

Pension reform in The Netherlands

Mark Irwin | May 11, 2023

Public



From pension alert to pension agreement

2008 - 2019



What was in the pension agreement?



Slower increase National Old Age Pension Act-age ([link](#))



Maximum of 10% of value old age pension




Working people without pension plan

But the biggest change is that...

Law future of pensions

All pension plans need to be revised!



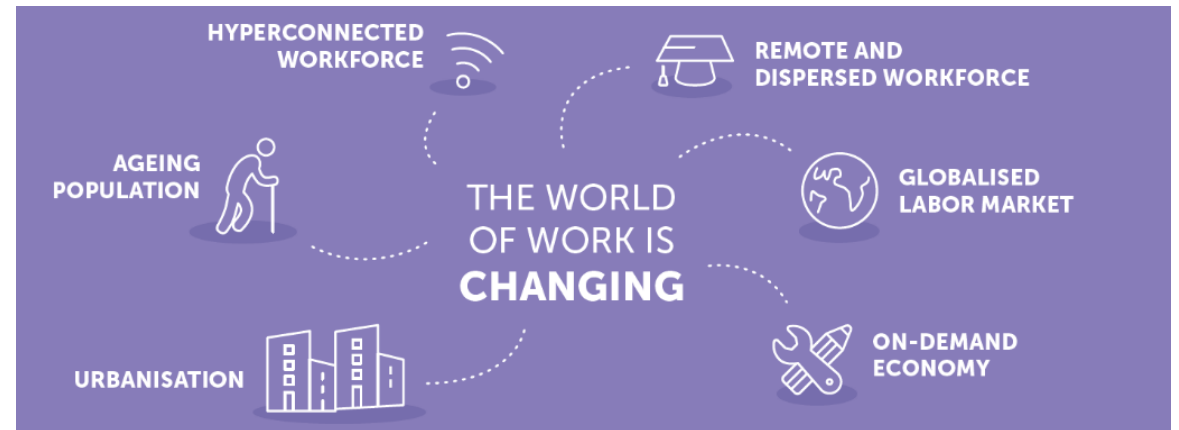
Pension Plan

[ˈpen(t)-ʃən ˈplæn]

An employee benefit that commits the employer to make regular contributions to a pool of money that is set aside in order to fund payments made to eligible employees after they retire.

 Investopedia

Why the need for new pension system?



Pension funds unable to compensate for inflation.

People no longer work for same employer all their life



From Defined Benefit to Defined Contribution

No more promises

DB



DC

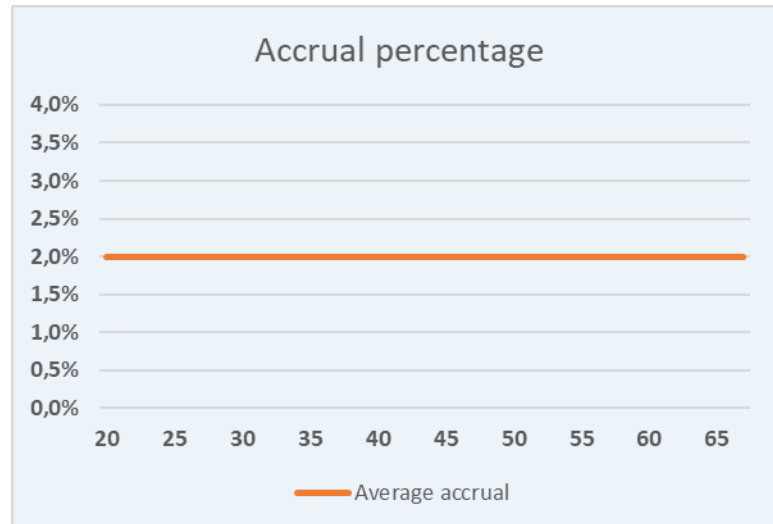
- Benefit is (more or less) certain.
- One collective pension capital for all participants in a pension fund.
- Indexation or cuts of accrued pension rights are based on the funding ratio of the fund.
 - And complex rules!

