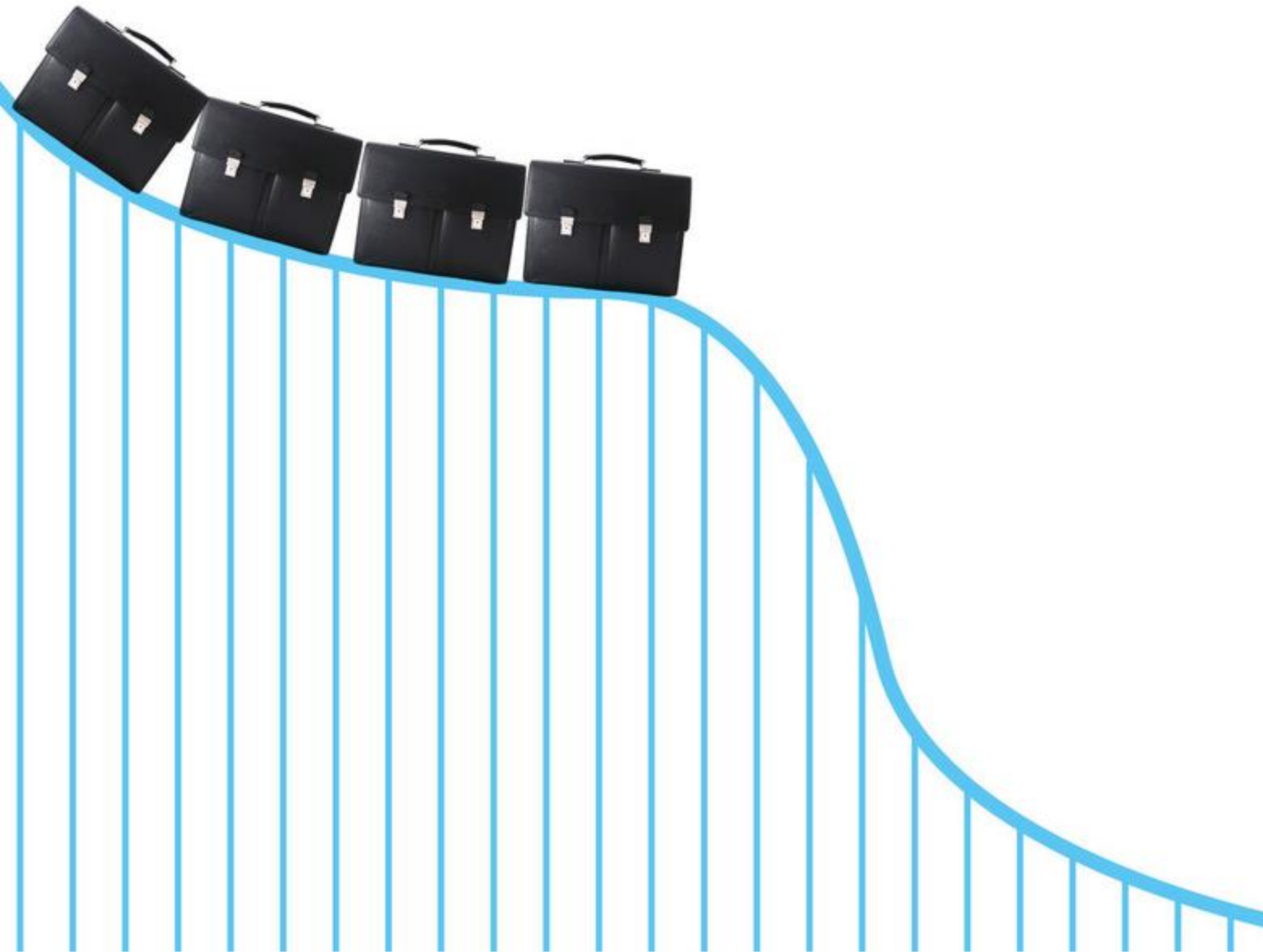
EVERSHEDS SUTHERLAND

Coming down the track

Upcoming legislation based on the Pension Agreement ("Pensioenakkoord")



Contents

Introduction

On 12 June 2020 the Dutch Government and the 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 has resulted in a full new package of pension legislation. Our minister of Social Affairs and Employment has sent an extensive letter with the pack of details and the explanatory memorandum to parliament.

The value of the accrued pension rights under the current system tops EUR 1,700 billion. The new pension system aims to make pensions more sustainable and less dependent on the ultra-low interest rates. Another aim is to decrease the level of certain ways of solidarity. Given these aims, the introduction of the new system will cause a lot of debate 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 face in the transition to the new pension system. We generally advise parties to prepare for this transition and to start to work out their strategy as soon as possible, since there are several difficulties to be overcome, in order to step into the new system as smoothly as possible.

