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Helping you manage the impact of pension reforms in the Netherlands

Summary upcoming legislation based on Pension Agreement

Introduction

On 12 June 2020, the Dutch Government and social partners have reached an agreement on the elaboration and details of the pension reforms in the **Pension Agreement** ("Pensioenakkoord"), as broadly agreed on 5 June 2019. In this document, we will summarise the most important details of this elaboration which will result in a full new package of pension legislation. Our minister of Social Affairs has sent an extended letter with the pack of details to the parliament.

The value of the accrued pension rights under the current system tops EUR 1,700 million. The new pension system aims to make the pensions more sustainable and less dependent of the ultralow interest rates. Another aim is to decrease the level of certain ways of solidarity. Given these aims, the introduction of the new system will bring a lot of debates between several stakeholders to reallocate contributions, risks and accrued rights. In this document, we present a high level overview of the new system and the challenges that all stakeholders phase in the transition to the new pension system. We generally advise parties to prepare for this transition and to start to work out the strategy as soon as possible, since there are several difficulties to be bridged during the conversations to step into the new system as smooth as possible.

New pension legislation

The new pension legislation is meant to be applicable on January 1, 2022. All pension contracts must comply with the new legal and tax framework no later than 1 January 2026. The legislator will facilitate that contracting parties can switch to the new system earlier than 1 January 2026 through a transition period between 2022 and 2026. It will be a major operation to first get all relevant details into both the pensions legislation and to amend all pension contracts within a relatively short period of time. This hasn't been done before in the history of Dutch employment and pension legislation.

The most important measures from the Pension Agreement

State pension (first pillar)

The amendments in the state pension (AOW; first pillar pension) have already been adopted. In the original document in 2019 was already foreseen in a decrease of the rate in which the pensionable age was increased. This has been implemented in the legislation per 2020 already.

Employer's pension (second pillar)

- The introduction of the Pension Agreement creates two types of permitted pension contracts. These are both DC-contracts and it is mandatory for pension funds to offer one of these two DC-contracts. Defined benefit contracts are no longer allowed

The first option to be offered is what is simply called "the new contract"; the second option is a revised variant of the current 'improved' DC-contract that also foresees in collective investments during the decumulation phase, currently called in Dutch *"verbeterde premieregeling"*. This contract is called the 'improved+' variant.

Both are DC-contracts with a flat rate contribution with some kind of risk sharing (see addendum for more details):

'The new contract'

The level of contributions for the employer is set at a certain percentage of the pensionable salary. There is no relationship between the benefit and the income. For each participant, a part of the collective assets is reserved for his distribution. Returns are allocated on an age-dependent basis. A solidarity reserve is also being formed (thus, this can only be executed by a pension fund); the calculation for the share of the employee is calculated via a 'projection method' and not via an interest method. There is no additional risk for the employer; his liability is maximized to pay the contributions. The allocated amount for the individual (contributions and roi) remains invested after the retirement age, so that the amount of the benefits varies. A fixed benefit level is not possible in the accrual phase. This type of contract has less elements of a proper individual DC-contract and is more comparable with a 'collective DC' variant.

The 'improved+ variant'

The level of contributions for the employer is set at a certain percentage of the pensionable earnings. There is no relationship between the benefit and the income, but the participant has his own pot of money. The risks are worn by the individual participant, but are shared to some extent by means of a solidarity reserve. This solidarity reserve is filled from premiums and excess returns. This type is called the 'improved +' variant, because it is similar to the current 'improved DC' contract that is one of the choices for DC-contracts in the current system. With the word 'improved' is meant that the new contract provides with a proper decumulation investment option. The 'traditional' DC-contract provided with DC-accrual without an investment option in the decumulation phase, but only with a fixed annuity. The 'improved +' variant is based on the 'improved' variant, but has some added elements of solidarity.

Continuation of current DC-contract

In addition to these two contracts, insurers and premium pension institutions ("PPI") can still opt for an individual premium scheme, in which this risk-sharing does not recur.

So there will be effectively three different types of DC-contracts!