- Contribution is certain. The eventual pension benefits are not.
 - No more promises!
- Participants have a personal pension capital within the fund.
 - Contributions by employer and/or employee are added to the capital.
 - After retirement benefit payments are extracted from the capital
- Benefit payments are connected more directly to events in the economy.

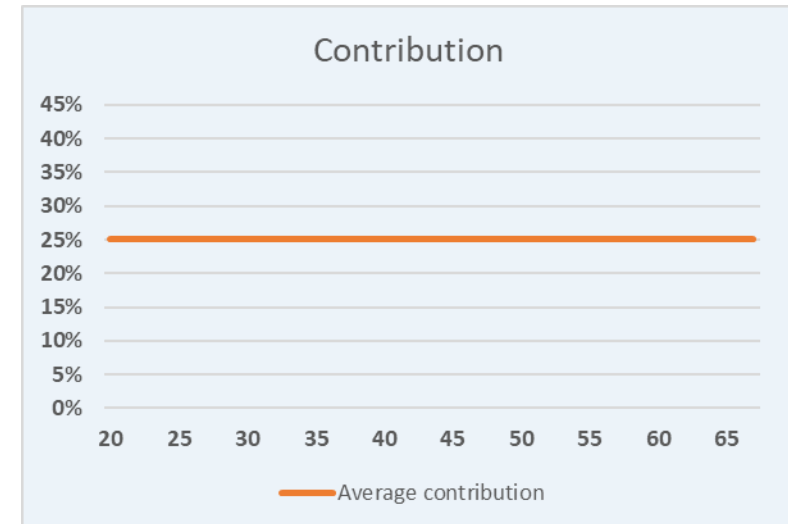
From average accrual to average contribution

Changing workforce

Current system



- Yearly accrual = $x\% \times \text{pensionable salary}$
- E.g. accrual percentage = **2%** and pensionable salary = **€ 10.000**
 - Accrual = $2\% \times € 10.000 = € 200$

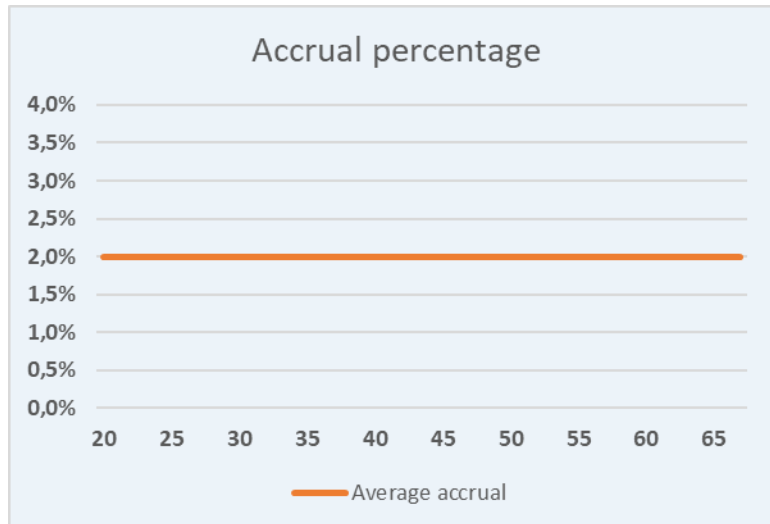


- Contribution is same for everybody. And related to salary or pensionable salary.
- However, ...

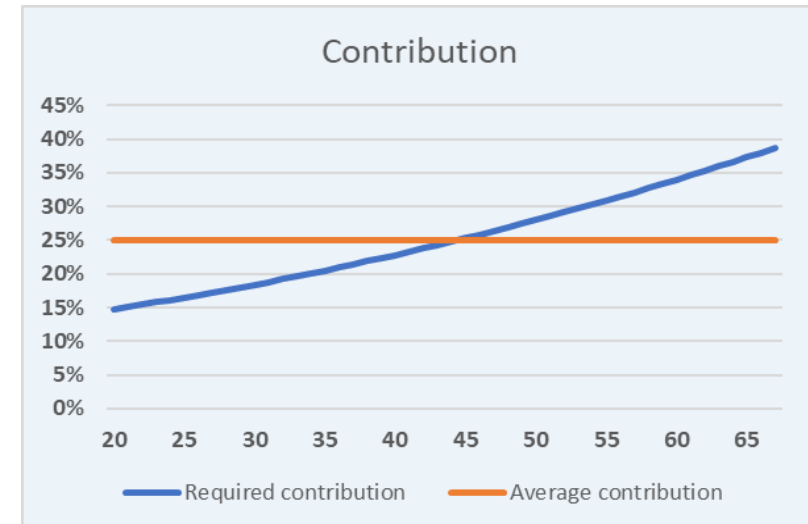
From average accrual to average contribution

