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Update on the Social Partner Model (SPM)

Pure defined contribution pension commitment before the breakthrough in practice?

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Presentation & Agenda

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Agenda

I. Introduction

II. Pure defined contribution pension commitment (*reine Beitragszusage, rBZ*): General legal framework

III. Current selected legal developments in design practice

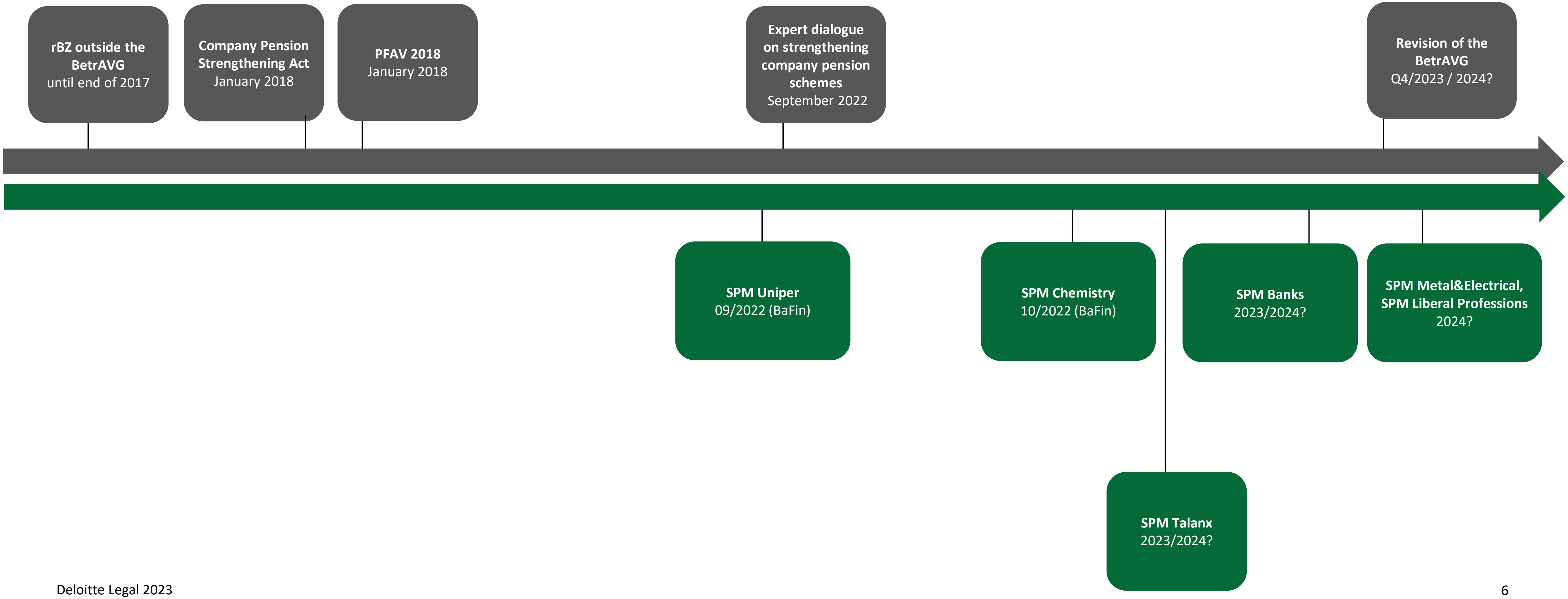
IV. Security contribution and biometric cover: restrictions and design options

V. Q&A

Introduction

Introduction: The long road of the legislator and the first SPM models in practice