- The average contribution (age-independent) as defined benefit schemes have now, will be replaced by a certain percentage of age-independent contributions. The big differene will be that this contribution buys decreasing entitlements. The only exception will be made for current participants in defined contribution schemes. Their progressive premium (increasing premium per five years as current DC-contracts have) can be continued. This only applies to the current employees of an employer who offers the defined contribution scheme at the date of the introduction of the new system. The statutory maximum premium applies to new employees.
- The Pension Agreement refers to the so-called "double transition". First, the average system is abolished and then the old entitlements and rights must be transferred to one of the two new

pension contracts in the new system. This is called "entry" and is the default option. It is possible not to transfer the old rights to the new system, if it can be motivated that entry leads to unbalanced outcomes for stakeholders/scheme members. This could include the protection of a top-up obligation of the employer

Sustainable employability

- It will be fiscally possible to save a hundred weeks of leave without a direct tax instead of fifty weeks which is currently allowed
- Under certain conditions, a (partial) exemption from the "RVU-levy" is possible between 2021 and 2026. This RVU levy is a tax pension for offering an early retirement scheme

Other measures from the Pension Agreement

- There will be a legal option to include a one-off payment of ten percent of the pension assets at the pensionable age
- By default, the survivor's pension will only provide risk coverage and will no longer be on an accrual basis. The basis for the amount of the survivor's pension is the entire income, not just the pensionable salary; nor will it be limited to the actual years of service with the current employer

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What does this mean to the market?

When the new legislation as a result of the Pension Agreement is implemented, all kind of contracts have to be renewed:

- The pension contract, as part of the employment relation, between employer(s) and employees:
  - For the future accrual; there are two options for new accrual and in some cases can also be opted for continuation of the current DC-contract for existing employees
  - For the transfer of the accrued benefits to the new contractual environment
  - Whether compensation will be offered for the delta between the old accrual and the accruals under the new system. For employees in the age between (in average) 35-55, the new system may be worse off compared to the accruals under the current system. This is mainly a huge topic in (mandatory) pension funds with an average contribution and DB-accrual. The current text of the Pension Agreement and the newly published documents show the need for compensation; however, there is no (legally obliged) solution for the question, who is going to pay the invoice for this compensation.
- The execution or administration contract between employer(s) and pension institution (pension funds, PPI's and insurance companies).
- The transfer from the current system to the new system. Currently, all accrued pension fund benefits are (more or less) guaranteed; in the new system, there is no guarantee anymore. Social parties have to negotiate on sectoral level or on corporate company level on the way forward with the transfer. The current text of the Pension Agreement and the newly published documents show the need for this transfer into the new system; however, there is no (legally obliged) solution for the question, who is going to pay the invoice for this transfer.

So employers, pension funds and pension insurers must each make an analysis for their own organisation how they will shape the transition and the compensation. We foresee that this will take a lot of time since the legislation will be very complex.

It is of great importance to pension providers that they inform their participating employers and members about the choices they make for the future of their scheme.

Pension funds will also have to take a critical look at the valuation of the previously accrued entitlements and the way in which these rights are transferred in the new system. In addition, there will be funds for which entry is not necessarily the best option. These funds can explore their options for not transferring the under the current legislation accrued rights to the new system.

There are big opportunities for pension insurers and premium pension institutions (the so-called PPI's) and for foreign entrants to improve their position in the market, partly because they already have more experience in offering and administering DC-schemes.

Employers will need to have a clear vision and strategy of how they envision future pension accrual for their employees, as well as whether they want to compensate for any deterioration in their pension. In addition, the employee representation will have to be properly informed and advised to ensure that they agree to the employment condition change resulting from the change in the pension scheme. It is also important that the employer discusses his choices regarding compensation with the pension provider in good time if the employer wishes to compensate within the current pension scheme. In some situations, compensation can also be designed outside the pension sphere, in the broader package of benefits.

Addendum

	Individual DC	**CDC**
	('DC improved & variant')	**('the new contract')**
Cumulation and decumulation phase	*separated*	*Integrated: one collective pot*
% contribution	fixed percentage, calculated to a projected level of benefits at retirement age; limited by tax legislation	fixed percentage; calculated to a projected level of benefits at retirement age; limited by tax legislation
Pension pot	*individual; slow transfer to a (kind of) collective pot is possible in the course of retirement age*	*share in collective pot*
Investment strategy	*Individual investments with mandatory life cycle and individual alternatives; transfer to collective investments as option in the course of retirement age*	*Collective, no individual options*
ROI allocation	*On individual base, based on life cycle by default*	*Share in collective returns, based on upfront fixed sharing rules dependent of age of the participant*
Right to shop for best provider in decumulation phase	*Yes*	*No*
Duration annuity in decumulation phase	Lifelong	Lifelong
Type annuity	*fixed of variable*	*Variable*

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