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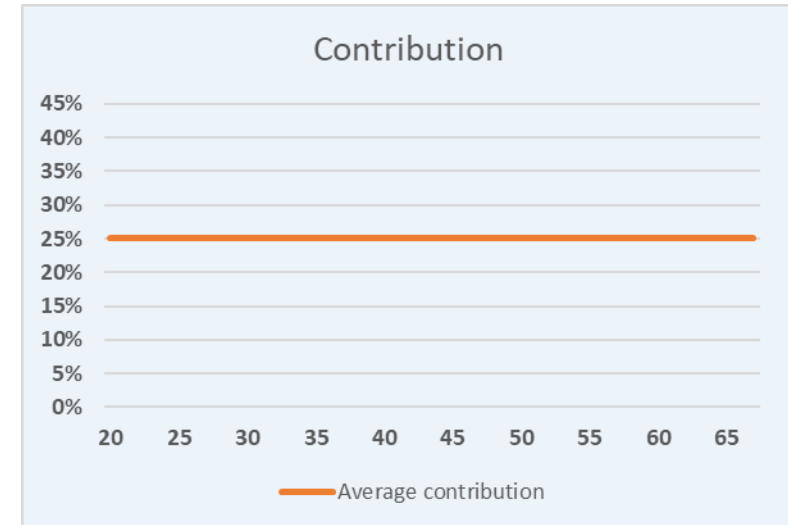
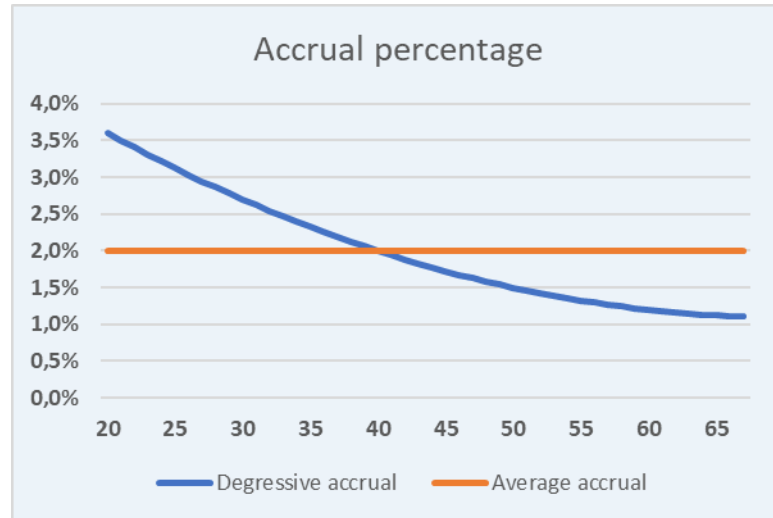


- Contribution is same for everybody. And related to salary or pensionable salary.
- However, required contribution is dependent on age.
 - If, expected return is 4%, then cost of € 1.000 at age 68 is:
 - € 185 for 25 year old
 - € 731 for 60 year old

From average accrual to average contribution

New system

New system



- Contribution is same for everybody
- ➔ Accrual is higher for younger people

So why is this change taking so long?



DC with a twist



Compensation



Conversion accrued rights



Complex elements added to “simple” system

- In its core DC is simple:
 1. Contributions are paid and added to a personal pension capital
 2. Personal pension capital is invested (life cycles) and returns are made on investments
 3. From retirement age on pension benefits are extracted from the personal pension capital
 - This is actually already a little bit different from “classical” DC where the pension capital is used to buy a lifelong annuity
- However,...

