

The transition to the new Dutch pension system

“This transition is unavoidably affected by future developments on financial markets”

Anne Balter ¹, Jan Bonenkamp ² and Bas Werker ¹ – ¹ Tilburg University, ² APG

The transition from the current Dutch pension system to the new pension contract means a switch from a benefit scheme to a premium scheme. Pension funds will therefore need to convert collective capital into personal pension wealth and a solidarity reserve. That conversion is sensitive to fund-specific assumptions (such as initial coverage and age structure of the participant population), economic circumstances (interest rate term structure), and policy-related assumptions (such as ultimate forward rate (UFR)). So how should these sensitivities be dealt with in the transition period for the new pension system?

Principal Findings

- The standard method implies a reduction in the first pension payment in the case of an initial funding ratio of less than 100%.
- Applying the standard method leads to age-dependent decreases or increases in personal wealth.
- Sensitivity for age structure of the participant population is relatively low.
- High sensitivity especially with respect to the initial funding ratio.
- The sensitivity to future interest rates depends primarily on the amount of interest rate hedging.
- Increasing the UFR shifts wealth from younger to older participants and vice versa.

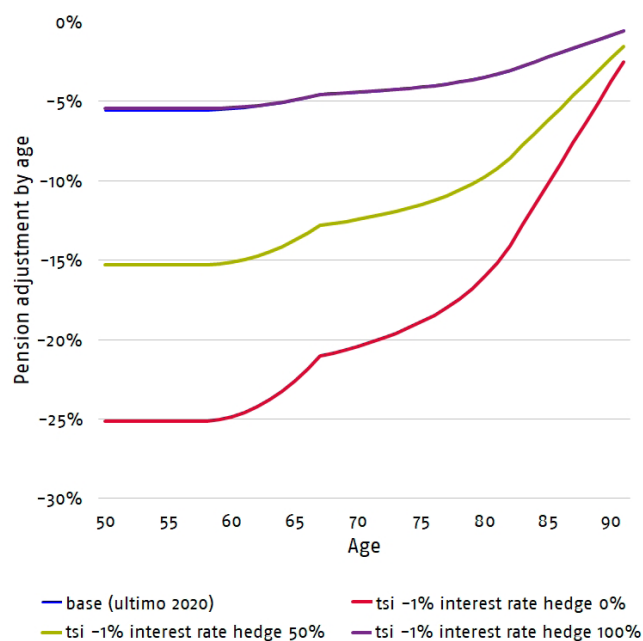


Figure: Pension adjustment by age for a shift in the term structure by a one percent decrease for different degrees of interest rate hedging

Key Takeaways for the Industry

- The so-called ‘standard method’ values pension entitlements and converts the funds’ collective capital into individual pension wealth based on a smoothing technique resembling the recovery rules when a fund is under- or overfunded in the current system.
- The sensitivity to future interest rates depends primarily on the amount of interest rate hedging.



Want to know more? Read the paper

‘Transitie: gevoelighed voor veronderstellingen en omstandigheden’ (in Dutch)