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CLIENT ALERT

Update on German Pension Law – Germany Introduces Defined Contribution ("DC") Plans

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On January 1, 2018, the "Law Strengthening Occupational Pensions" (*Betriebsrentenstärkungsgesetz – LSOP*), one of Germany's biggest pension law reforms, will take effect.

The aim of the legislative change is to further expand coverage of occupational pensions (*betriebliche Altersversorgung*) as one of the three pillars of Germany's old-age pension system (statutory pension insurance, occupational pensions and private retirement savings). So far, only half of the employees at German companies receive occupational pension benefits. Given the declining amounts paid under the statutory pension insurance plan, legislators are trying to reduce the risk of old-age poverty by expanding occupational pension plan acceptance.

Until now, occupational pension plans were predominantly offered within bigger businesses. The long-term liabilities and the required top-up payments for guarantees made employers in small and mid-size businesses reluctant to initiate them. The changes codified in the LSOP aim to make occupational pension plans more attractive and feasible for these businesses and for low-income workers.

The LSOP will implement the following key changes:

Introduction of pure DC plans

The biggest change is the introduction of defined contribution (DC) plans (*reine Beitragszusage*). Currently, the legal framework for occupational pensions (*Betriebsrentengesetz*) does not allow DC plans. Under current law, any plan could ultimately trigger a liability for the company if the plan went into default. The new DC plans let employers choose a pension plan for which they don't guarantee any defined or identifiable benefits. Instead, they are obliged only to pay contributions to an external plan administrator ("pay and forget"). For the German pension system, this is revolutionary.

Strengthening the role of collective bargaining agreement parties

However, the new law comes with a catch. The implementation, structuring and management of pure DC plans is reserved for tariff partners (*i.e.* trade unions and employers' associations) and can be implemented only by collective bargaining agreements. However, employers and employees not bound by collective bargaining agreements can also implement DC plans already set up by tariff parties through (i) respective agreements with the relevant German works council or (ii) by making reference to such collective bargaining agreement in the individual employment agreement.

Introduction of opt-out models for deferred compensation plans

Under the LSOP, collective or internal agreements may allow employers to unilaterally introduce deferred compensation plans that are financed by salary sacrifices (*Entgeltumwandlung*) for all of their employees (employers not bound by respective collective bargaining agreements can implement equivalent option systems). Until now, the participation of employees in deferred compensation plans required their prior active involvement. The new law reverses the procedure, with the result that employees will automatically be members of deferred compensation plans. Employees who do not wish to participate in such plans are required to refuse participation by a certain deadline ("opt out"). By ensuring that employees can participate in deferred compensation programs by default, the legislation aims to increase the number of employees participating in occupational pension plans.

Financial and tax incentives and support

To further expand occupational pension plans, employers who financially support low-income employees (maximum salary EUR 2,200 per month) with occupational pension participation are granted tax deductions.

The maximum amount of tax-free sacrificed amounts paid by the employer will be raised from four to eight percent of the statutory pension insurance contribution ceiling. Conversely the additional increase amount of EUR 1,800 will be abolished.

As sacrificed amounts up to a statutorily defined limit are free of social security charges, the LSOP provides for mandatory top-up payments by employers (at least 15 percent of the sacrificed amounts) into the employees' DC plan.

Outlook

It remains to be seen how the statutory changes develop in practice and whether the introduction of DC programs leads to the intended increase in occupational pension participation. We will keep you apprised of further developments with respect to the implementation of the LSOP and its application by tariff parties.

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