Complex elements added to “simple” system



- Not one, but two DC-systems
 - Collective premium agreement (CPA)
 - Flexible premium agreement (FPA)



- Collective risk sharing elements added
 - CPA: Solidarity reserve
 - FPA: Risk sharing reserve



- Multiple different policy options:
 - Loan restriction
 - Theoretical or “practical” hedge returns
 - Projected return
 - Smoothing of results

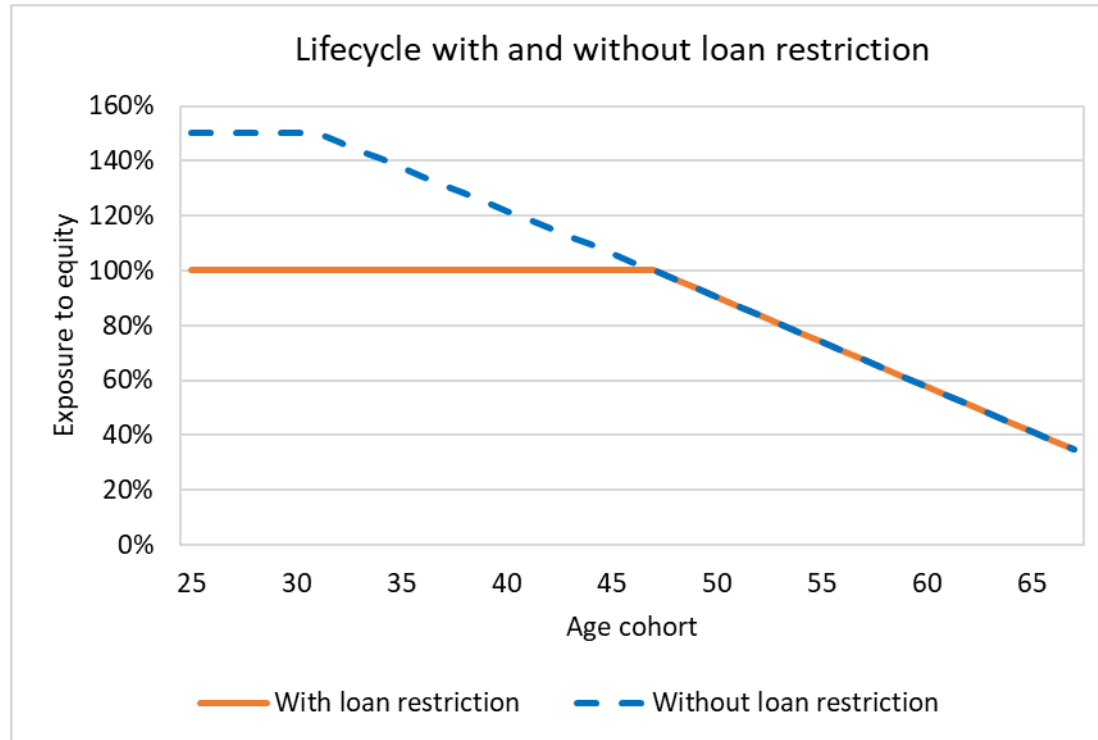
○ Ortec Finance is partially to blame for all this complexity by coming up with smart ideas...



Public

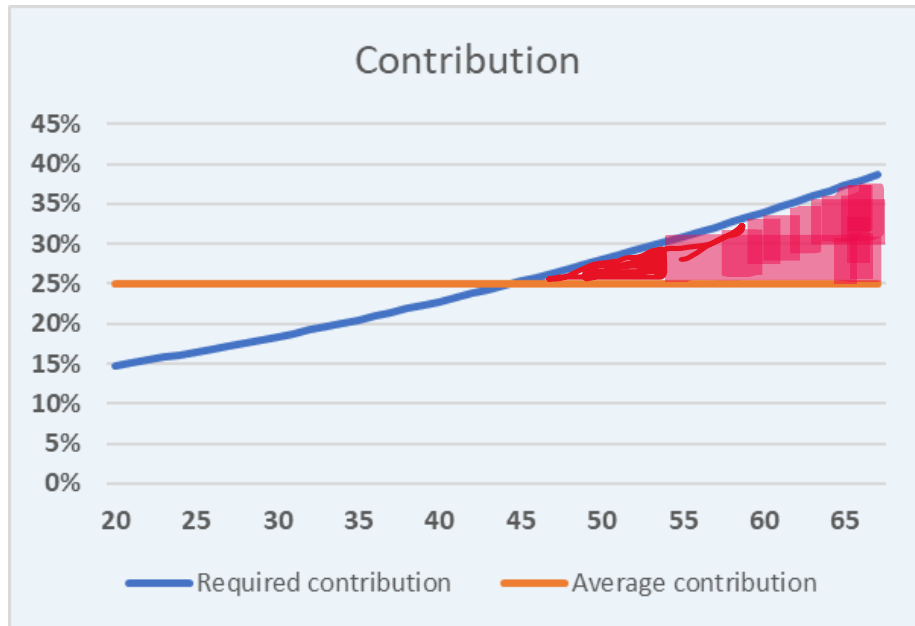
Complex elements added to “simple” system