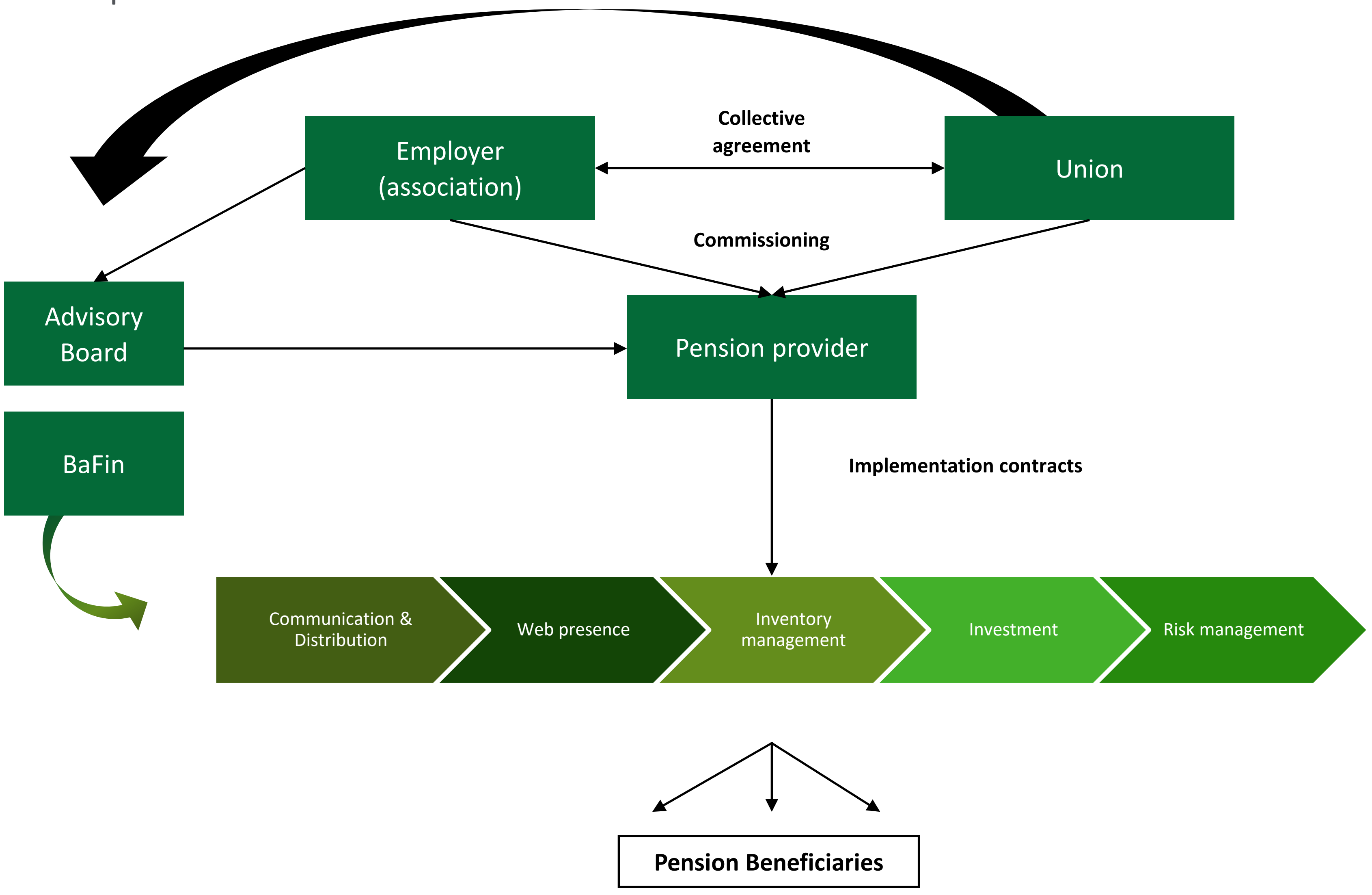
... to be continued



Pure defined contribution pension commitment (reine Beitragszusage, rBZ): General legal framework

General legal framework

SPM: The basic set-up



The general legal framework

SPM ... in distinction to traditional company pension schemes

Parameter	SPM	Traditional occupational pension commitments (direct commitment, direct insurance, pension fund, support fund, pension fund)
Benefits: Commitment (minimum amount)	No (employee bears investment risk)	Generally yes (depending, among other things, on the source of funding and the concrete content)
Benefits: Employer's liability arising from the company pension commitment	Only on contribution payments ("pay and forget")	(1) Direct commitment: direct entitlements of beneficiaries (economic reduction of the funding risk through CTA/reinsurance) (2) External implementation path: Ensurement Claim (Sec. 1 (1) sentence 3 BetrAVG)
Benefits: Statutory insolvency protection/insurance obligation(s)	No	(1) Direct commitment: in accordance with Sec. 7(1) sentence 1, 7 et. BetrAVG (2) External implementation parth: in accordance with Sections 7 (1) sentence 2, 7 et. BetrAVG
Benefits: Employer's adjustment obligation	No	In accordance with Sec. 16 BetrAVG (taking into account any (additional) commitments in the company pension commitment)
Performance: Legal basis	Exclusively collective agreement/company agreement/service agreement based on a collective agreement (Sec. 1 (2) no. 2a BetrAVG)	Depending on the specific labour law framework conditions, generally all possible legal bases (e.g. collective agreement, company/service agreement, employment contract, general commitment, company practice).
Funding: Utilities	Through contributions by the employer/employee in accordance with Sec. 2 BetrAVG in conjunction with SPM collective agreement	(1) Employer-funded: All implementation paths and depending on the specific content of the company pension commitment (defined benefit, BOLZ, BMZ). (2) Employee-financed: All implementation channels and depending on the specific content (taking into account paragraph 1a BetrAVG).
Funding: Capital (investment) risks	In accordance with Sec. 23 BetrAVG; administration costs included in contributions	No (with regard to administration costs: Employer may allocate Zillmer costs to the company pension commitment, especially in the case of external implementation paths (in accordance with BAG judgement dated 15.09.2009, 3 AZR 17/09)).
Portability of the company pension commitment	Only with existing SPM also with subsequent employer (Sec. 22 (3) no. 1b BetrAVG)	Generally within the framework of Sec. 4 BetrAVG

Current selected legal developments in design practice

Current legal developments in design practice

Benefits

Starting point (de lege lata): Generally (only) pension benefits

(1) Sec.22 (1) sentence 1 BetrAVG in conjunction with. (already concluded) SPM collective agreement: (Generally) Exclusively current (pension) benefits as monthly pension payments,

(2) Exceptionally severance payments in compliance with Sec. 3, 19 and 22 (4) sentence 3 BetrAVG.

