



Deloitte Legal Webcast
"Legal Update #02/2025"

Case Study Outsourcing pension obligations 2025

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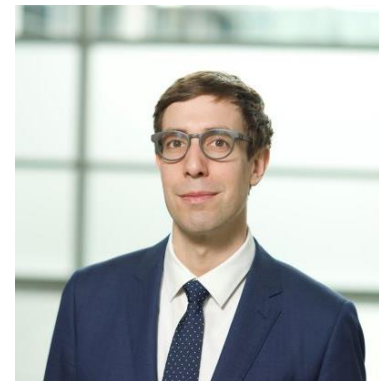
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Strategies, solutions, implementation - Our agenda

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Labour law framework and ...further options



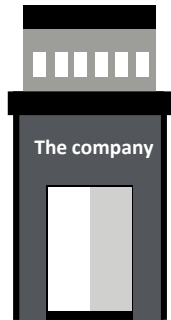
01

The "Case"



01 The case

Brief description

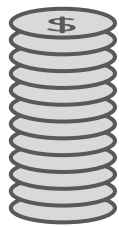


German company with **500 employees** and **1,500 Inactive**

From the **financial sector**

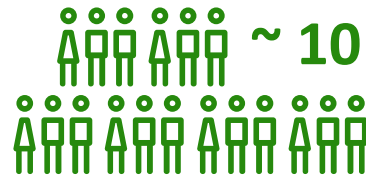
Economically challenging **market environment**

Pension adjustments suspended in the last two regular adjustment reviews



High burden from pension obligations

← deferred vested, pensioners & active employees



Complex pension landscape with a total of 10 different pension commitments



Miscellaneous Legal bases:

- under collective law
- Individual contract



80 million euros Pension obligations for active employees according to HGB



3 million euros annual service cost



270 million euros Pension obligations for deferred vested and pensioners according to HGB

Economic starting position:



Sharp increase in pension obligations in the last 10 years

High **burden on the income statement**

Lack of transparency regarding status quo and future development

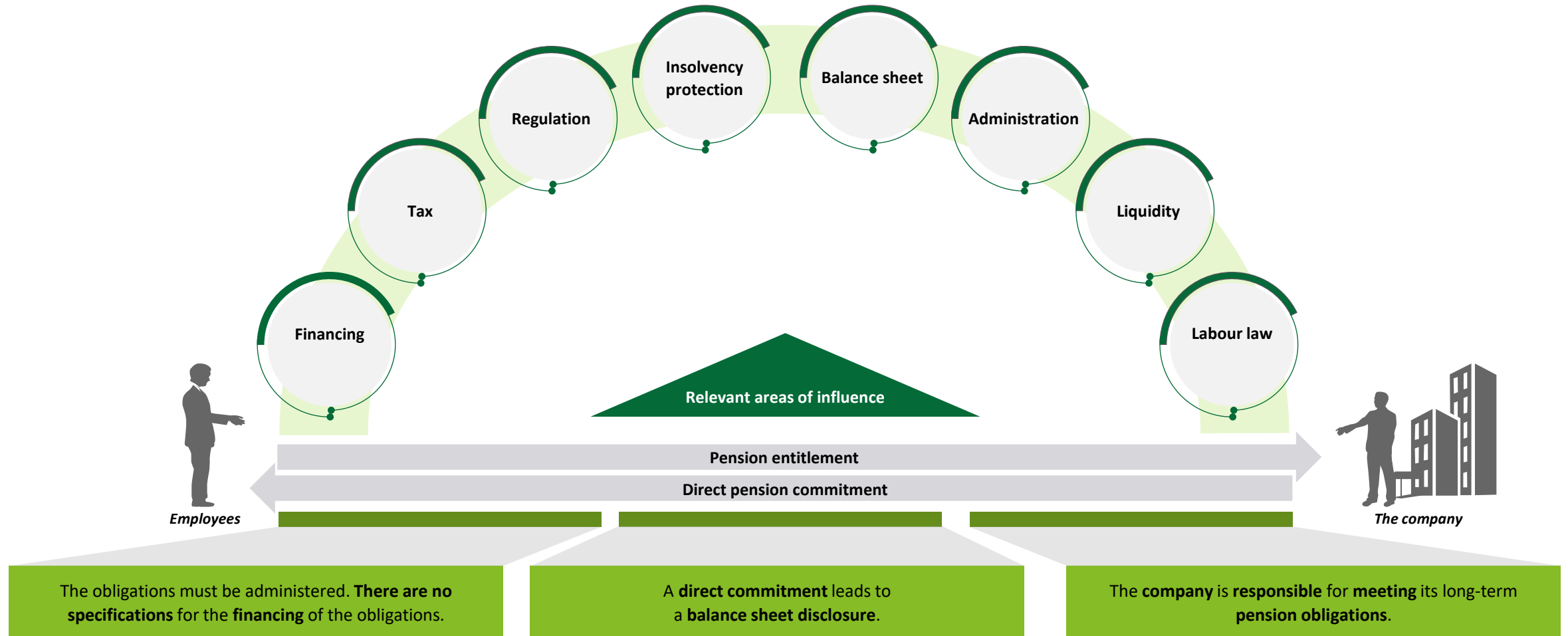
02

Strategic and operational Initial considerations



02 Strategic and operational initial considerations

Direct pension obligations have an impact on numerous areas of the company



02 Strategic and operational initial considerations

Economic, social and legal framework conditions influence the occupational pension environment

Market trends in the occupational pension environment



Demographic development

- In **2035**, there will be **4 million additional pensioners** in Germany¹ - this will lead to significantly **higher administrative costs** for IORPs and occupational pension² departments.



Technical renewal requirements for companies

- **The need to renew pension administration systems**, some of which are very **outdated**, and the challenge of communicating existing offers.
- Search for **alternatives to SAP Payroll** with regard to the announced end of maintenance, as new pension commitments can no longer be integrated.



Technologies have no bAV legacy plans in scope

- Many existing portal solutions are not specifically adapted to the complex occupational pension processes - **manual activities** and **technical workarounds** are widespread in day-to-day work.

Needs

1

Use of future-proof technologies and efficient bAV administration processes

2

Active management of pension risks and transparent and secure accounting

3

Fulfillment of all compliance requirements

4

Employee satisfaction and retention



Capital market development

- Due to the **changed interest environment**, there is currently a trend towards **funding existing pension obligations**.
- Uncertainty on the capital markets and inflation trends lead to an increased **need to manage (pension) risks**.



Regulatory pressure

- **Insurers and institutions for occupational retirement provision (IORPs) must become more resistant to the risks of the obligation to provide evidence - disclosure obligations** are to be expected.