Loan restriction



- In CPA it is possible to give younger participants an exposure to equity of more than 100%.
- Idea is based on life cycle theory
- As a result of political discussions the maximum exposure is 150%
- In indicative calculations by the Dutch Central Bank an exposure of 1600% was applied!
 - This was deemed unacceptable.

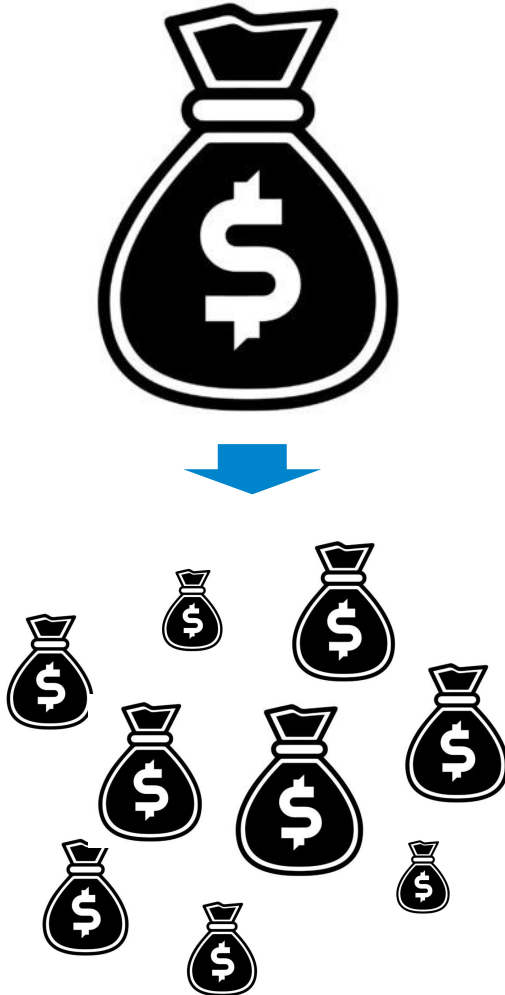
Compensation for abolition of average accrual



- Older participants have contributed to average accrual system when they were young.
- Now, just as they are about to profit from this system it is changed. And they will no longer profit from younger participants.
- Need for compensation!
- Estimated costs for compensation are between € 40 bln and € 100 bln.
 - Who is going to pay for this???



Conversion of accrued pension rights



- Total collective capital needs to be divided into:
 - Personal pension capitals of participants.
 - Collective reserves (e.g. solidarity reserve)
- How to distribute the capital fairly???
 - What is fair?
 - Use it for compensation abolition average accrual system?
 - Use it for compensation missed indexations?
 - What to do when funding ratio is below 100%?
 - Will the participants understand and accept the chosen distribution?
- Thousands of lawsuits expected...



Current state of legislation

- Proposed bill is being discussed in Eerste Kamer (Senate)
 - In 2019 the plan was that new rules would apply as of January 1, 2022
 - Plan/hope now is July 1, 2023
 - Multiple year transition period for all plans to be made compliant. January 1, 2027?
- Historic discussions. More than 1.000 questions have been asked by Senate!
- Vote in Senate is planned for May 30, 2023.



Will “she” make it over the finish line?





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