Outlook (de lege ferenda): Also capital benefits?

(1) Also permissible granting of capital benefits (one-off/ instalment payments).

(2) With possible types of design: (i) regulatory autonomy in the collective agreement, (ii) statutory requirement in Sec. 21 et. BetrAVG.

Current legal developments in design practice

Scope of application of the concrete SPM

Starting point (de lege lata): Generally (only) employers bound by collective agreements

(1) Sec. 21 BetrAVG in conjunction with. (already concluded) SPM collective agreement: Exclusively employers who are either (i) a party to the collective agreement (company collective agreement) or (ii) a member of the employers' association concluding the SPM collective agreement who is bound by the collective agreement.

(2) Sec. 24 BetrAVG: Individual contractual agreement on full application of the relevant SPM collective agreement (but follow-up questions including financing costs according to Sec. 21 BetrAVG etc.).

Outlook (de lege ferenda): non-tariff bound employers?

(1) Under current law plausibly justifiable in terms of labour law (but previous collective agreements do not in fact provide for access).

(2) Proposals from practice: (i) (Exclusive) opening by social partners of the specific SPM, (ii) Nationwide cross-industry collective agreement, (iii) Conclusion also via company agreement/service agreement.

(3) Status quo legislator (expert dialogue on occupational pensions): Modification of Sec. 22 and 24 BetrAVG.

Current legal developments in the design practice

Replacing existing company pension commitments

Starting point (de lege lata): Plausible, but not desired by legislator

(1) Starting point Sec. 21 (2) BetrAVG: Tariff parties should take appropriate account of already existing company pension schemes in the context of SPM collective agreements.

(2) Plausible under labour law: Replacement on the basis of (i) a company agreement taking into account the principles of protection of legitimate expectations and proportionality, (ii) on the basis of an individual agreement taking into account the principle of favourability.

Outlook (de lege ferenda): Practical implementation of the plausible approach under labour law

(1) In case of replacement due to company agreement: Direct application of the criteria according to the 3-level theory of the BAG generally possible; in individual cases, the concrete design of the current company pension commitment (final salary-related? contribution-oriented?) is decisive.

(2) In the case of replacement on the basis of a collective agreement: Principles of protection of legitimate expectations and proportionality based on the principle of the rule of law (Article 20 (3) GG).

Current legal developments in the design practice

Portability of company pension commitments due to SPM

Starting point (de lege lata): Only in case of contribution to SPM with new employer

(1) Starting point Sec. 22 (3) no. 1b) BetrAVG: Contribution to SPM with new employer

(2) Legal consequence: No portability option if new employer does not apply SPM

Outlook: Also inclusion in traditional company pension commitments (in accordance with Sec. 4 (3) BetrAVG)

(1) As portability of the projected unit credit from the rBZ

(2) With the insertion of Sec. 4 (3) BetrAVG

Security contribution and biometric cover: restrictions and design options

Basics and selected details

I Basics

II Security contributions

1. Uniform / differentiated
2. Fields of application
3. Dimension
4. Participation
5. Stabilisation at the start

III Biometric protection

1. Disability and death
2. Pensioner collectives
3. Rein (cover) insurance

The pure defined contribution plan in the SPM

Regulations in the Pension Fund Supervision Ordinance PFAV
PFAV Part 2 - Implementation of pure defined contribution plans in occupational pension schemes (1/3)

Overview

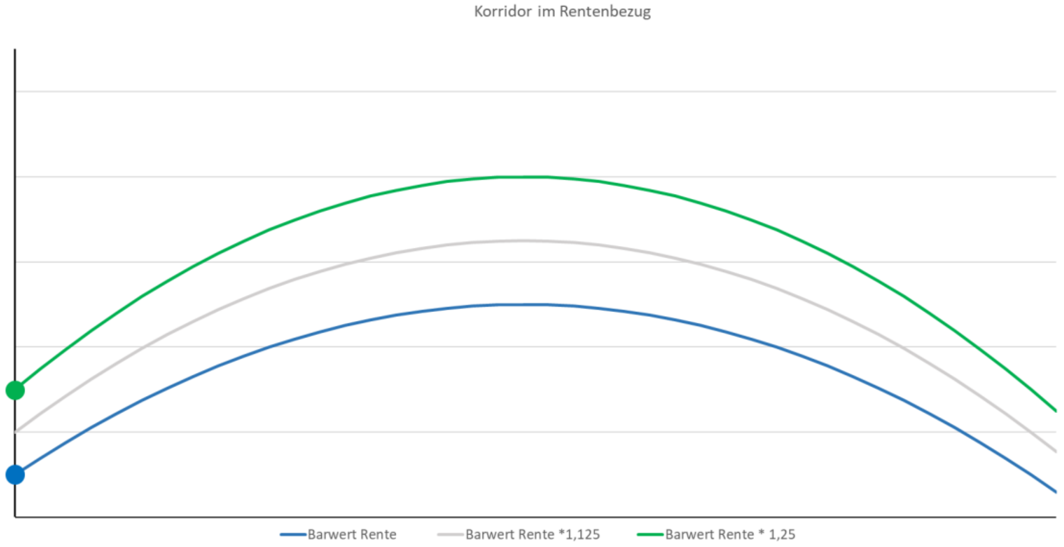
- Sec. 33 Scope of application
  - Implementing institutions: Pensionsfond (*Pensionsfond*), Pensions Fund (*Pensionskasse*), Direct Insurance
- Sec. 34 Investment
  - Investment of contributions pursuant to Sec. 16 - 20 PFAV
- Sec. 35 Actuarial reserve
  - Accumulation phase: a collective actuarial reserve can be formed from the earnings, which is to be allocated to the members as a whole.
  - Pension reference period: retrospective method for the formation of the actuarial reserves - at the beginning of the pension: actuarial reservers = the existing pension capital of the member.
  - With the security contributions according to Sec. 23 (1) BetrAVG, an additional actuarial reserve can be formed which can be allocated to the pension beneficiaries as a whole
- Sec. 36 Capital cover ratio
  - Best Estimate Accounting Principles
  - Capital cover ratio = 100*
(actuarial reserve for pensioners / present value of benefits to pensioners)
  - Capital cover ratio must not exceed 125 percent
- Sec. 37 Initial amount of the lifetime payment
  - Pension is determined from pension capital
  - Interest rate may be chosen cautiously (no best estimate!)
  - This results in a buffer - but: Upward limitation of the capital cover ratio to be observed
- Sec. 38 Adjustment of lifetime payments
  - 100 % ≤ capital cover ratio ≤ 125 %
  - The above limitations shall be observed at all times
  - If capital cover ratio falls below 100 %: Reduce power accordingly
  - If the 125 % is exceeded: Benefit to be increased accordingly - in doing so, a capital cover ratio of 110 % must be achieved after the increase

