Philips
Pensioenfonds

# 2024 Bridging Plan

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## Getting off to a strong start with the new pension system

*Philips Pensioenfonds wants each of its members to get off to the best possible start under the new pension system. It is important that, when we make the switch (in 2026), each member has a pension that is as close to our ambition as possible: full pension accrual and full indexation. To achieve this goal, starting on 1 January 2024 Philips Pensioenfonds has adopted the more lenient rules for indexation under the 'transitional financial assessment framework'. The transitional financial assessment framework sets out legal rules for pension funds to apply if they intend to convert their accrued pensions to the new pension plan when switching to the new pension system ('entitlement conversion', or in Dutch 'invaren'). The transitional financial assessment framework makes it easier for pension funds to index their pensions, and at a higher rate.*

If it is easier for the Board of Trustees to index the pensions, and it then indexes them at a higher rate, this means that the pension fund's assets will be 'shared out' sooner than they would be without the more lenient indexation rules under the transitional financial assessment framework. 'Sharing out' the assets sooner increases the risk that the pensions might need to be cut if the pension fund's finances suffer an unforeseen hit. However, this is unlikely to happen: Philips Pensioenfonds's finances are healthy. Moreover, measures are in place to protect them: another of the goals is that, when we switch to the new pension system, we must be in a strong financial position (meaning that we should have a financial buffer). The pension fund's financial buffer at the time of the switch will be used, directly or indirectly, for the benefit of all our members when converting the accrued pensions to the new pension scheme ('entitlement conversion', or in Dutch 'invaren').

This bridging plan explains why Philips Pensioenfonds wants to have the option of applying the more lenient indexation rules, why this is a sensible decision given the pension fund's finances, and how it will affect our members in the different age categories.

## 1. Greater certainty about annual indexation to increase the pensions

Since 1 July 2023, pension funds that apply the transitional financial assessment framework may make use of more lenient indexation rules: indexation (full or partial) is permitted if the policy funding ratio is 105% or higher. This option will remain available to pension funds during the transitional period until they switch to a new pension plan that reflects the new legal pension rules. The idea is that pension funds should not have to take any measures during this period that they would not need to under the new pension system, for example refraining from indexing their pensions by the full rate.

If Philips Pensioenfonds did not apply the transitional financial assessment framework, we would not be permitted to grant any indexation at all as long as the policy funding ratio was less than 110%. Full indexation would only be permitted if full indexation in the future was also certain. This means that Philips Pensioenfonds would only be permitted to grant full indexation if its policy funding ratio was 138.8% or more at 31 December 2023. On that date, however, the policy funding ratio was 127.1%, and so full indexation would not be permitted in 2024, and probably not during the years ahead either.

Instead, effective 1 January 2024 Philips Pensioenfonds has adopted the more lenient indexation rules described above, making it easier for us to index our pensions, and at a higher rate, than without the more lenient rules for indexation. Applying the transitional financial assessment framework gives the Board greater possibilities for achieving the goal of getting members off to the best possible start under the new pension system: a pension for all our members that is as close as possible to our ambition when we switch to the new pension plan.

**Even under the more lenient indexation rules, compensatory indexation remains impossible**

The transitional financial assessment framework does not apply to compensatory indexation. Compensatory indexation is only possible if the policy funding ratio passes a legal minimum, which for Philips Pensioenfonds was 138.8% at the end of December 2023. The policy funding ratio was nowhere near the required minimum, however, and so the law does not permit us to grant compensatory indexation in 2024.

## 2. A sensible decision given the financial health

Philips Pensioenfonds has calculated how the more lenient indexation rules will affect its financial health, expressed in the funding ratio. If a pension fund has a funding ratio of 100%, this means that its assets are precisely enough for it to pay its existing pension liabilities. If the funding ratio is greater than 100%, the portion above that 100% is called a ‘reserve’ or ‘financial buffer’.

**Minimum target funding ratio for entitlement conversion**

For each of our members to get off to a good start under the new pension system, our financial situation needs to be healthy. We have calculated what funding ratio we should have, at a minimum, when we switch to the new system in 2026. We call this the ‘minimum target funding ratio for entitlement conversion’. The Board believes that the minimum funding ratio that we should have in 2026 is 114%, to give us a financial buffer of 14%. This minimum target funding ratio for entitlement conversion makes allowance for the possibility of forming a ‘solidarity reserve’ under the future pension plan, which might then draw its initial funding from the pension fund’s assets. At this time, we expect that the reserve will be in the 3-5% range. With that in mind, we allowed for 4%.

