The PHF manages a mortgage portfolio exceeding €12 billion, yielding an annual cash flow from interest and repayments ranging between €800 million and €1.4 billion. Additionally, PHF has an excellent track record of facilitating rapidly changing allocations.

Achmea Mortgages also provides discretionary mandates (separate account solutions) through the Achmea Mortgage Investment Platform (AMIP), investing in 'Centraal Beheer Leef' mortgages. Discretionary mortgage mandates differ from fund solutions and offer liquidity based on interest payments, repayments and prepayments. Besides that, our platform-based approach with existing investors ensures standardized tradability of mortgages among investors. This allows investors to generate liquidity. This feature enhances liquidity options within discretionary mandates, aligning with the liquidity demands of the Wtp framework.

Faster Mortgage Exposure During Transition

The moment of transition involves an abrupt shift from the old to the new framework. This may lead to an asset allocation shift where younger participants receive higher allocations to riskier investments, while interest rate risk management differs from the FTK approach. Under the Wtp's Solidary Pension Scheme (SPR) variant, interest rate risk is managed per age cohort. Typically, younger participants are not covered for interest rate risk, while older participants receive a higher level of protection than under the FTK. Consequently, the liability hedging portfolio's returns are largely allocated to older participants, while excess returns from the return portfolio mainly benefit younger participants.

In theory, the pension fund must transition to the new asset allocation at the point of implementation. After transitioning, a mismatch may arise between the initial and target portfolios. This is particularly challenging for illiquid investments like mortgages, which require time to deploy. Within our AMIP platform, investors can not only build exposure gradually but also purchase existing, already-originated mortgages. This enables a swift shift toward the target asset allocation. Furthermore, since 2022, the mortgage market has undergone structural changes due to rising interest rates. While consumers previously preferred long-term mortgages, demand has shifted towards shorter maturities, particularly 10-year mortgages (rising from a 15% market share in 2022 to over 50% in 2024). Through Achmea, investors can acquire a pre-2022 portfolio, predominantly comprising of long-term mortgages. Under current market conditions, such a portfolio is difficult and time-consuming to construct independently. Long-term mortgages better match the long-term liabilities of pension funds.

A More Efficient Protection Portfolio by Collateralizing Mortgages

Under the Solidary Pension Scheme (SPR), many pension funds opt for indirect returns from the liability hedging portfolio, where changes in the interest rate term structure are allocated to the liability hedging portfolio. Mortgages make this portfolio more efficient. Alongside other fixed-income assets, mortgages contribute to higher returns and increased diversification benefits within a pension fund's total investment portfolio, enhancing its risk-return profile. The Wtp allows for a more diversified liability hedging portfolio than the FTK since there is no minimal coverage ratio necessary under the Wtp.

However, a limitation of mortgages is their relative illiquidity and the requirement to provide collateral for swaps[1] within the liability hedging portfolio. Government bonds are typically included as a safe haven and as collateral for swap margin requirements. Government bonds can be used in the repo market for posting collateral. To mitigate the risk of cash requirements for mandatory collateral posting, many pension funds hold a liquidity buffer in the form of cash. The challenge remains that mortgages cannot be used as collateral to free up liquidity for cash collateral requirements.

[1] Due to the disappearance of bilateral swaps and the shift towards increasingly centrally cleared derivatives, collateral will primarily need to be provided in cash.

This prevents full optimization of the higher expected returns from mortgage investments. Achmea Mortgages sees opportunities to establish a bilateral repo facility with banks, using the Centraal Beheer Leef brand as collateral. This facilitates a more efficient construction of the liability hedging portfolio.

There are two main methods to collateralize mortgages. The first solution is structuring a Residential Mortgage-Backed Security (RMBS), which is a labour-intensive approach that transforms mortgages into liquid RMBS notes, usable in a repo facility offered by multiple banks. However, this approach is not only resource-intensive but also costly. Alternatively, Achmea Mortgages provides a significantly simpler and more cost-effective solution compared to the traditional RMBS route. With this approach, the only expenses incurred are the financing costs of the potential repo facility, based on a pledge deed on the mortgages. This allows investors to continue benefiting from mortgage investments while maintaining the desired return profile within the protection portfolio.

The transition to the Wtp introduces age-based interest rate hedging, where younger participants have no interest rate hedging, while older participants have a higher coverage than under the FTK. Although the duration of the liabilities subject to interest rate hedging is shorter, they still require long-term investments. Mortgages are generally well-suited for this purpose, but their illiquidity and buy-and-hold nature mean that the duration of a mortgage portfolio may shorten and deviate from liability durations over time. However, due to the diverse range of investors on the AMIP platform, some investors specifically prefer shorter-maturity mortgages. This allows for internal liquidity generation, leveraging complementary investor preferences. Banks are natural buyers of shorter-maturity mortgages, while pension funds primarily seek longer durations.

Liquidity and Flexibility Are Essential for Mortgage Investments Under the Wtp

The transition to the Wtp framework presents new opportunities for institutional investors but also imposes different requirements on mortgage investments.

Achmea Mortgages' innovative solutions offer greater liquidity options, flexibility in asset allocation adjustments, and a faster build-up of the target portfolio after transitioning.

With the Achmea Mortgage Fund and the Achmea Mortgages Investment Platform, you have the tools to optimize your mortgage investments under the new pension system. Mortgage investing remains attractive, and with the right partner, you are prepared for the future.

Would you like to learn more about how Achmea Mortgages can support you in the transition to the Wtp framework? Contact Peter Verleun.

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Disclaimer

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