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Through Wtp, active management will be about more than alpha.

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The Wtp broadens the rationale for active management. In addition to expected alpha, alignment with policy objectives, risk appetite, cohorts, sustainability, and explainability also count. This article analyzes what this broadening means for the choices of pension fund boards and shows why an operationally passive portfolio can also contain strategically active choices. How does the Wtp change the assessment of active management, at which levels does this play a role, and what does this require of pension fund boards?

Wtp does not automatically make active management more or less desirable, but it does place higher demands on its substantiation and accountability to participants. Pension funds must distinguish more clearly whether active choices are being made in policy, tactical allocation, or execution, and how the associated risks and results impact each life cycle and cohort.

Custom benchmarks require special attention. A portfolio can passively track a custom benchmark, while the benchmark itself contains a strategically active deviation from the broad market. If this risk is not visible in the ALM, an incomplete picture of the alignment with the risk appetite may emerge.

Active management thereby becomes more explicitly an administrative issue. The choice must align with policy and risk appetite, be feasible and limited, and be linked in advance to monitoring, reporting, and communication.

ACTIVE MANAGEMENT HAS VARIOUS DEFINITIONS. In this article, a distinction is made between active management as an execution, tactical, or strategic choice. The analysis will also show that the transition to the Wtp can take place at different levels.

In this article, we discuss active management within *execution,* defined as the deliberate deviation from a benchmark within an investment class to achieve additional net return (alpha).

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Following the Global Financial Crisis (GFC), several influential studies1 called into question the utility of active management in terms of alpha. Active returns were disappointing, and this also made the high costs, about which people were already becoming more critical at the time, alarmingly visible. This led to pension funds switching en masse from active to fully passive management.

To an increasing extent, institutional investors are *strategically* defining their own (customized) benchmarks, and the resulting deviations from a standard market index are viewed as active choices. In fact, pension funds have gradually begun to personalize the passive approach they previously adopted with full conviction by introducing explainable principled (particularly ESG) and financial (including alternative beta strategies, home bias) policy rules. Consequently, a benchmark is replicated passively, yet the benchmark itself is actively determined; after defining that benchmark, the pension fund once again enjoys the benefits of replication, such as low costs and limited effort.

In both the execution and strategic variants, a deliberate deviation is made from the market indices underlying the strategic asset allocation (SAA) and the financial target profile established via the ALM study. Differences in returns are accepted in the short term based on the conviction that the risk-return profile or the non-financial aspects will be better for the participants in the longer term. The interim rate of return deviation is then expressed as tracking error. In addition, benchmark deviations are used to measure non-financial added value.

ACTIVE MANAGEMENT GOES BEYOND ALPHA

At the *tactical* level, active management plays a role in relation to the SAA through, for example, deliberate choices to overweight or underweight the allocation of an asset class versus the strategic weighting, or to select an interest rate hedge other than the strategic one. The goal, extra return or reduced risk, is a third form of alpha generation.

It is important to note that in practice, private assets are almost always actively managed. After all, within private markets, active management is inherent to the asset class, as broad, liquid, and fully replicable market indices are absent or of limited use.

The follow-up question is whether the Wtp has consequences for active management, and if so, at what level? Based on this insight, a pension fund can reconsider existing choices regarding active versus passive management and investigate whether policy needs to be adjusted.

STARTING POINTS OF THE ANALYSIS

This section addresses the aspects of investment policy, communication, and implementation that change due to the transition to the Wtp.3

FROM FUNDING RATIO TO PENSION OUTCOMES PER COHORT

Under the FTK, the funding ratio was central as a collective measure of the pension fund's financial position. Under the Wtp, the focus shifts to individual pension assets and pension outcomes per cohort. Consequently, not only does the total fund return become relevant, but particularly the question of how risks and returns impact different individuals.

groups of participants. Active management should therefore not be assessed solely at the fund level, but also based on the contribution to the pension outcomes of individual cohorts.

Moreover, individual pension assets become more visible to participants. As a result, investment results, costs, and deviations from market indices become more direct explainability and communication issues.