### Minimum legal funding ratio for entitlement conversion

The minimum target funding ratio for entitlement conversion, which is established by the Board, is used for the decision about what a sensible maximum rate of indexation is each year. Besides the pension fund's 'own' ambition, the law also dictates a minimum funding ratio for entitlement conversion: a pension fund must have a funding ratio higher than that minimum for entitlement conversion (which we have provisionally assumed to be 95%) for it to convert its accrued pensions to the new pension plan.

### Movements in the funding ratio during the next 3 years

According to the transitional financial assessment framework, pension funds must calculate the movements in their funding ratio in a specific economic scenario. That scenario, which is prescribed by law, contains certain predefined assumptions such as projected inflation and investment yields.

Philips Pensioenfonds has calculated those movements for the period from 2024 until the end of 2026. All Philips Pensioenfonds's members are expected to fall under the new pension plan in 2026. During that time, three moments remain when the pension fund may grant indexation on its pensions. Every year, the Board decides what a sensible rate is for raising its pensions (indexation), bearing in mind the goals of granting as much indexation as possible, while also protecting the financial buffer. This has been taken into account by making a substantiated estimate of what the indexation decisions will be in the period between now and the end of 2026.

### Conclusion regarding the pension fund's finances

Based on the foregoing, the movements in the funding ratio are expected to follow the diagram below. As the diagram shows, in 2026 the funding ratio will be higher than the 114% minimum target funding ratio for entitlement conversion, and therefore higher than the minimum funding ratio prescribed by law for entitlement conversion (provisionally assumed to be 95%). This provides data to substantiate that applying the more lenient indexation is a sensible decision given Philips Pensioenfonds's financial situation.

| Movements in FR (causes for movements in the funding ratio) | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| **Year** | **Current funding ratio (start of year)** | **Contri-butions** | **Bene-fits** | **Index-ation** | **Inter-est** | **Excess returns** | **Other** | **Current funding ratio (year-end)** | **Policy funding ratio** |
| | **%** | Δ% points | Δ% points | Δ% points | Δ% points | Δ% points | Δ% points | **%** | **%** |
| **2024** | **125.1%[1]** | -0.1% | 1.3% | -3.1% | 0.0% | 1.2% | -0.1% | **124.3%** | **123.8%** |
| **2025** | **124.3%** | -0.1% | 1.2% | -4.7% | 0.0% | 1.9% | -0.3% | **122.3%** | **121.8%** |
| **2026** | **122.3%** | -0.1% | 1.1% | -3.7% | 0.0% | 1.9% | -0.3% | **121.2%** | **120.6%** |

[1] The current funding ratio at 31 December 2023 was subsequently confirmed as 125.2%.

# 3. Effect on the situation of our members' pensions

If it is easier for the Board of Trustees to index the pensions, and it then indexes them at a higher rate, this means that the pension fund's assets will be 'shared out' sooner than would be possible under the existing legal rules. This translates as an immediate increase in the pensions of pension beneficiaries, but also as an increase in the pensions of members who are not yet drawing theirs. 'Sharing out' the assets sooner increases the risk that the pensions might need to be cut if the pension fund's finances suffer an unforeseen hit. However, this is unlikely to happen: Philips Pensioenfonds's finances are healthy. Moreover, measures are in place to protect them. If the pensions are cut, this will also affect every group of members.

Even so, the impact will not be the same for each of the age groups. The Board considers each decision to determine whether it is 'balanced': we carefully examine how the decision will affect the separate groups of members, to see whether those effects are fair. We ran these calculations before deciding to apply the transitional financial assessment framework as well.

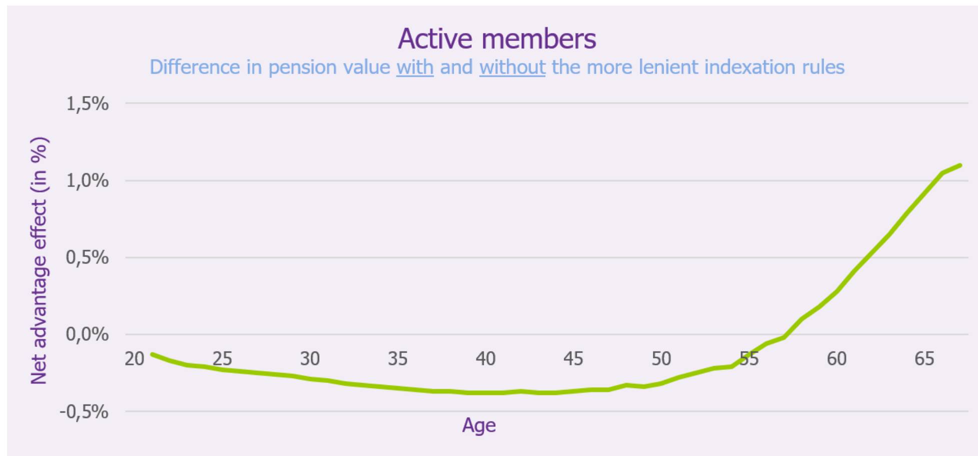
**Two ways of calculating pension values**

