

Germany set for massive reform of occupational pension landscape

Introducing DC and opting out to a traditional environment

By Dr. Nicolas Roessler, LL.M. (Notre Dame)

Germany is about to see the biggest reform of its pension landscape since the enactment of the Pensions Act (*Betriebsrentengesetz*) in 1975. The Act on the Strengthening of Occupational Pensions (*Betriebsrentenstärkungsgesetz*) is expected to be adopted in parliament in June 2017, and to come into force on January 1, 2018.

As the name suggests, this reform aims to strengthen the use of occupational pensions in Germany. Today, occupational pension promises are common in large companies but are not as widespread as they should be in mid-cap and small companies. This is where the reform seeks to make changes.

Introduction of real defined contribution systems

The core element of the reform introduced by the Act on the Strengthening of Occupational Pensions (the Act) is the legal recognition of real defined contribution arrangements (DC) as occupational pension promises under the Pensions



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Act. For the first time in German history, employers will be allowed to fulfill their obligations under a pension promise by

paying contributions. The new DC plans will be introduced alongside the existing traditional defined benefit and hybrid

plan designs that have been around in Germany since the beginning of the millennium.

Today, the closest to a real DC setup that is recognized as a pension promise under German pensions law are the contribution-oriented defined benefit plans and defined contribution with guaranteed minimum payout plans. The investment risk lies with the employer in both scenarios.

Under the new defined contribution setup, the beneficiaries will have legal entitlements exclusively against a third-party financing vehicle. DC promises can be financed through *Pensionskassen*, German pension funds, or direct insurance contracts. The old German way of financing pensions internally through book reserves (in practice often backed up by contractual trust arrangements) will not be available for DC plans.

Different from today, there will be no secondary liability for the employer; any entitlements under a DC promise will vest →

immediately. No lump-sum payout will be allowed (benefits under a DC promise must be paid out as annuities). In order to provide additional security, employers will be obliged to pay a security premium on top of actual contributions.

The amount of benefits payable to the employee will depend exclusively on the investment performance. It can, therefore, vary during the payout phase, and there is no room for indexation. While the respective financing vehicles will have significant freedom to invest, they will be bound by certain regulatory limits. The legislative process debated long and hard whether to offer the combination of a DC setup with a guaranteed return. In the end, the introduction of tariffs with a guaranteed minimum return was abandoned.

Tariff parties to play key role in occupational pensions

In the belief that the constitutional balancing of interests between employer organizations and unions will lead to just and sustainable results, the Act specifies that details of DC plans are to be agreed in collective bargaining agreements. The legislator assumes that tariff partners are better placed to tailor solutions to their respective industries than statutory

provisions. It is also expected that tariff partners will set up most of the financing vehicles to be used for DC plans.

The biggest industries in Germany are already familiar with joint establishments between unions and employer associations. If the tariff partners decide to use external existing financing vehicles, the Act obliges them to exert proper influence on the decision-making process (by securing seats on the supervisory board or comparable bodies, for example).

The possibilities for individual employers to set up DC plans are rather restricted; so is their ability to design such plans. Employers that are not bound by collective bargaining agreements will be able to use the systems set up by the tariff parties either by means of agreements with works councils or by reference to the respective collective bargaining agreements in individual employment contracts. These approaches will also be necessary to open the DC plans up to nonunion employees.

Employers will only be allowed to refer to the applicable tariff rules. Whether a non-tariff employer or employee can use the funding vehicle used by the tariff parties is subject to the funding vehicle's discretion. The current draft of the bill does not foresee an obligation to contract.

Opting out of deferred compensation plans

Another new feature in the German pensions landscape will be the possibility for tariff partners to provide opting-out rules in collective bargaining agreements (the introduction of mandatory deferred compensation rules in collective bargaining agreements that give employees the right to opt out of such programs). To opt out, an employee needs to expressly declare that he or she objects to the conversion of certain parts of his or her salary into pension rights. The legislator expects that only a small number of employees will actually object and, therefore, this feature will significantly help to increase the number of individuals with occupational pension rights.

Deferred compensation arrangements can be combined with DC plans. Since the deferred amounts up to certain statutorily defined limits are free of social secu-

rity contributions and employers would save their share thereof, the Act provides for a mandatory top-up of the deferred amounts used for a DC plan by at least 15%. The Act specifies that the privileged deferred compensation amount will be increased from 4% to 8% of the social security contribution ceiling. ←



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