YIELD ALLOCATION: PROTECTION YIELD AND EXCESS RETURN

An important difference compared to the FTK is that returns are allocated more explicitly under the Wtp. Whereas returns under the FTK were reflected generically via the funding ratio, the Wtp distinguishes between protection return and excess return. This makes it clearer where active

choices countries and which participant groups benefit from them or, conversely, run a risk. In active management, it must therefore be clear in advance whether the choice is primarily relevant to the protection component, the excess return, or the solidarity reserve, and whether the nature of the risk is consistent with the function of that component.

RISK ATTITUDE AS A NEW POLICY ANCHOR

Under the Wtp, participants' risk appetite becomes a more important anchor for investment policy due to statutory requirements. Active choices must therefore not only fit within the expected risk-return profile of the fund, but also demonstrably align with the established risk appetite per cohort or life cycle.

LIFE CYCLE AND COHORT DIFFERENTIATION

The Wtp includes life-cycle investing and age-dependent risk management. Even when investing collectively, such as within the SPR, allocation takes place to age cohorts. Consequently, it must be assessed at various levels whether the policy objectives have been achieved. An active risk that may be appropriate for young participants due to their long investment horizon may be less suitable for older participants if setbacks become visible more quickly in the expected pension. The assessment of active management thus becomes more specific and sensitive to the distribution of risks across cohorts.

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LIMITATION OF REDISTRIBUTION AND ACTIVE RISK

Under Wtp, redistribution is expected to be more explicitly limited, and risks must be better substantiated in advance.
The relevant question is no longer merely whether active management is expected to add value, but also where the fund is willing to take active risk and why precisely there. This requires clear risk budgets, explainable choices, monitoring per scheme and cohort, and a consistent link to risk appetite, life-cycle design, and communication to participants.

SPR AND FPR HAVE DIFFERENT EFFECTS FOR ACTIVE MANAGEMENT

The implications are not the same for the SPR and the FPR. In the SPR, collective allocation via protection return, excess return, and solidarity reserve remains relevant, whereas in the FPR, results have a more direct impact on individual pension assets. As a result, active management becomes visible more quickly under the FPR and must be explained more explicitly, especially in the case of negative results.

THE INFLUENCE OF THE WTP ON ACTIVE MANAGEMENT, DIFFERENCES BY SCHEME

The role of a benchmark is shifting, as described above, from primarily measuring alpha to reflecting broader managerial choices.

Our Wtp advice highlights five policy objectives in particular where the transition may impact active management *(Table* 1). Together, they form a practical framework to map out to highlight where administrative attention is needed regarding strategic, tactical, and operational active choices during the transition to the Wtp. The framework links the policy objective to risk appetite, implementation, reporting, and monitoring. The five areas are elaborated upon in the remainder of this article.

ACTIVE MANAGEMENT AND THE SPR

Under the SPR, collective risk sharing via the protection return and the allocation of excess returns remains part of the investment policy. Due to the elimination of buffer requirements, this makes illiquid investments and the associated active management choices easier to implement and justify than in the case of the FPR.

PASSIVE INVESTING CAN BE ACTIVE

The statutory obligation to allocate returns to protection returns and excess returns represents a fundamental difference from the practice under the FTK, where all returns were accounted for generically via the funding ratio. In practice under the Wtp, we observe that, for practical reasons, investments for protection returns are often invested in the same way as other investments. The question is whether active investments, in terms of nature and objective, should be invested in the same way.