New pension legislation

The new pension legislation was meant to be applicable on 1 January 2022. On 10 May 2021 the minister of Social Affairs informed parliament that this deadline will not be met. The details of the new pension system have been elaborated in a draft law, called the 'Future Pensions Act'. The minister published the draft for consultation just before Christmas 2020. This consultation has led up to 800 responses. In view of the great number of reactions, the minister concluded that this draft legislation underlines the great social involvement and value to improve the act and decided that the new pension legislation is postponed with one year and will be applicable on 1 January 2023. However, certain elements of the new legislation have been taken out and have already been brought to the parliament. We will explain these elements later in this document.

With the introduction of the new pension legislation, all pension contracts must comply with the new legal and tax framework no later than 1 January 2027. The legislator will facilitate that contracting parties can switch to the new system before 1 January 2027 by way of a *transition period* between 2022 and 2027. It will be a major operation to include all relevant details into 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 a decrease of the rate in which the pensionable age was increased was already foreseen. This has already been implemented in the legislation per 2020.

Employer's pension (second pillar)

The introduction of the Pension Agreement creates two types of permitted pension contracts. These are both Defined Contribution-contracts (hereinafter: DC-contracts) and it is mandatory for pension funds to offer one of these two DC-contracts. **Defined benefit contracts, like most pension funds in the Netherlands currently execute, are no longer allowed.** Next to the new contracts, there are two options to continue certain contracts that are currently executed, by a way of transition. In total, there will be 4 different options for social partners to choose from.

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. The third option is the existing premium capital agreement. Finally, the fourth option is the existing benefit agreement.

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

Option 1: '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. This immediately makes clear for the participant how much capital is available for their own pension provisions. 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 payment of the contributions. The allocated amount for each 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.

Option 2: 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 capital that is built is converted into a lifelong annuity. The investment policy is mandatorily based on life-cycle. 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 a proper decumulation investment option. The 'traditional' DC-contract provided 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. Social partners can determine that variable benefit becomes default. However, the participants retain the option of choice for a fixed benefit. Next to the two new contracts, in certain cases employers will be allowed to continue the current pension contract for a limited period of time.

Option 3: Continuation of current DC-contract

In addition to the two new contracts, insurers and premium pension institutions ("PPI") can still opt for an individual premium scheme, in which this risk-sharing does not recur. The main difference with the new contracts is that the participant immediately profits from return on interest on an individual base; however, the participant will not profit from a solidarity reserve in case of negative investment results.

Option 4: the existing defined benefit agreement

In this option, the employer is allowed to convert the contributions into an entitlement to a fixed annuity as of the retirement date. The investment and longevity risks involved in this option are taken over by the pension administrator (and have to be paid, so this will be a very expensive option).

So there will be effectively four different types of DC-contracts! However, the explanatory memorandum clarifies that option 1 and option 2 will be accessible to all pension providers, while options 3 and 4 are only allowed for insurers and are considered transitional. The legislator will only allow the continuation of one of these two options on an exceptional basis. The pension providers are not allowed to introduce these two options as a new pension scheme.

The average contribution (age-independent) as defined benefit schemes have now, will be replaced by a certain percentage of age-independent contributions. With this change the minister aims to stabilize the contributions and offer the older participants security for finding or keeping their job without facing difficulty regarding the costs involved. But also the aim with this choice is to achieve a longer average investment period for each Euro that is being paid for the contribution. The big difference will be that this contribution buys decreasing entitlements. The only exception will be made for current participants in defined contribution schemes. Their progressive premium (automatic increasing premium per 5 years that current DC-contracts have) can be continued. This only applies to the current employees of an employer who has been offering a 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 will be 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 will lead to unbalanced outcomes for stakeholders/scheme members. This could include the protection of a top-up obligation of the employer.

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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 penalty for offering an early retirement scheme.

Consequences of late agreement

There will be a number of consequences if social partners do not reach an agreement in time. The main consequence is that pension institutions will no longer execute the current schemes. However, to stop the pension 'promise' of the employer, individual consent of each employee is needed. No consent means: the employer has to continue the pension scheme, but no pension fund will execute it. The risk that this will happen and the financial consequences thereof weigh heavily on the employer; generally spoken, we don't expect that the employer can defend by invoking unforeseen circumstances, since employers have been able to start up the transition many years before. Therefore, we strongly recommend to start the transition process as soon as possible and not to wait for the finalisation of the legislative procedure.

