Deloitte.

2023

"Bedrag ineens" (lump sum) withdrawal: Impact of the transition moment for pension funds

"Bedrag ineens" (Lump sum) withdrawal

Participants in pension schemes will soon have the option to withdraw a lump sum of up to 10% of the value of their old-age pension upon retirement. This choice enhances the freedom of participants in utilizing their pension and enables them to better align their retirement benefits with their personal circumstances.

This option allows for a maximum withdrawal of 10% of the accumulated capital, but it is also possible to withdraw a smaller percentage, such as 5%. This is only possible at the start of the old-age pension but can be deferred under certain conditions. The partner's pension and orphan's pension are not covered by this arrangement. Additionally, there is a requirement that the remaining lifelong old-age pension after the withdrawal of 10% must be higher than the small pension buyout threshold.

From the perspective of a pension fund and pension provider, there is a significant difference in the application of the lump sum withdrawal before or after the transition date under the recently adopted Wet toekomst pensioenen. Before the transition date, the pension fund must determine the capital based on the participant's current entitlement, whereas after the transition, it can be directly determined from the participant's own pension capital. This article addresses several aspects regarding the lump sum withdrawal before and after the transition moment, including determining the conversion factor, effects on the coverage ratio, and determining the amount from the established pension capital after the transition.

"Bedrag ineens" (Lump sum) before transition moment

With the recently adopted Wet toekomst pensioenen by the Dutch Senate, pension funds have until January 1, 2028, to transition to the new system. With this transition, the guaranteed entitlements can be converted into personal pension capitals for participants through the so-called "invaren" process. It is expected that the lump sum withdrawal will come into effect on January 1, 2024. As no pension fund will transition to the new system before this date, there will be a bridging period for all funds during which the lump sum withdrawal must be determined based on the entitlements and not from the personal pension pot.

When making a lump sum withdrawal before the transition moment, a pension fund converts the amount from the entitlement into capital using actuarial factors. The law requires pension funds to determine the bases for calculating the present value of pension entitlements. This means that the pension fund's board can decide which rates to use when determining the actuarial factors for calculating the lump sum withdrawal. Options for establishing the actuarial factors include the interest rate used (risk-free interest rate or a fixed discount rate) and the choice of mortality tables. Differences in these factors can result in a higher lump sum withdrawal for participants in one pension fund compared to another.

Varying the interest rate can also lead to variations in the possible lump sum withdrawal for a participant over time. When withdrawing an amount from the pension capital, it is essential to ensure transparency for the participants. Therefore, it is advisable to maintain stability in the established actuarial factors so that participants in comparable situations but with different commencement dates receive equal amounts. To ensure consistency, funds can align the determination of the lump sum withdrawal with other factors related to buyouts, such as the buyout of small pensions.

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The law specifies that the coverage ratio of the pension fund should not be taken into account when determining the lump sum withdrawal. This means that unlike in a value transfer, there is no restriction when the fund's coverage ratio is too low. The lump sum withdrawal will always be based on a 100% value of the old-age pension, making it independent of the fund's current coverage ratio. This results in the fund paying out more than its available assets when the coverage ratio is below 100% and less when the coverage ratio is above 100%. As more participants opt for the lump sum withdrawal, it will further affect the coverage ratio. Therefore, it can be important to have a good understanding of the population and make an estimation of the number of people who will utilize the scheme.

"Bedrag ineens" (lump sum) after transition moment

Even after the transition moment when individual pension capitals are created for participants and the plan is a defined contribution plan, there are aspects that the pension fund needs to consider in determining the lump sum withdrawal. The law specifies that after the transition moment, the withdrawal should be 10% of the valued capital intended for the old-age pension. However, this capital is composed of two components: the old-age pension and the partner's pension intended for the spouse in case of the participant's death after the retirement date.

For defined contribution plans, there are three possible ways to determine the maximum amount of the lump sum withdrawal. First, the withdrawal can be financed from the total capital, but this also means that a portion of the assets allocated to the partner's pension will be bought out. This approach seems clear in terms of communication with the participant and has the additional benefit of maintaining the proportion between the old-age pension and the partner's pension. However, in this situation, the consent of the partner is required because financing also comes from the partner's pension. Second, the capital can be kept and tracked separately for the old-age pension and the partner's pension. In theory, this would be the most accurate method as the lump sum withdrawal is linked to the portion allocated to the old-age pension. However, this solution may be challenging to implement due to the active tracking of two components. Since the proportion between the old-age pension and the partner's pension changes when the lump sum withdrawal is taken, this can also pose challenges for the continuation of the variable pension. Third, the total capital can be converted first into the old-age pension and the partner's pension, and then a maximum of 10% of the old-age pension can be bought out. This method utilizes conversion factors, making the buyout dependent on the bases of a pension provider.

Careful Implementation

The option for participants to withdraw up to 10% of their old-age pension as a lump sum provides them with more freedom and flexibility in utilizing their pension benefits. However, both before and after the transition moment, there are various aspects that need to be considered. Careful implementation of this scheme is essential. Due to the complexity and feasibility of this topic, pension funds have indicated that this part of the new legislation should preferably take place after the fund's transition. If that is not possible, funds strongly prefer the legislation to come into effect from July 1, 2024, to allow sufficient time for the implementation of this scheme.

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