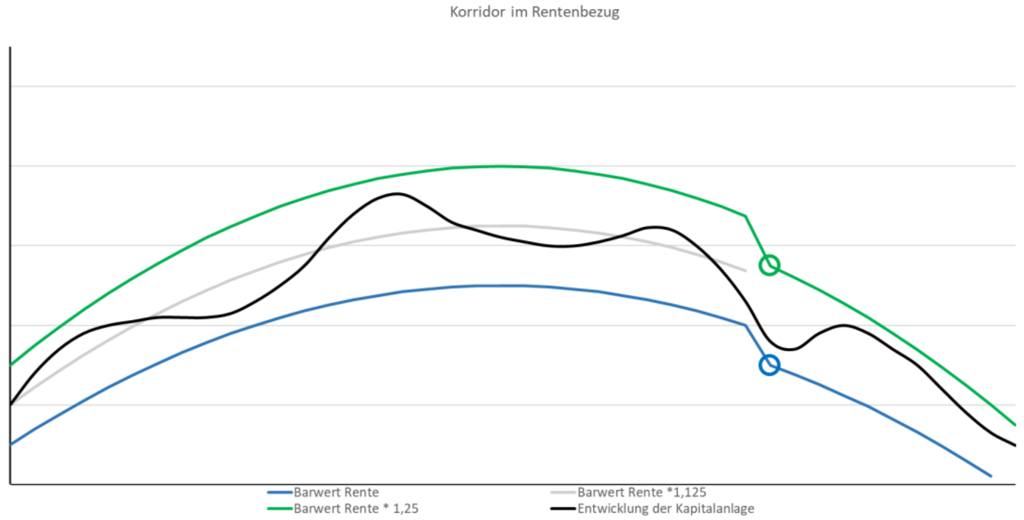
The pure defined contribution plan in the SPM

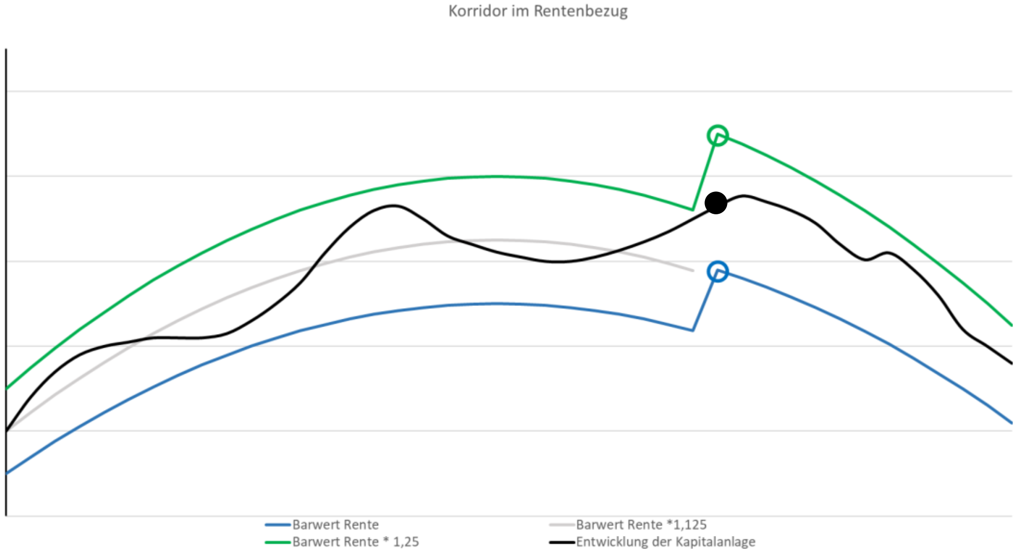
Regulations in the Pension Fund Supervision Ordinance PFAV