Three stages of transition

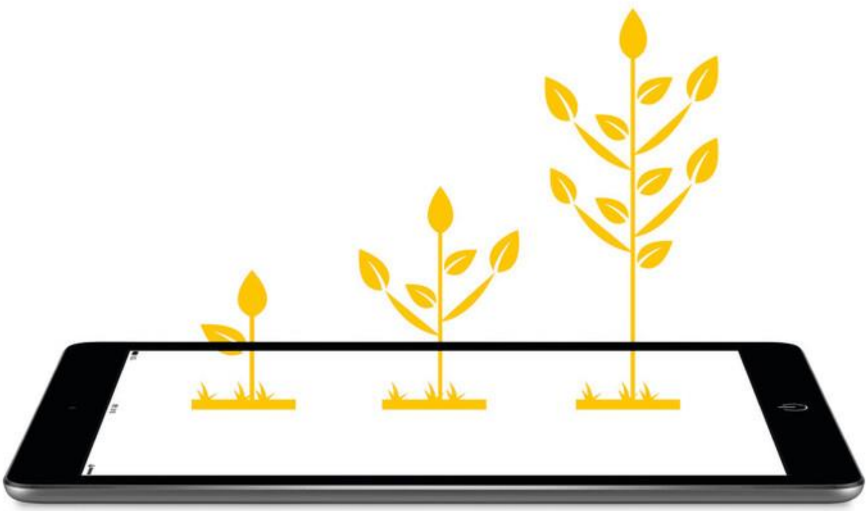
The transition of the new legislation consists of three stages:

1. The employment conditions phase. In this stage social partners make agreements subject to conditions of employment concerning modification of the pension scheme.

2. The employment conditions are housed by a pension provider and an implementation plan is drawn up.

3. Implementation phase.

The planning on the next page shows the timetable of these stages.



	2022				2023				2024				2025			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Employer																
Social Fund Board																
Social partners																
Pension Fund bodies																
Advisors																
Administrators																
	Employment phase								**Reach agreement**		**Implementation**					

Transition plan

Social partners are obliged to make agreements regarding the pension scheme. These agreements should be transparent to employers, employees, former participants, former partners and pensioners. The choice for a new pension scheme and considerations with insight of the advantages and disadvantages compared to the current scheme must be laid down in a **transition plan**. Employers are obliged to draft or have it drawn up when there is an pension agreement with an employee on 31 December 2022.

The transition plan mandatorily must contain at least the following elements:

- the nature of the new pension scheme (according to the mentioned options);
- information concerning the existing pension entitlements and pension right and the considerations on which they are based;
- an overview of the effects per age cohort of the transition to the new pension scheme. These effects will be calculated based on by law given criteria;
- the agreements regarding eventual compensation per age cohorts;
- a financial plan for the compensations of the age cohorts (how is the employer going to fund the compensations);
- as far as applicable (only in one of the two new contracts), the agreements about the initial filling of the solidarity reserve.

The works council of a company has to consent the transition plan.

As mentioned before the Pension Agreement knows double transition. The first transition has been discussed. The second transition is the entry of the existing pension entitlements and rights. The existing pension entitlements and rights will be transferred via a collective value transfer. However article 83 of the Dutch Pension Act consist a right for every pensioner or person entitled to a pension must give the opportunity to object to the proposed collective value transfer. This right might cause a potential obstacle.

With the introduction of the explementary memorandum three conversion methods are available. The first possibility is value based ALM-method. The second method is the standard method. The final method is granting a variable pension benefit after the transition.

Co-determination employment contract

The explanatory memorandum of Future Pension Act established the right to co-determination in employment terms.

When the agreements between an employer and employers' and employees' organisation is laid down in a labour agreement or a company participates to a pension fund on a mandatory order it is assumed that the voice of the participant is regulated through the collective consultation between the employers' and employees' organisation. In case of an individual agreement the employer is obliged to ask consent of the works council. In such matter the employer is also obliged to ask consent of the individual employees as well. This consent is not required when the employer is authorised to change the pension agreement unilaterally. The possibility to change the pension agreement unilaterally must be laid down in the pension agreement. Such change is only allowed when it is make on the basis of a substantial interest.

However the minister has introduced a new guarantee for the pensioners and former member, namely the possibility of an association introduced. This association representatives a substantial amount of pensioners at a pension fund which must be given the opportunity to be heard or given advice regarding the transition plan. What is been understood under substantial is yet to determined. The association receives a right to give an opinion concerning the motivations of the new pension 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.

What does this mean to the market?