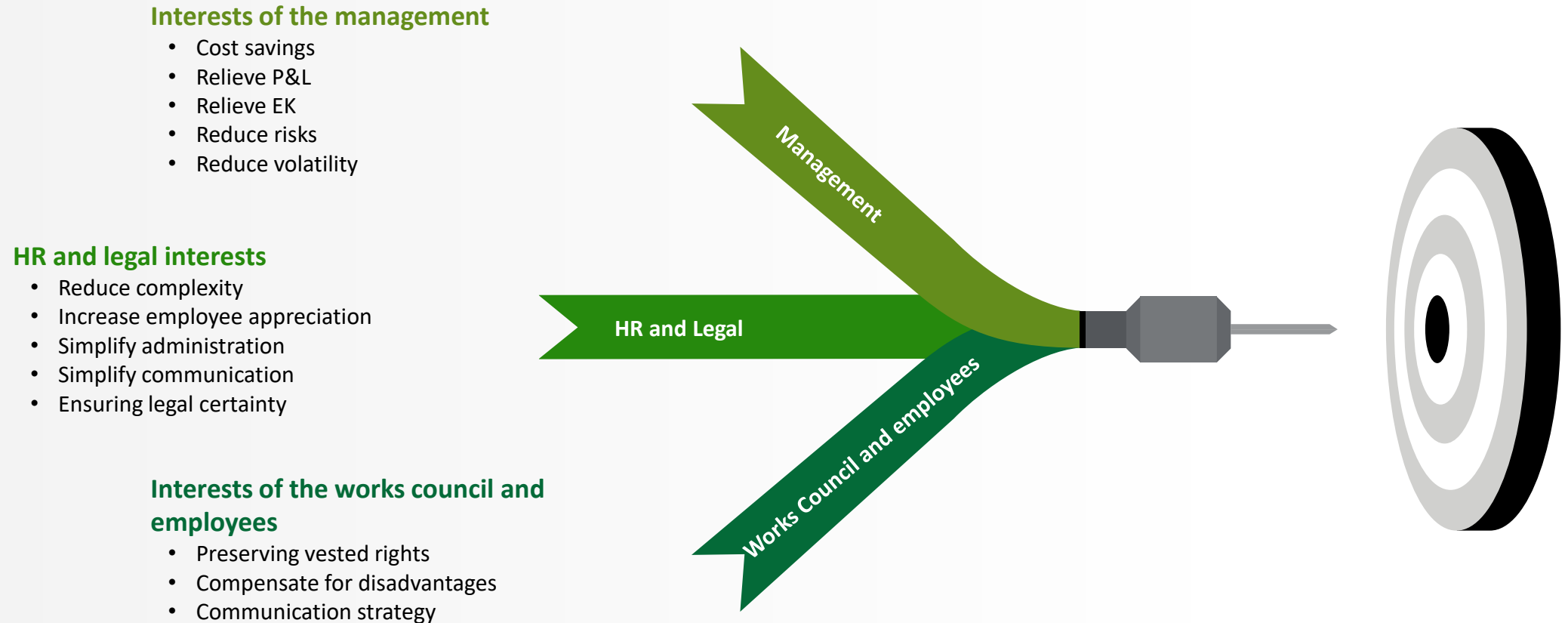


Skills shortage

- Both occupational pension departments and occupational pension service providers will have to replace **departing administrative staff in the coming years** without losing expertise.
- Companies are faced with the **choice of outsourcing or insourcing**, often with a lack of documentation of histories and business transactions.
- Attractive occupational pension schemes are becoming more of a focus for **young talent**.

02 Strategic and operational initial considerations

Numerous stakeholder groups of a company are involved in the occupational pension scheme and pursue different interests