To determine what effect using the more lenient indexation rules would have, we calculated the pension values for separate groups of members using the existing legal indexation rules and using the more lenient indexation rules under the transitional financial assessment framework. This approach reveals how using the transitional financial assessment framework will affect our members' pensions.

**Net advantage: valuation of a pension plan**

A pension's value is expressed using the concept of 'net advantage' (*'netto profijt'* in Dutch): a legally prescribed method for determining the value of a pension plan. The figures below show the **difference** between the pension values of separate groups of members **with** and **without** the more lenient indexation rules, expressed as 'net advantage'. All the gains and losses that are identified for the various groups of members are expressed in terms of the net advantage. This is, therefore, **not** about raising or lowering the pensions.

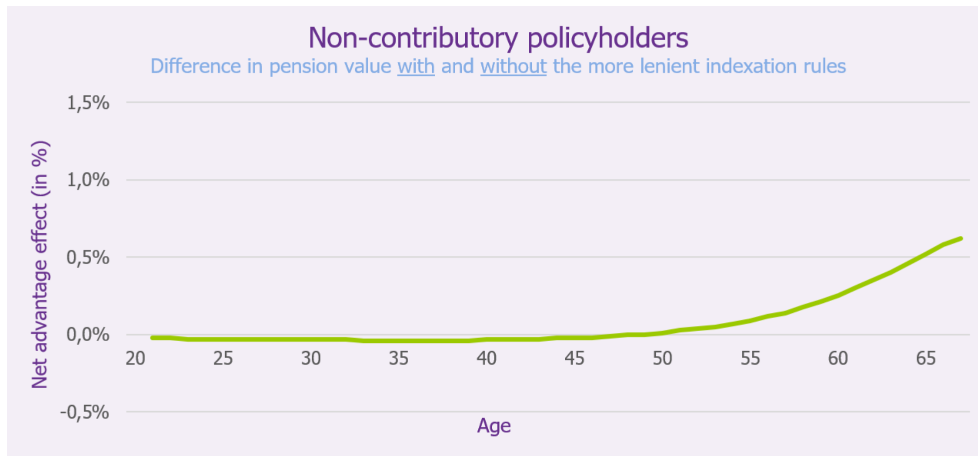
**Minor loss for younger active members, favourable for members of 55 and up**
The more lenient indexations are favourable for active members over the age of 55: they gain up to 1.1% by benefiting from the extra indexation in the short term. The younger group of active members suffer a minor loss of up to 0.4%, as they would benefit more from having a greater financial buffer and more indexation in the future, when they have accrued more pension.




**Gains for all pension beneficiaries**
The more lenient indexations have a favourable effect for all the pension beneficiaries, who see an immediate financial effect of the extra indexation. Maximum indexation in the short term means a gain for them of up to 1.1%.

**Gain for non-contributory policyholders over 45**

For non-contributory policyholders, the age when the more lenient indexation rules becomes favourable is slightly lower than for active members. If they are above the age of 45, they gain up to 1.1%. Younger policyholders will have barely any loss or gain.




**Minor impact on groups of members**

In the Board's opinion, the differences for the various groups of members are minor. The effects of the more lenient indexation rules are limited to the three years ahead (until we switch to the new pension plan), which is a short period of time. They are also limited by the Board's annual decision to consider what a maximum sensible rate of indexation is, bearing in mind the goal of protecting the financial buffer. As such, that measure helps to ensure that the transitional financial assessment framework is applied in a balanced manner. The Board's conclusion therefore is that using the more lenient indexation rules is balanced. This is reinforced by the fact that every annual indexation decision involves weighing indexation against protecting the financial buffer. The differences between groups of members are included in this consideration.

If any material differences between groups of members emerge when we make the switch, we will make allowance for those differences when we convert the accrued pensions to the new pension plan.