PFAV Part 2 - Implementation of pure defined contribution plans in occupational pension schemes (2/3)

Buffer in pension drawdown can be thought of as a corridor







The pure defined contribution plan in the SPM

Regulations in the Pension Fund Supervision Ordinance PFAV
PFAV Part 2 - Implementation of pure defined contribution plans in occupational pension schemes (3/3)

Overview (continued)

- Sec. 39 Risk management
  - Ccollective agreements to be taken into account
  - In particular, regulations on volatility
  - Supervisory law
  - Proportionality
- Sec. 40 Risk reports
- Sec. 41 Ongoing information obligations vis-à-vis the pension members and pension recipients
- Sec. 42 Reporting to the supervisory authority
  - Agreement with social partners
  - Collective agreement
  - ...
  - No later than 7 months after the end of the financial year:
    - Amount of the capital cover ratio and the upper limit
    - Assumptions and methods for determining the pension
    - Extent of adjustments and assumptions and methods

The pure defined contribution plan in the SPM

Guarantee contribution, actuarial reserve, capital cover ratio

Sec. 23 BetrAVG Additional contributions of the employer

(1) To safeguard the pure defined contribution plan, a security contribution is to be agreed in the collective agreement.

Sec. 35 PFAV Actuarial reserve

(1) In the accumulation phase, the actuarial reserve is the pension capital to be allocated according to plan on the basis of the contributions paid and the income generated from them. In the process, a collective pension capital can be formed, which is allocated to the members as a whole according to plan.

(2) In the annuity drawdown period, the actuarial reserve is to be formed according to the retrospective method, whereby the actuarial reserve at the start of the annuity corresponds to the existing pension capital of the member.

(3) Additional contributions pursuant to Sec. 23 (1) BetrAVG and income earned therefrom can be used to form an additional actuarial reserve that is allocated to the pension beneficiaries as a whole.

Sec. 36 PFAV Capital cover ratio

(1) The funded ratio is the ratio of the actuarial reserve to be formed for the pension beneficiaries in accordance with Sec. 35 (2) to the present value of the benefits to be paid by the implementing institution to these pension beneficiaries, including any associated entitlements to survivors' benefits. When calculating the cash value, Sec. 24, 2 sentences 2 to 4 shall be applied accordingly.

(2) The capital cover ratio may not exceed 125 per cent.

The pure defined contribution plan in the SPM

Amount of the lifelong benefit, adjustment of the benefit

Sec. 37 PFAV Initial amount of the lifetime benefit

(1) The initial amount of the lifelong payment is calculated by annuitising the pension capital of the member at the start of the pension. The scheduled administrative costs shall be taken into account in the annuitisation. In all other respects, the calculation bases used to calculate the cash value in accordance with Sec. 36(1) sentence 2 shall be used. Notwithstanding sentence 3, the actuarial interest rate may be chosen more cautiously in accordance with paragraph 2.

(2) The actuarial interest rate for the annuitisation of the pension capital available at the start of the pension may only be chosen more prudently to the extent that the capital cover ratio for the pension relationship does not exceed the upper limit pursuant to paragraph 36(2) when applying Sec. 36 (1) mutatis mutandis.