Table 1
Policy areas requiring attention for active management under the Wtp

Area	Core question	What this tests	Pitfalls	Attention-areas*
1. Justification Which policy	objective justifies the deviation from the broad market? Is this financial, sustainability-related, identity-driven, or risk-driven?	Whether there is a concrete, pre-identifiable one is a reason to deviate, and not “because it is possible”.	The objective cannot be traced back to one of the four categories, or multiple objectives overlap without clear priority.	A, d, e
2. Risk consistency	Does the active risk fall within ALM, risk attitude and cohort assignment?	Whether the risk of the deviation has been modeled and fits within the established risk attitude, per cohort.	The risk is not (properly) modeled in the ALM, or the outcome falls for specific cohorts outside the risk assessment.	B, c, e
3. Feasibility	Is the choice feasible at reasonable cost?	Whether the expected added value outweighs the costs of construction, maintenance, and monitoring.	The costs structurally reduce a substantial part of the expected added value, or the execution requires expertise or additional capacity.	C, a, e
4. Explainability	Is the outcome explainable if it is temporarily disappointing?	Whether the board has a clear narrative for participants and the supervisor prior to implementation in the event of disappointing results.	The only explanation for setbacks is technical or defensive, rather than attributable to the predetermined objective.	D, a, e
5. Exit and adjustment	Is it clear in advance when adjustments will be made or when to stop?	Whether concrete, measurable criteria have been agreed upon based on which the board reassesses the choice.	There are no predefined recalibration moments or criteria, meaning adjustments only take place ad hoc under pressure from disappointing results.	E, c, d

Primary **focus areas** are always capitalized and **in bold.** A = Policy and investment beliefs; B = ALM, SAA and risk appetite; C = Mandate, liquidity and governance; D = Reporting and communication; E = Monitoring and decision-making
Source: Montae & Partners

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can be treated within the solidarity reserve and

'General' return portfolio. After all, the solidarity reserve may have a much shorter duration, meaning that interim underperformance can have undesirable consequences. This is a subject that might not immediately come to mind, but does require managerial consideration and justification.

ACTIVE MANAGEMENT AND THE FPR

The defining characteristic of the FPR—a fully individual pension asset—leads to a direct relationship between the return achieved and the individual assets. This means that both positive and negative results on active investments come under close scrutiny. Explaining negative results, in particular, can pose an additional challenge for pension fund boards, especially when the investment horizon of the active investment is longer than the reporting frequency. A negative short-term result can weigh more heavily for a participant than the expected positive return in the long term. This requires targeted and consistent communication from the board regarding the rationale behind active investment choices and the expected long-term added value.

ACTIVE MANAGEMENT UNDER BOTH SCHEMES

Active management costs are always a sensitive point in discussions with participants. The pension fund would do well to explicitly communicate returns after costs. This makes it clear whether the investment has truly paid off for the participant. It requires skill not to decide in advance on passive mandates in the various investment categories and to wrongly disregard the benefits of successful active products due to communication complexity.

MAKE ACTIVE RISK EXPLICITLY VISIBLE

Another point of attention is liquidity management at the portfolio level. Liquidity management across different life cycles can cause additional complexity and, consequently, an increase in costs. The extent to which this plays a role can vary in practice. Additionally, there is a lack of risk sharing, making it more difficult to adjust the investment policy. From a liquidity perspective, active management may be less desirable in this regard under the FPR.

In summary, there are operational requirements that could lead to the allocation to active investments coming under pressure under the FPR, because it is simpler and cheaper to invest less actively. Additionally, the Wtp already entails more communication obligations towards participants.

Active management further increases this communication burden, as the added value and associated costs must be explicitly accounted for. Moreover, active management must not conflict with the risk appetite of participants in the different cohorts.

ACTIVELY MANAGING (CUSTOMIZED) BENCHMARKS

Under the FTK, the benchmark primarily served as accountability.

investment instrument within a collective framework, with the funding ratio and fund return as central metrics. Under the Wtp, results are assessed based on multiple metrics that differ between SPR and FPR and between cohorts. Life-cycle investing and the allocation of pension assets reveal divergent risk profiles and results per cohort. This calls for greater transparency regarding deviations from the broad market while simultaneously providing scope for a distinctive investment policy and a unique fund identity. Furthermore, risk headroom is no longer limited by the collective funding ratio and Required Own Capital, allowing the investment policy to differentiate further.

Moreover, various funds are already following such an approach because they wish to formally embed specific strategic choices in the portfolio. Examples include ESG screenings, sector exclusions, or style preferences. Defining a custom benchmark therefore makes the underlying choices clearly communicable to stakeholders and implementers, and furthermore, replicating such a benchmark can be done at relatively low implementation costs.