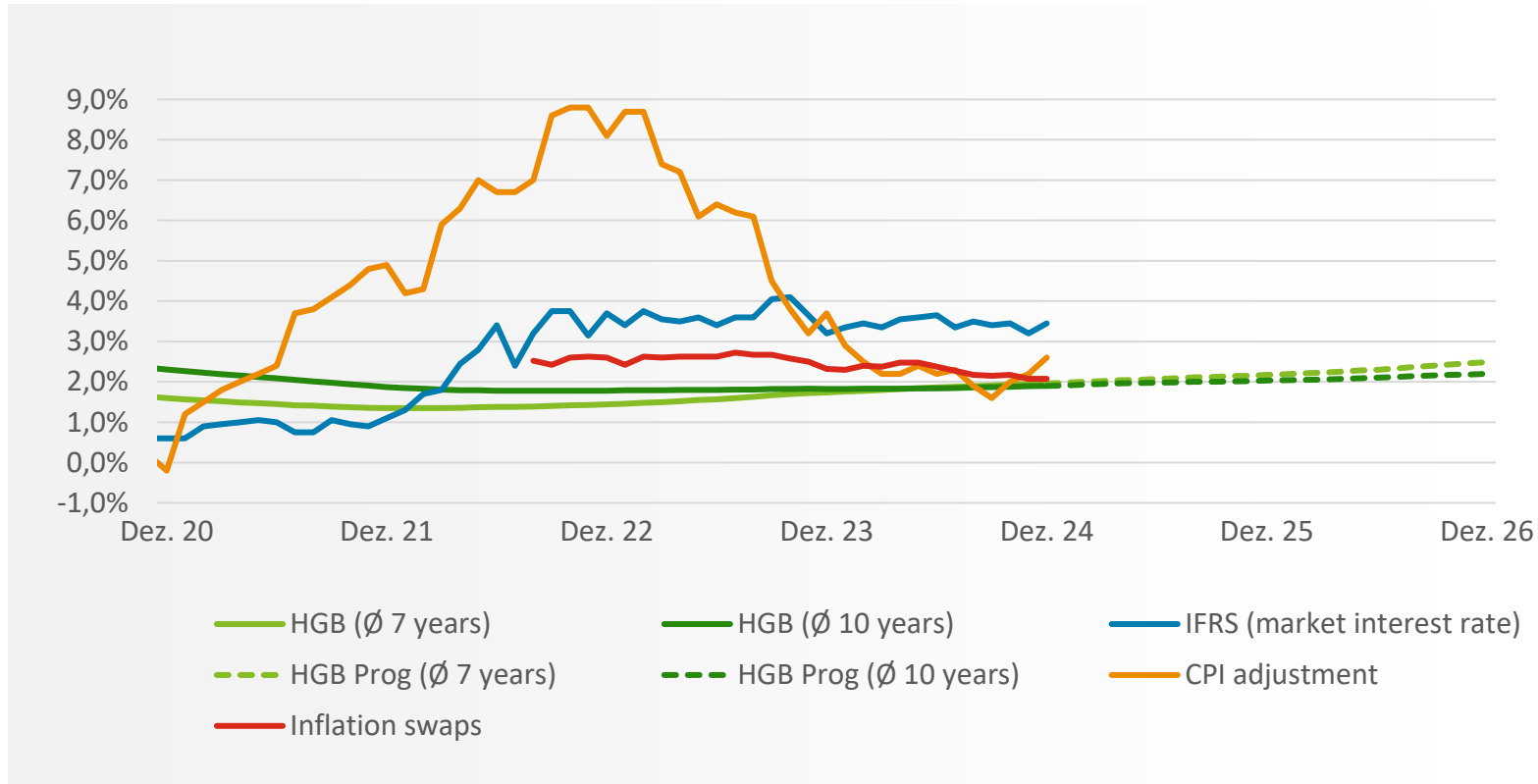
03

(Financial) economic parameters,
Legal requirements and implementation



03. (Financial) economic parameters

The actuarial interest rate and inflation are key parameters in the measurement of pension obligations