Sec. 38 PFAV Adjustment of the lifetime benefit

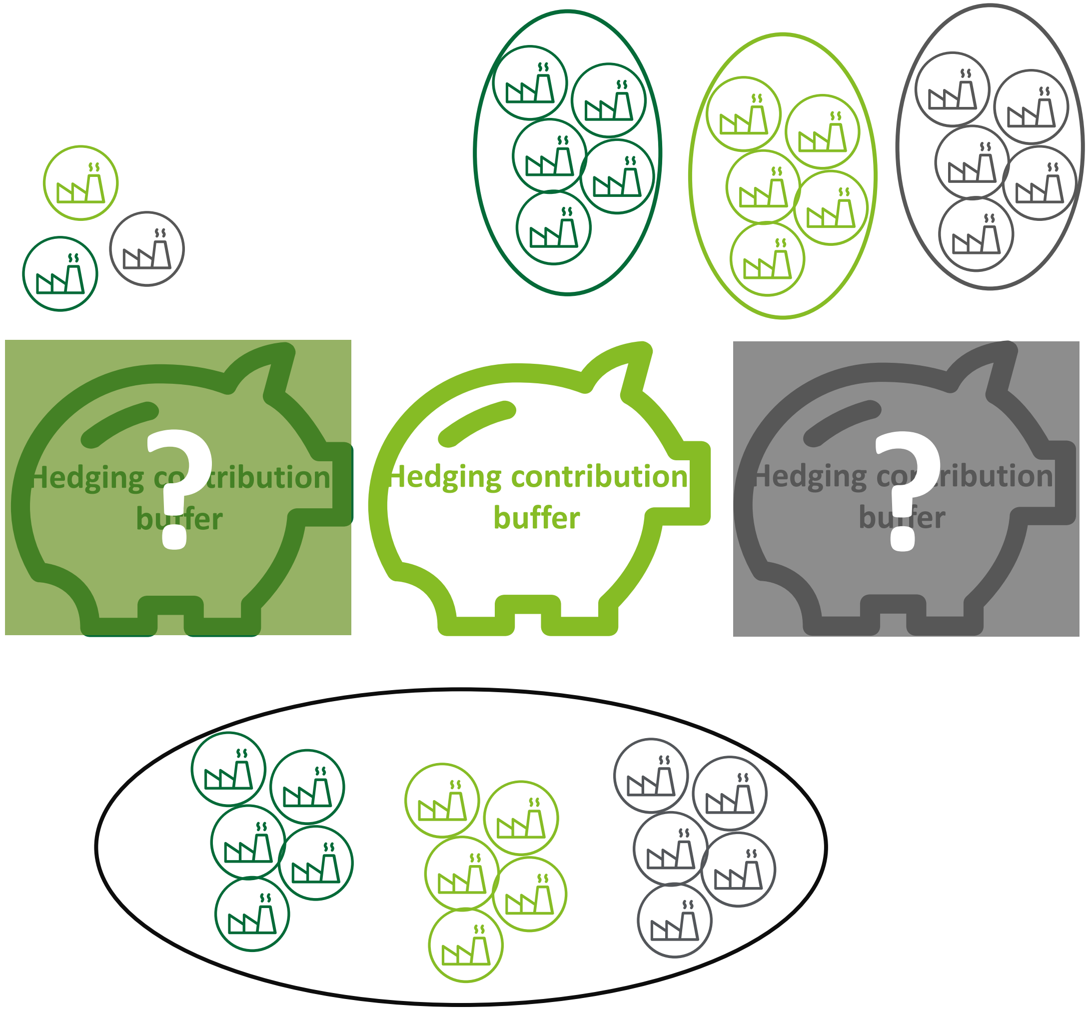
(1) The capital cover ratio pursuant to Sec. 36 (1) may not fall below 100 per cent and may not exceed the upper limit pursuant to Sec. 36 (2). If the funding ratio falls below 100 per cent, the benefits to be paid by the implementing institution to the pension recipients shall be reduced; if the funding ratio is too high, these benefits shall be increased. After the adjustment of the benefits, the requirement according to sentence 1 must be fulfilled again.

(2) An increase in benefits may only be made to the extent that a capital cover ratio of 110 per cent is not fallen short of.

(3) The implementing institution shall ensure that the requirement under paragraph 1 sentence 1 is complied with at all times. At least once a year, it shall review the benefits to be provided to pension recipients and adjust them if necessary.

Security contribution

Uniform - differentiated



Initial situation: We are in a unified protection asset

- Security contributions <u>are not</u> paid in <u>a uniform amount for employers</u>
  ➔ Beneficiaries receive a (pro rata) security measure from their employer's corresponding security buffer at most if this employer-specific security buffer is sufficiently dimensioned
- Security contributions, <u>for different employer groups</u>, assessed in different percentages (of contributions).
  ➔ collective idea within the respective employer group
  ➔ Procedure for any reduction requirements

Determinations of the <u>parties to the collective agreement on the amount of the security contribution</u>

- Administrative expenses
- Changers within the industry
- Connection with investment policy
  Excursus: same investment or hedging idea

Determination for <u>pensioners</u>

- Pensioners with vested pension rights: Continuation of the pension with own contributions

Possible applications

Various options

At the start of the pension: replenishment of the pension capital

If the target pension capital is not reached at the start of the pension, losses in value during the phase before the start of the pension can be (partially) replenished (compensation for extraordinary losses).

Replenishment in the event of an early claim

- as far as not otherwise covered

Preventing or reducing benefit cuts

Use when the minimum capital cover ratio of 100 % (+) is reached:

- Basic procedure
- Frequency
- Scope
- Dimension to be used
- Complete / partial

Compensation for fluctuations before the start of the pension

The beneficiaries here are the claimants, for whom smoothing is carried out in the event of volatile development of the pension capital

Dimension of the security contribution buffer

Options for handling particularly large hedge contribution buffers

Pensioners

- Increase in pensioner assets (cf. Sec. 35 (2) PFAV)

Beneficiaries individual

- Increase in the pension capital individually allocated to the pension beneficiaries

Anticipation buffer

- Increase of the so-called entitlement buffer (cf. Sec. 35 (1) sentence 2 PFAV)

Suspend security contribution

- Temporary non-levying of security contributions until a lower threshold value of the security contribution buffer is reached or undercut

Participation in the security contribution buffer over time

Collective view - individual view

Basic information on participation

Different groups of persons

Functioning of the SPM system

Advantages for first generations of pensioners (?)

Disadvantages for the last generation of pensioners (?)