Benchmark as a policy instrument

Under the Wtp, the benchmark becomes more than a yardstick for relative performance. Pension fund boards can choose to define a custom benchmark that establishes in advance which portfolio characteristics the board consciously selects, such as risk, sustainability, and deviation from the broad market. In doing so, active management shifts partly from execution to policy: the portfolio follows the custom benchmark as closely as possible, while the choice of that benchmark itself is an explicit board decision.

EXPLICITLY LIMIT ACTIVE RISK

Custom benchmarks make visible where and how much activity risk the fund is willing to take. The board must substantiate.

why there is a deviation from the broad market, what tracking error is acceptable, and how this aligns with risk appetite, ALM, and life-cycle design.

ACCOUNTABILITY REMAINS NECESSARY

Even if the execution is operationally passive, accountability remains required regarding the return effect of the customization choice. Funds must be able to explain how the choice of benchmark impacts the broad market and how those effects differ per cohort or life cycle. In doing so, the benchmark forms the link between policy, implementation, reporting, and participant communication.

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SIGNIFICANCE OF CUSTOMIZED BENCHMARKS FOR ALM AND RISK ATTITUDE If the strategic active choice is captured in the benchmark, the active risk embedded therein must also be consistent with the ALM study and the associated risk attitude per cohort. If this does not happen, a blind spot arises.

This blind spot arises because ALM studies in practice are often fed with traditional market indices. A custom benchmark deviates from this by definition and thus implicitly adds active risk that is not automatically included in the modeling. The consequence is that scenario outcomes, and thereby the picture of the risk appetite and the composition of the portfolio, are based on a reference that does not correspond to the portfolio actually held by the fund. The outcomes then provide a distorted picture, after which decisions are made based on incomplete information. Even worse: in an extreme case, it may be incorrectly concluded that the policy fits within the Wtp risk appetite. Precisely the risk that the board consciously chose is then missing from the study with which the fund substantiates the strategic allocation, determines the risk profile per cohort, and tests whether the simulated pension outcomes in favorable and unfavorable scenarios still fit within the established risk appetite.

This requires alignment between ALM, policy, and implementation. It is no longer a matter of three separate tracks, but of one coherent whole in which the benchmark selection, risk frameworks, and implementation are aligned.

THE BECHMARK IS POLICY INSTRUMENT

At the same time, this raises the question of how to deal with this in practice. Ideally, a fund incorporates the custom benchmark directly into the ALM, so that active risk is weighed integrally. In practice, however, this is difficult: custom benchmarks cannot always be easily translated into the building blocks of an ALM model, partly due to a lack of representative historical data.

The solution therefore lies in a middle ground. It is crucial that active risk is explicitly modeled, even if only approximately, so that it facilitates board decision-making rather than remaining out of sight. Where possible, deterministic climate scenarios, for example, can also be included, as sustainability and climate impacts are increasingly becoming part of policy.

A workable compromise is to execute the ALM traditionally at its core, based on standard indices, and to explicitly allow room for deviation within that framework by means of a certain tracking error. It must, however, be clear.

how those spaces operate per cohort. Within this framework, the customized benchmark can express its characteristics, while the board retains a manageable and consistent model framework. In this way, active risk is limited and made visible, without the need to fully replicate the customized benchmark in the ALM model.

Consequently, steering shifts from a single key performance indicator to the interplay between the benchmark, ALM, and risk frameworks. Tracking error remains relevant, as does the analysis of outcomes in worst-case scenarios. These performance metrics show how much the portfolio deviates from the benchmark and how much risk is being taken, but not whether the portfolio aligns with the policy and risk appetite. The core question therefore becomes: do the benchmark, ALM, and risk frameworks align with one another? Moreover, this interplay must be traceable in the accountability reports

The practical implication is that, after structuring their Wtp portfolio, pension funds must also reassess the allocation within investment categories, specifically whether it conflicts with the allocated scope. Within the new life-cycle context, the benchmark choices and active mandates must

be re-evaluated against policy, risk budget, explainability, and reporting. These are not one-off actions during the transition, but matters that must be repeated regularly. This shifts the focus from the implementation of the Wtp to the functioning of the portfolio within the new system.

CONSEQUENCES FOR REPORTING AND COMMUNICATION If a customized benchmark is chosen, reporting and communication must be aligned with it, both towards supervision and the board and towards participants.

