

Income smoothing with equal adjustments

“Can income adjustments for all participants remain equal under the new Dutch pension scheme, even with smoothing of income adjustments over time and without any redistribution?”

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In the proposed new Dutch pension system, period-by-period fluctuations in income adjustments can be large. In the current defined benefit system, such fluctuations are contained by smoothing income adjustments over time and the adjustments made are equal for all participants. In the new system, such smoothing can lead to unequal income adjustments of different participants within the same period. However, pension funds could resolve this by using a smoothing method that ensures that all participants have an identical income adjustment within the same period.

Principal Findings

- The smoothing method ensures that all participants have the same income adjustment within one period, without any redistribution between participants.
- Income adjustments are a fixed proportion of unexecuted adjustments from the past.
- The administrative burden in each period is limited to administering one smoothing ratio for the entire pension fund.
- An ex-ante time-independent distribution of income adjustments can be optionally chosen.
- The smoothing method entails certain restrictions on the hedge return to hedge annuity risk, on the mechanism to allocate excess returns, and optionally on the fund's asset mix.

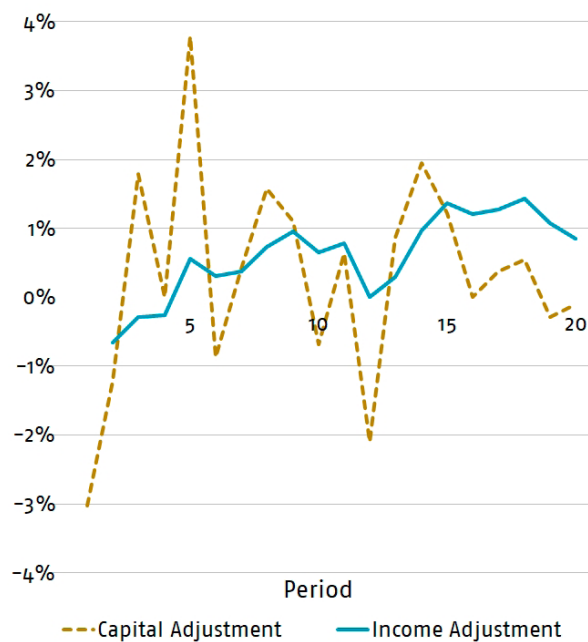


Figure: The smoothing method ensures that income adjustments are more contained than capital adjustments. Within each period, income adjustments are identical for all participants and without any redistribution of wealth.

Key Takeaways for the Industry

- In the new Dutch pension scheme, income adjustments can remain equal for all participants within one period, even when smoothing the adjustments over time.
- The smoothing pattern is similar to current DB schemes and minimize the administrative burden.
- The smoothing period provides a more stable and uniform pension for the participants.



Want to know more? Read the paper

'Geheugenloos spreiden met gelijke aanpassingen'