Handling considerations

01 Evenly distributed among generations (?)

02 Differentiation according to cohorts (?)

03 Limitation of the Buffer use (?)

Stabilisation of the beginning phase of an SPM

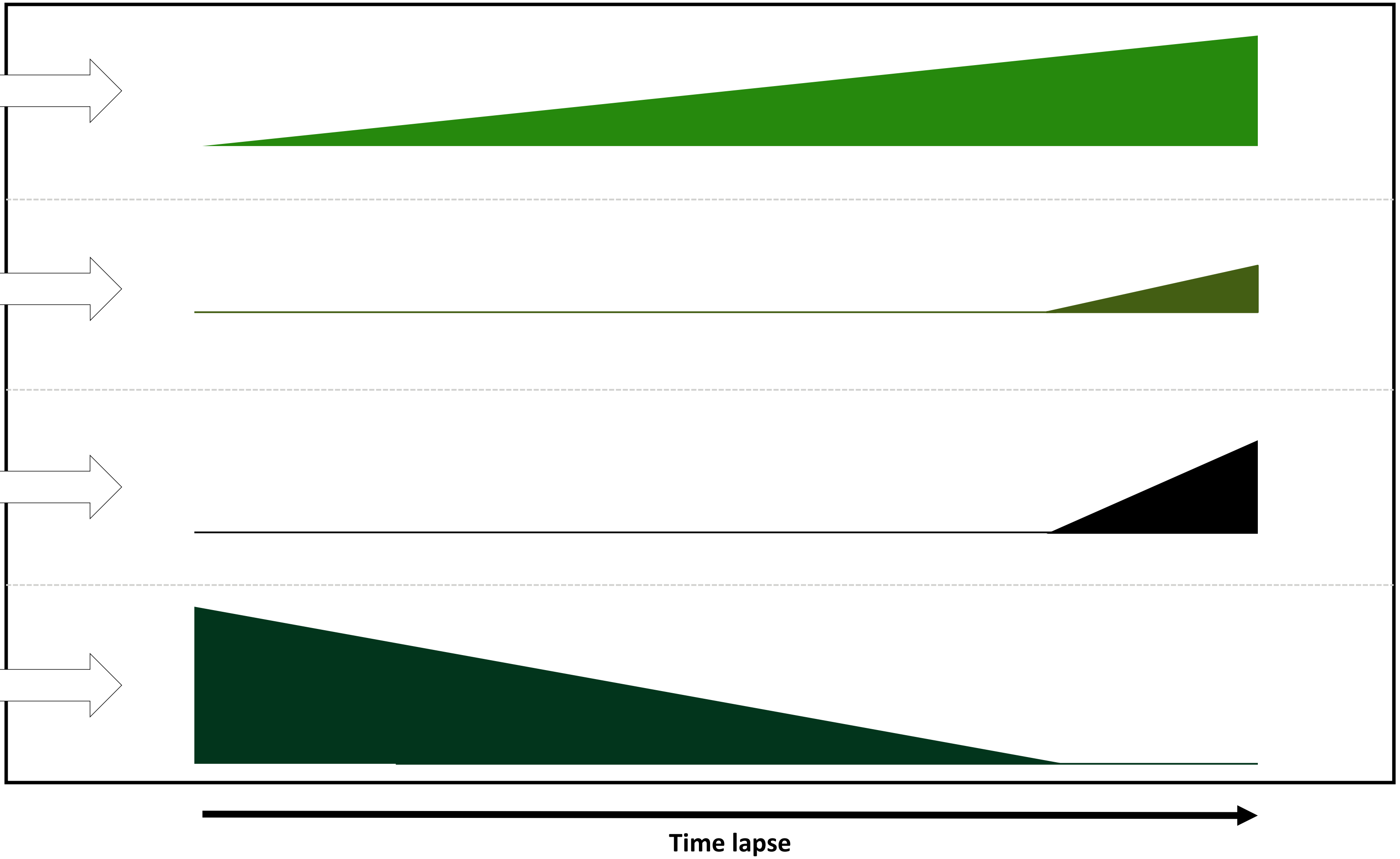
Basic considerations for the (limited / permanent) stabilisation of pension rights (illustrative)

1 **Expected buffer in relation to annual contributions**

2 **Expected ratio of Pensioners to aspirants**

3 **Maximum buffer use for pensioners as a share of total available buffer assets**

4 **Maximum buffer use for aspirants as a proportion of total available buffer assets**



Biometric protection in SPMs

Disability and survivors' insurance

Amount

Performance-based

- Euro amount, share of salary, percentage AR, annual dependency

Risk contribution-based

- Benefit calculation from contribution-based amount by means of RGL 2nd order
- Depends from paid contributions
- Top-ups (in the event of invalidity)

Asset-based

- Annuitisation of existing assets
- If applicable, increased by parts of the expectancy buffer
- No settlement balances

Option

- Mandatory inclusion
- Optional inclusion ➔ Avoiding anti-selection

Benefit trigger (in the event of invalidity)

- Occupational disability/incapacity
- (Partial) reduction in earning capacity according to SGB - statically or dynamically defined

Duration of benefits

- Disability: up to retirement pension or for life
- Death: No death benefit

Special aspects for the design

- Uneven contribution levels / exemption from contributions
- Handling in performance-based design
- Handling in the case of risk-contribution-based design
- Regulations in the event of reactivation

Separation of pensioner collectives

Advantages and disadvantages

Old-age, disability and survivors' pension collectives (+)

