New regulations on occupational pensions in Germany

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A few months before the federal elections, the Federal Parliament passed legislation introducing far-reaching changes to the rules governing occupational pension schemes. As part of the collective bargaining process, it will now be possible to agree defined contribution occupational pension schemes without any warranty liability concerning minimum benefits or interest rates being imposed on the company. In addition, many new regulations have been incorporated into the Occupational Pensions Act.

Description

For several years, the reform of the pension system has been a key issue in the German social policy debate. The main difficulties to be resolved are the avoidance of old-age poverty and the maintenance of living standards in old age. However, the Grand Coalition, which came into power in 2013, has failed to put forward a proposal for longer-term reform because the Christian Democrats and the Social Democrats have been unable to reach agreement. Thus in the final phase of the current legislative period only a few more narrowly focused reforms have been introduced. In June 2017, the Federal Parliament enacted three bills: “Improvements in Benefits for Recipients of a Reduced Earnings Capacity Pension”, “Conclusion of the Pension Transfer between West and East Germany” and “Strengthening Occupational Pensions”. The latter (*Betriebsrentenstärkungsgesetz*) is the focus of this Flash Report.

In Germany, only a certain proportion of employees acquire entitlements to occupational pensions, because access to such schemes is usually voluntary and is normally determined by collective agreements negotiated at sector or company level or by company agreements. The coverage rate was about 57% in 2015 (latest figures available). The beneficiaries are predominantly male workers employed in large companies on standard contracts and with average-to-higher incomes. This means that for more than 40% of the work force the declining level of pensions paid under the statutory pension insurance scheme (SPI) is unlikely to be offset by the accrual of entitlements in occupational pension schemes.

The aim of the new law, which will come into force on 1 January 2018, is to extend the coverage of occupational pensions. The focus of the regulations is on the introduction of a so-called social partnership model:

- The new law allows pure defined contribution schemes (also referred to as “pay and forget” schemes), i.e. plans with no minimum benefit or interest guarantees. These schemes expand and act as a top-up to existing occupational schemes, most of which are defined benefit schemes, or defined contribution schemes with a guarantee of a minimum investment return of 0%. Many employers had been shying away from offering pension plans because of the long-term liabilities they entail and the required top-up payments for guarantees.
- The new schemes are permitted only if they are negotiated as part of the collective bargaining process. The pension fund must be managed jointly by trade unions and

employers' organisations, and only staff covered by a collective bargaining agreement may make contributions.

- The new schemes can be set up either as new industry pension funds, or within the framework of existing pension funds and direct insurance contracts as permitted funding vehicles.
- This "social partnership model" will offer the possibility of automatic earnings conversion for all employees of a company – i.e., the employees' earnings up to a certain limit (4% of the contribution assessment ceiling of the statutory pension insurance scheme, i.e. €254 per month in 2017) are used to accumulate an occupational pension fund. The employees can, however, opt out. Collective agreements are a prerequisite in this case as well.
- Entitlements accrued under defined benefits schemes are non-forfeitable from the outset. In contrast, entitlements accrued under "traditional" defined benefit schemes, which may still co-exist with the new schemes, are not protected in this way until a certain period of employment ("vesting period") has elapsed.
- Because employers profit from reduced SPI contributions in the case of an earnings conversion, they are required to pay at least 15% of the converted earnings as a bonus payment into the employee's defined contribution account.
- The plans are regulated under the Insurance Supervision Act.

In addition, there are other new regulations:

- The maximum amount of the tax-free earnings conversion is raised from 4% to 8% of the SPI contribution ceiling.
- The basic allowance for private pension contracts that fulfil certain requirements as a precondition for either a state subsidy (supplements) or extra tax relief (known as the *Riester-Rente*) is raised from €154 to €175.
- Tax incentives are being introduced to encourage employers to pay occupational pension contributions for low-income earners (up to €2,200 per month).
- For the "needs-based pension supplement in old age" and in the event of "reduced earning capacity", as defined in Social Code Book XII, an allowance for low voluntary additional pension payments is introduced (up to €202 per month).

Outlook & commentary

The Strengthening Occupational Pensions Act has been intensively discussed and developed in consultation with the umbrella organisations of the trade unions and employers. However, the new law was and remains extremely controversial within the trade unions. In particular, attitudes towards defined contribution schemes vary considerably. On the one hand, the exclusion of any performance guarantees may expand the investment opportunities in global stock markets in a low-interest rate environment. On the other hand, employees have no certainty about the eventual value of their occupational pensions. Even the risk of losses cannot be excluded.

If the objective is to have a reliable income in old age that is adjusted in line with the general evolution of wages and prices, then a defined contribution scheme is not recommended. It remains to be seen how the trade unions and employers' organisations will perceive the new possibilities offered by this social partnership model.

Further reading

Deutscher Bundestag (2017), Bundestagsanhörung zum Gesetzentwurf am 24.03.2017: Schriftliche Stellungnahmen von Verbänden und Einzelsachverständigen, Deutscher Bundestag Ausschussdrucksache 18(11)971. [German Federal Parliament (2017), Hearing on the draft bill on 24 March 2017, written comments from national associations and individual experts, Federal Parliament Committee document No. 18(11)971.]

Bäcker, G. (2017), Verbesserungen bei den Erwerbsminderungsrenten und Herstellung der Renteneinheit, Anhörung des Bundestagsausschusses Arbeit und Soziales am 12.05.2017, Schriftliche Stellungnahme, in: IAQ-Standpunkt 01/2017. [Bäcker, G. (2017), Improvements in Reduced Earnings Capacity Pensions and Conclusion of the Pension Transfer between West and East Germany, Hearing of the Federal Parliament Committee on Labour and Social Affairs on the draft bill on 12 May 2017, written comment, in: IAQ-Standpunkt 01/2017.]

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