Pension choices: implications on the pay-out stream for a heterogenous population

"Participants' freedom of choice should not lead to undesirable pension pay-out situations"

Servaas van Bilsen (UvA), **Johan Bonekamp** (TIU) **and Eduard Ponds** (TIU and APG)

Individuals can influence the drawdown rate of their second-pillar pension assets in various ways. This paper studies how choices offered by Dutch pension funds impact the payout stream. We show that too much freedom of choice could potentially lead to undesirable situations where the participant receives far less pension compared to the benchmark case (no choices exercised). One possible way to avoid this, is to apply the principle of conditional freedom of choice: participants can use their pension assets as they wish, as long as certain conditions are met and remain met.

Principal Findings

- Only one of the considered funds allows retirement from the age of 55 onwards, the rest from 5 years before retirement age.
- The high-low pension construction or lump-sum payment scarcely affects pension pay-out.
- Funds differ little in the high-low construction: high payment tends to stop after 10 years.
- Early retirement has the biggest impact on pension pay-out, especially if combined with a high-low pension.
- Under the Improved Defined Contribution Scheme Act (WVP), early retirement has a far greater impact on pension pay-out than uncertainty in equity returns.
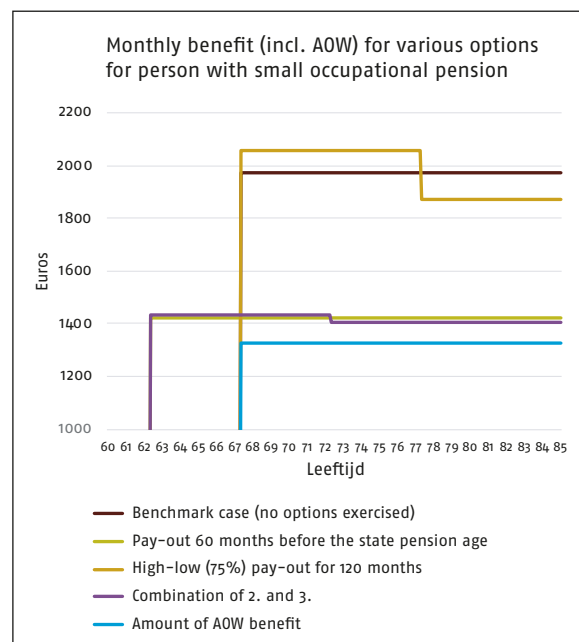

Figure: Monthly benefitprogramme (incl. AOW)

Key Takeaways for the Industry

- Early retirement has the biggest impact on the pay-out stream, especially for participants with little accrued pension rights.
- Allow for conditional freedom of choice so that pension funds can do justice to the heterogeneity in individuals' incomes and assets.

Want to know more? Read the paper **'Keuzes rondom pensioen: implicaties op uitkeringssnelheid voor een heterogeen deelnemersbestand'** (Dutch only)