- With the same security assets
  - Same capital investment strategy
  - Three degrees of capital cover
- In the case of separate security assets
  - Different capital investment strategies possible
- Separation of the pensioners' collectives
  - Adequate retirement factors per collective can be designed
  - Misjudgements of one type of pension do not lead to a burden on the other types of pension
  - Reinsurance policies: Surpluses can be left in the collective

Old-age, disability and survivors' pension collectives (–)

- Smaller collectives ➔ Higher fluctuations
- Higher complexity

Reinsurance (cover)

Designs and their effects

Risk contribution-based
Determination of risk benefits

- Risk contributions are used as premiums for risk reinsurance policies
- Benefits from the reinsurance can represent the risk benefits promised - **but no guarantee!!!**

Performance-based
Determination of risk benefits

- The amounts for the premiums for the risk reinsurance are taken from the pension assets of the member.
- The capital maturing in the event of benefits is used to increase the pension capital for the beneficiary when it matures
- Regular reassessment of the premium for the insurance, if applicable.
- Possibilities of performance measurement:
  - Example 1: The beneficiary is informed of the amount of the agreed lump-sum payment by the life insurer/reinsurer. The starting pension is then formed from this payment together with the existing pension capital according to the rules in the GCI or in the pension plan.
  - Example 2: The beneficiary is promised an initial pension in euros in the event of a benefit. This is calculated from the one-off payment of the life insurer/reinsurer and the pension factors currently available at the pension provider. Assuming that the pension factor only changes once a year and that the reinsured/insured one-off payment is also adjusted on an annual basis, *a quasi-guaranteed initial pension can thus be promised.* The pension actually paid is then calculated together with the already existing pension capital.*

* see the results report of the DAV's expert committee on old-age provision: Disability and survivors' insurance in the case of pure defined contribution plans Cologne, 9 May 2023

Q&A

Many thanks

for your attention

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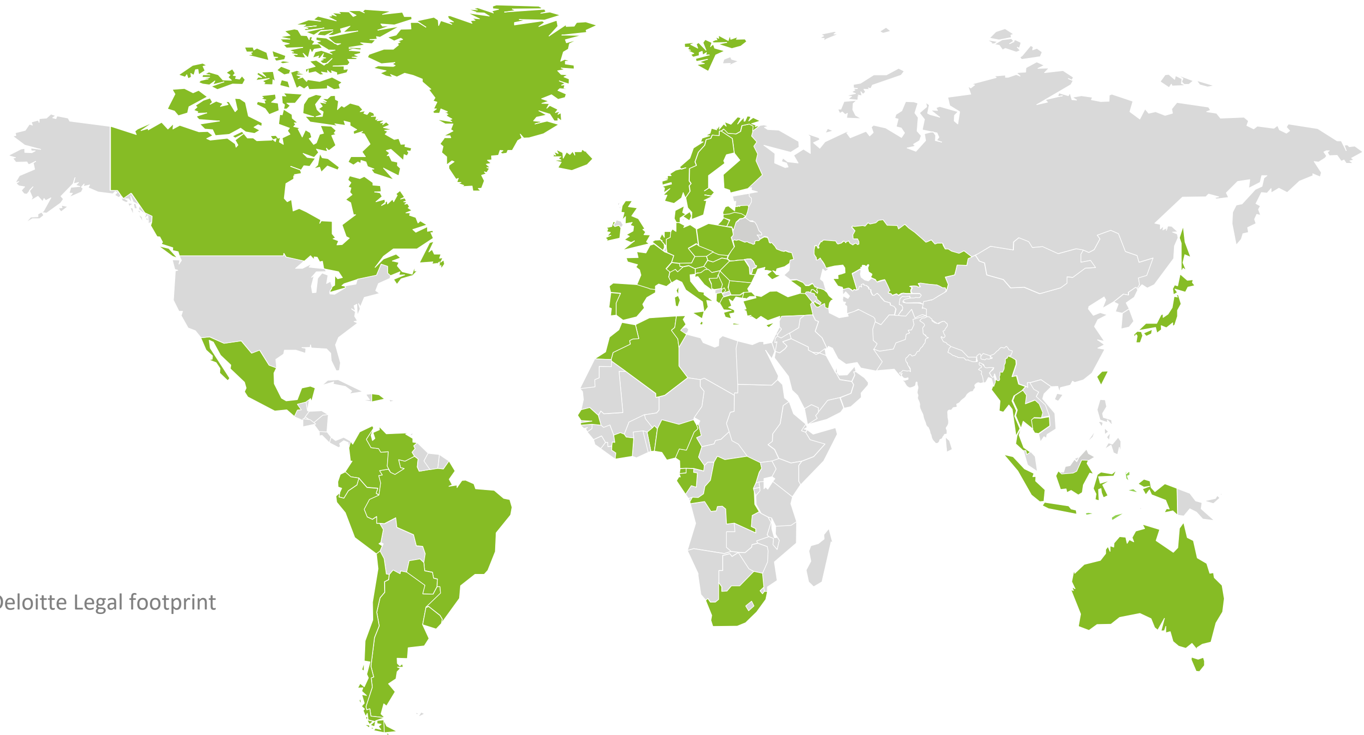

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