REPORT ON POLICY CHOICES MADE

With custom benchmarks, reporting shifts from solely relative performance to insight into the pre-selected benchmark characteristics and the active risk inherent therein.
In addition to the portfolio's return relative to the custom benchmark, it must therefore also be visible what the custom benchmark itself has added or cost relative to a broad market index.

IMPACT PER COHORT OF LIFE CYCLE

Under Wtp, a total return at the fund level is insufficient. Benchmark choices have different effects on cohorts and life cycles via protection return and excess return.
Reporting must therefore demonstrate whether the outcomes per group still align with the risk appetite and previously made policy choices.

EXPLANATORIBILITY TOWARDS PARTICIPANTS

Participants see their pension assets move more directly and will primarily want to understand why this is happening. Communication should therefore not technically explain whether the benchmark has been followed, but clarify which choices have been made, how they have worked out, and why they fit within the policy.

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In this way, policy, benchmark construction, reporting, and participant communication are aligned.

Communication is therefore becoming more explicit and detailed, but this does not mean that active management must be avoided under the Wtp: if a fund can convincingly substantiate that an active choice adds value, aligns better with the participant population, or fits the fund's identity, it may actually be undesirable not to make that choice.

It is important, however, that with custom benchmarks or active management reporting, one does not have to look for explanations only after the fact. Pre-agreed attribution rules are necessary: what portion of the result is due to market movements, benchmark choices, manager selection, ESG or exclusion policies, interest rate hedging, or life-cycle allocation. This makes accountability more consistent and prevents communication from becoming ad hoc in the event of disappointing results.

EXPLANATORIZABILITY BEGINS BEFORE IMPLEMENTATION

Choices regarding sustainability, impact, sector orientation, investments close to the fund's own participant base, or a specific risk appetite are not only technical portfolio choices but also ways in which a fund becomes recognizable to participants and employers. This can be a legitimate reason to deviate from a broad market index, provided the choice is financially responsible, explainable, and consistently executed.

ACTION PERSPECTIVE

Pension funds that wish to continue investing actively, or are considering active investing after the transfer, must take into account a number of important points.

- **Clearly define active management.** Make this clear distinction between strategic benchmark choices, tactical allocation decisions and active execution.
- **Determine where active risk is consciously taken.** Determine in which investment classes, cohorts, or life cycles active risk is appropriate, and where passive or simpler management is preferred.
- **Assess the choice against the risk appetite and ALM.** Ensure that active management, in whatever form, aligns with the risk appetite and that active risks are visible in scenarios and risk budgets.
- **Limit and monitor the active risk.** Maximum allowable tracking errors can help here, provided there are also predetermined escalation limits and evaluation or corrective action points.
- **Arrange reporting and attribution in advance.** Before implementation, agree on how results will be broken down by market development, benchmark selection, manager selection, costs, sustainability, and life-cycle allocation.
- **Make the communication strategy part of the decision.** Even in the event of disappointing results, the board must be able to clearly explain why certain choices were made previously, and how they contribute to the pension outcome or non-financial goals.

CONCLUSION

The Wtp does not change the economic advantages and disadvantages of active management, but makes its consequences more visible and potentially different per life cycle and cohort. This calls for a sharp distinction between strategic benchmark choices, tactical decisions, and active execution. Tailor-made benchmarks, in particular, deserve attention: operational passive execution may contain active risk that is not automatically visible in the ALM.

The central question is therefore not whether active management under the Wtp becomes more or less desirable, but whether every deviation from the broad market has been consciously chosen, demonstrably aligns with the risk appetite, and remains explainable even in the event of disappointing results. Only then do policy, ALM, execution, monitoring, and communication form a single consistent whole.

Notes

1 including Fama, EF & French, KR (2010). Luck vs. Skill in the Cross-Section of Mutual Fund Returns. Journal of Finance

2 including MSCI and other index providers, Bloomberg, Chief Investment Officer (CIO) special coverage (2025) Custom Benchmarks and Performance Management

3 https://www.montaepartners.nl/content/de-wtp-als-kantelpunt-what-changes-for-pension-funds-and-what-doesn't/