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

1. **The pension contract**, as part of the employment relation, between employer(s) and employees:

    1.1 For the future accrual; there are two options for new accrual and in some cases the employer can also opt for continuation of the current DC-contract for existing employees;

    1.2 For the transfer of the accrued benefits to the new contractual environment;

    1.3 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.

2. **The execution or administration contract** between employer(s) and pension institution (pension funds, PPI's and insurance companies).

3. **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 to best shape the transition and the compensation. We foresee that this will take a lot of time since the legislation will be very complex. The time that the minister has given for the transition MUST BE USED PROPERLY.

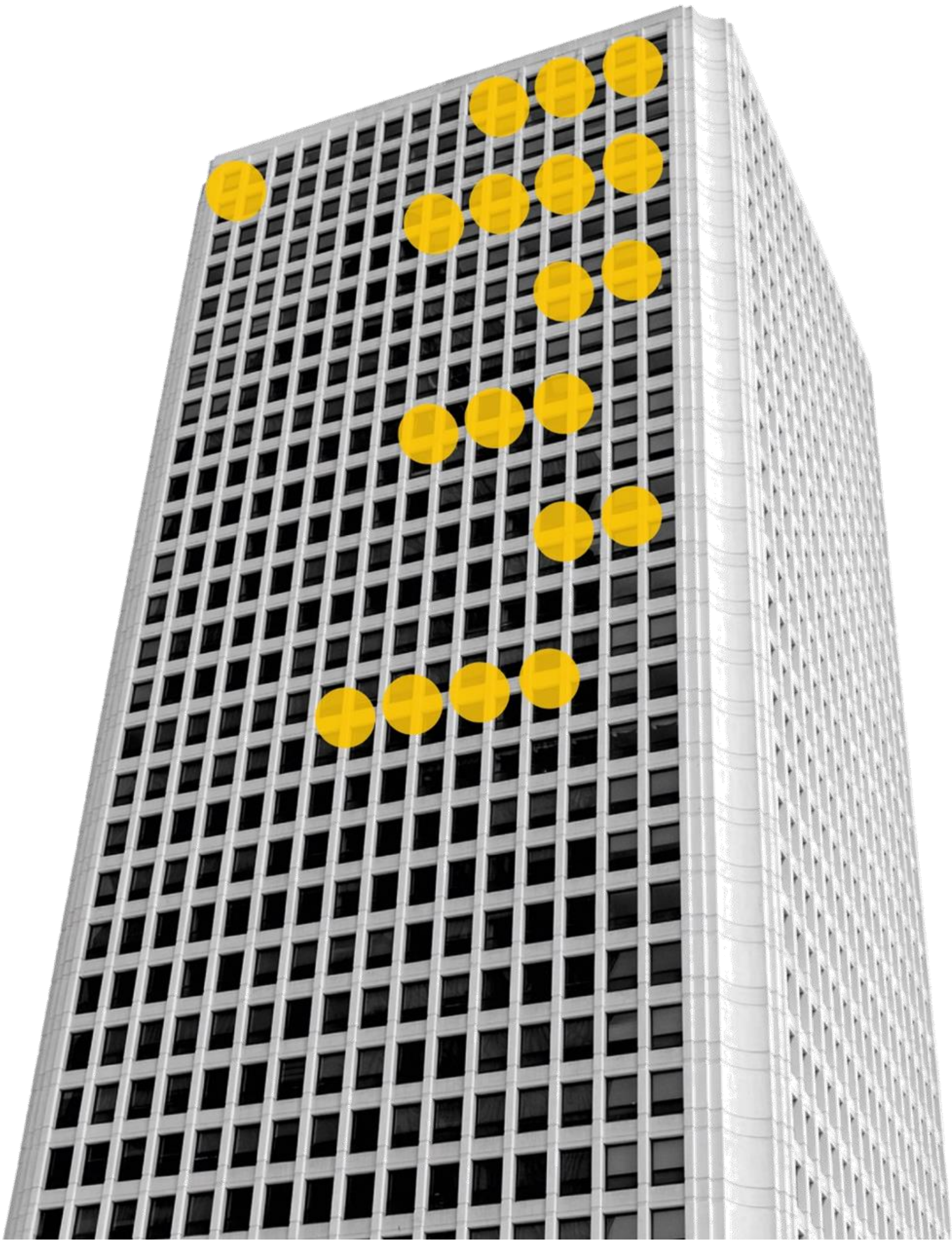
It is of great importance to pension providers that they inform their participating employers and members about the choices they make for the future of their scheme.

Pension funds will also have to take a critical look at the valuation of the previously accrued entitlements and at the way in which these rights are transferred to 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.

(Rotterdam, August 2021)



Addendum

	Individual DC **('DC improved + ' variant)**	**CDC** **('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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