Time to retire from the second pillar, design your own pension!

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You can retire from the second pillar five years earlier than the official retirement age, i.e., the national old-age pension age. The national old-age pension age is increasing every year, and the retirement age of the second pillar is also shifting in the same way. By 2026, the old-age pension age will reach 65 years of age and will then start to rise in accordance with the increase in life expectancy, until then the old-age pension age is determined by the year of birth, see here for more details.

Thus, everyone who has joined the pillar and is 60 years old or older has the opportunity to retire from the second pillar. Of course, there is no obligation to retire at that age. Retirement can be postponed as long as you want and have the opportunity, continue saving money and thus increase your pension. With the same accumulated amount, a fixed-term retirement from the second pillar in 2022 at the age of 65, for example, would mean a 23.5% higher monthly pension than if you retired at the age of 60*. If at the same time you continue to work and continue to make contributions to the second pillar, the difference in pension will be even greater.

The state old-age pension is paid for life. In the second pillar, however, it is up to everyone to decide how to withdraw the pension, either as a lifetime or fixed-term pension, simply in parts or all the money in one lump sum. What exactly to choose depends on the sum accumulated in the pension pillar, but also on whether, in retirement, you are ready to take the risk that there may come a time when the size of the pension does not increase or remain the same, but instead decreases, or that the accumulated money will not last you for the rest of your life.

Lifetime pension

If the accumulated sum is large enough and it is important to receive a pension for the rest of your life, then it is worth choosing a lifetime pension. For this purpose, a corresponding pension contract must be concluded with the life insurance company. In this way, the pension is guaranteed for life, and the investment risk of such a contract remains with the life insurance company instead of the pensioner. Being retired, there is therefore no risk that the pension may decrease at some point. On the other hand, there is no hope that the pension will grow, because it no longer depends on investment results. In terms of taxation, the lifetime pension is advantageous - it is tax-free. As the name suggests, this pension is paid for the rest of your life, and once you have chosen a lifetime pension, you cannot change your mind later.

Fixed-term pension

If it is not so important that the second pillar pension will definitely be distributed for the rest of your life, you may choose a fixed-term pension instead of a lifetime pension. As with a lifetime pension, a pension contract with a life insurance company can also be used for a fixed-term pension. In this case, there is no risk that the amount of the pension at some point could decrease. However, if you want to continue to participate in the investment results and leave your chance to increase the pension over time, it is worth choosing a fund pension. The fund pension is also a fixed-term pension, but the money raised remains in pension funds. The amount of the pension payment depends on how the fund goes - as the value of the fund grows, the pension paid will increase and vice versa.

For how many years your fixed-term pension could last, it is up to you. The shorter the deadline, the higher the monthly pension and vice versa. The deadline sets the monthly pension and how long this pension is paid, and also whether or not you need to pay the income tax. If you choose a fixed-term pension based on the average life expectancy, you do not have to pay income tax. The average life expectancy of the Estonian population is published by Statistics Estonia and this data is updated every year. According to recent data, for example, when retiring at the age of 60, the deadline for their fund pension should be set at least 21 years to be tax-free. When retiring at the age of 65, the deadline should be at least 17 years and, for example, 14 years at the age of 70. A few shorter deadlines may also be chosen, but then you will have to pay 10 percent income tax. At the same time, the income tax must be paid even if you simply withdraw all the money at once or in some parts.

If your second pillar pension is subject to 10 percent income tax, then the tax-free income that is left over from the first pillar pension will be taken into account before the tax is detained. As of January 1, 2023, the tax-free income is 704 € per month, which means that if your first and second pillar pensions do not exceed that amount, the second pillar pension, which would otherwise have to pay 10 percent income tax, will still not be taxable.

The years left to live show how long people live on average, but it is important to remember that in fact about half of us live longer and others less. Thus, a pension distributed over the average years left to live may be enough for the rest of their lives, but it may not be the case. If the pensioner dies and still has units in the pension fund, they are inherited. This is the plus of a fund pension. However, if all the money is paid out and the pension recipient is still alive, the fund pension will end and there will be no pension supplement from the second pillar.

Benefits of fixed-term pension

If the accumulated sum is perhaps not very large, then you have to decide whether to use a fixed-term pension or withdraw the money all at once or simply in few parts. A fund pension is actually a very flexible pension option. If you wish, you can terminate your funded pension at any time and choose another way of receiving a pension or, for example, agree on a new funded pension with a different term. The fund pension can also be conveniently combined with a partial lump sum payment. This means that when you retire, you can start with a fund pension distributed over the average number of years you will live, which is tax-free for you (if your first and second pillar pensions together do not exceed the tax-free income at retirement age, then thanks to this tax-free income you would not have to pay income tax on a shorter fund pension either).

If you need a slightly larger sum in the meantime, you can withdraw the necessary amount with a partial lump sum, regardless of the fact that you are already being paid a fund pension. As long as you have enough pension fund units, you can repeatedly use the partial lump sum payment to withdraw an amount larger than the usual pension. Income tax of 10 percent must be paid on this payment, but the fund pension remains tax-free. Due to the fact that you have less money left in your pension column because of this one-time payment, your monthly fund pension will be smaller in the future.

Even in the case of a fixed-term pension contract, you can withdraw a larger amount if your contract has a guarantee period. If you wish, you can receive the pension to be paid during the guarantee period in advance. A 10 percent income tax must then be paid on this amount. You will start receiving regular pension payments from the insurance company again when the guarantee period of the contract is over. Since the pension contract does not have to be signed for all the money collected in the second pillar, you can also leave part of the money in the pension fund when signing the contract, and then withdraw it in addition to your monthly pension if necessary.

Retiring

If you decide to retire from the second pillar, but you are still working, then the accumulation of your pension will end with a short notice. Pension collection ends either in January, May or September. The exact time depends on what month you retire from the second pillar. If you retire in December, January, February or March, you stop saving from September. If you retire in April, May, June or July, you stop saving in January. If you retire in August, September, October or November, you will stop saving in May. In the case of a pension contract, the end of pension collection is determined by the month when the withdrawal period for your pension contract expired - you can withdraw from the pension contract within 14 days after signing the contract. Therefore, if you want to keep accumulating money in the second pillar, don't retire from there yet.

It is reasonable to think about what is the most suitable and affordable way of getting a pension for you. Before making a decision, it is worth checking the website of the Pensionikeskus (Pension Centre). When you log into the self-service environment "My pension account" there, you will find a fund pension calculator under pay-outs, where you can see how the terms of the fund pension affect the amount of the pension. You can also submit a fund pension application there and calculate the pension amount of the pension contract.

* The basis is Statistics Estonia's pension distributed over the average years of life, these data are updated every year.