Rule of thumb:
1% decline in interest rate leads to 15% increase in obligation

Change in the balance sheet

HGB result

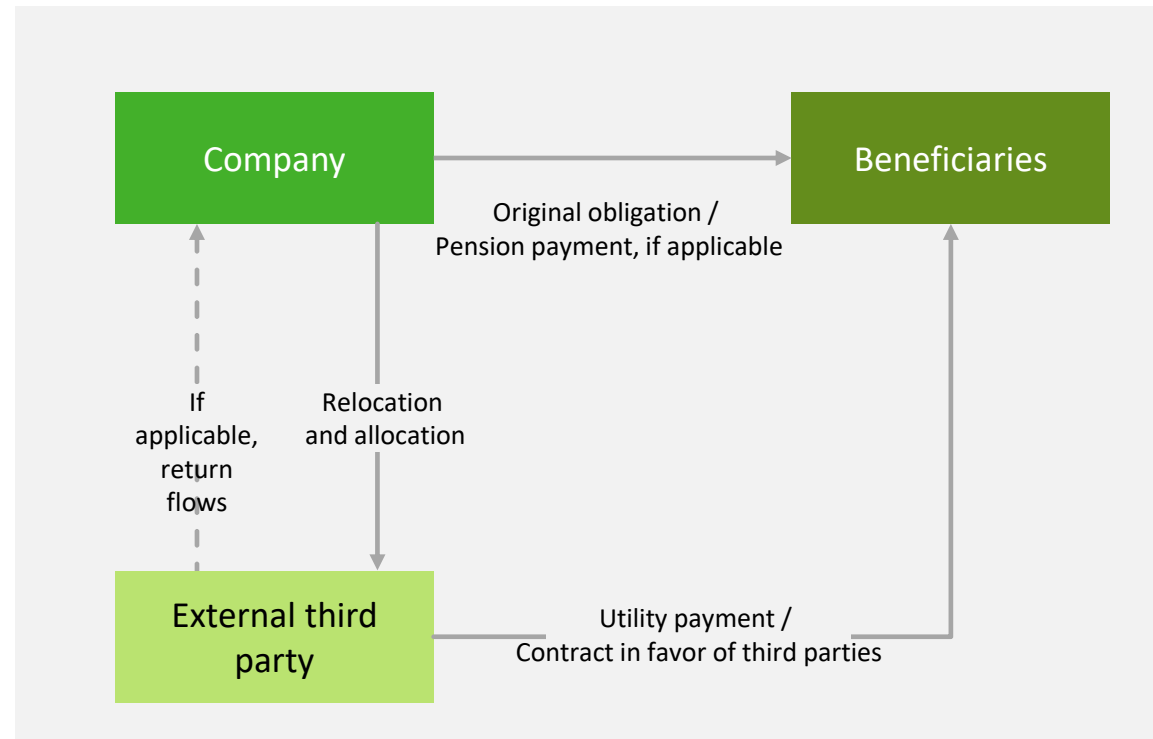
Influencing key figures

Pension obligations can play an important role in assessing the economic situation of a company of a company or its enterprise value.

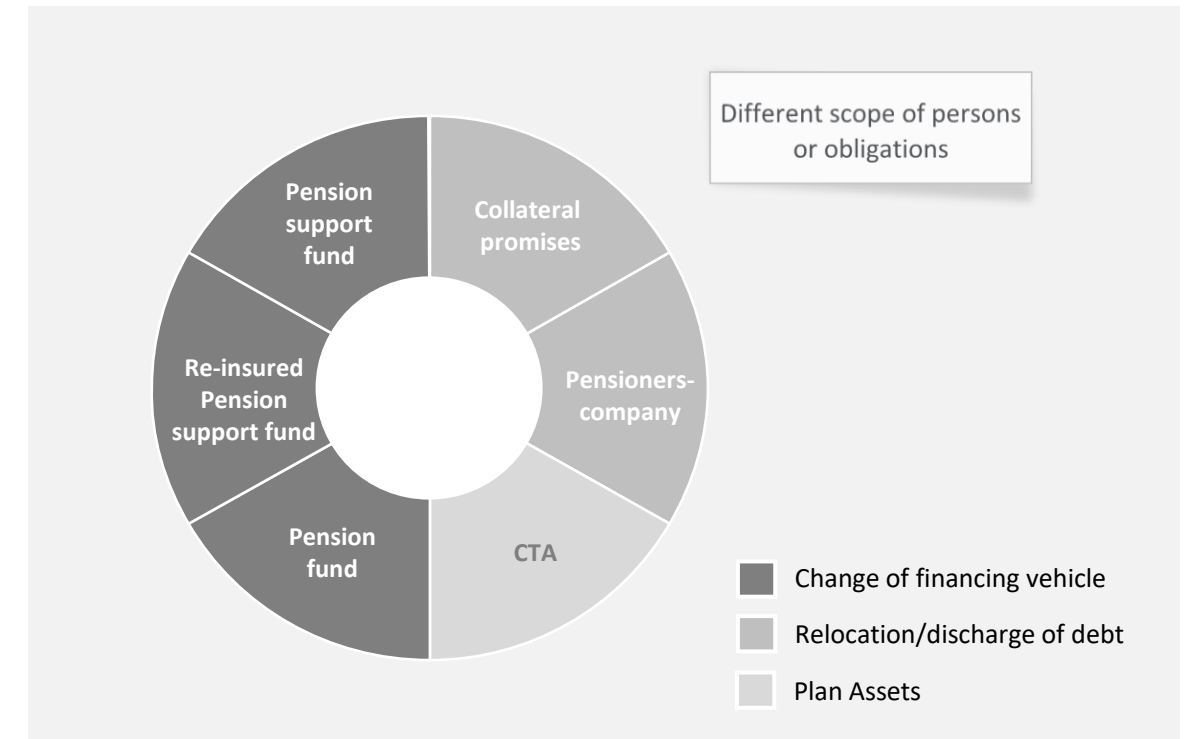
03 Legal requirements and implementation

Range of action for the outsourcing of obligations

Schematic representation



Framework for action

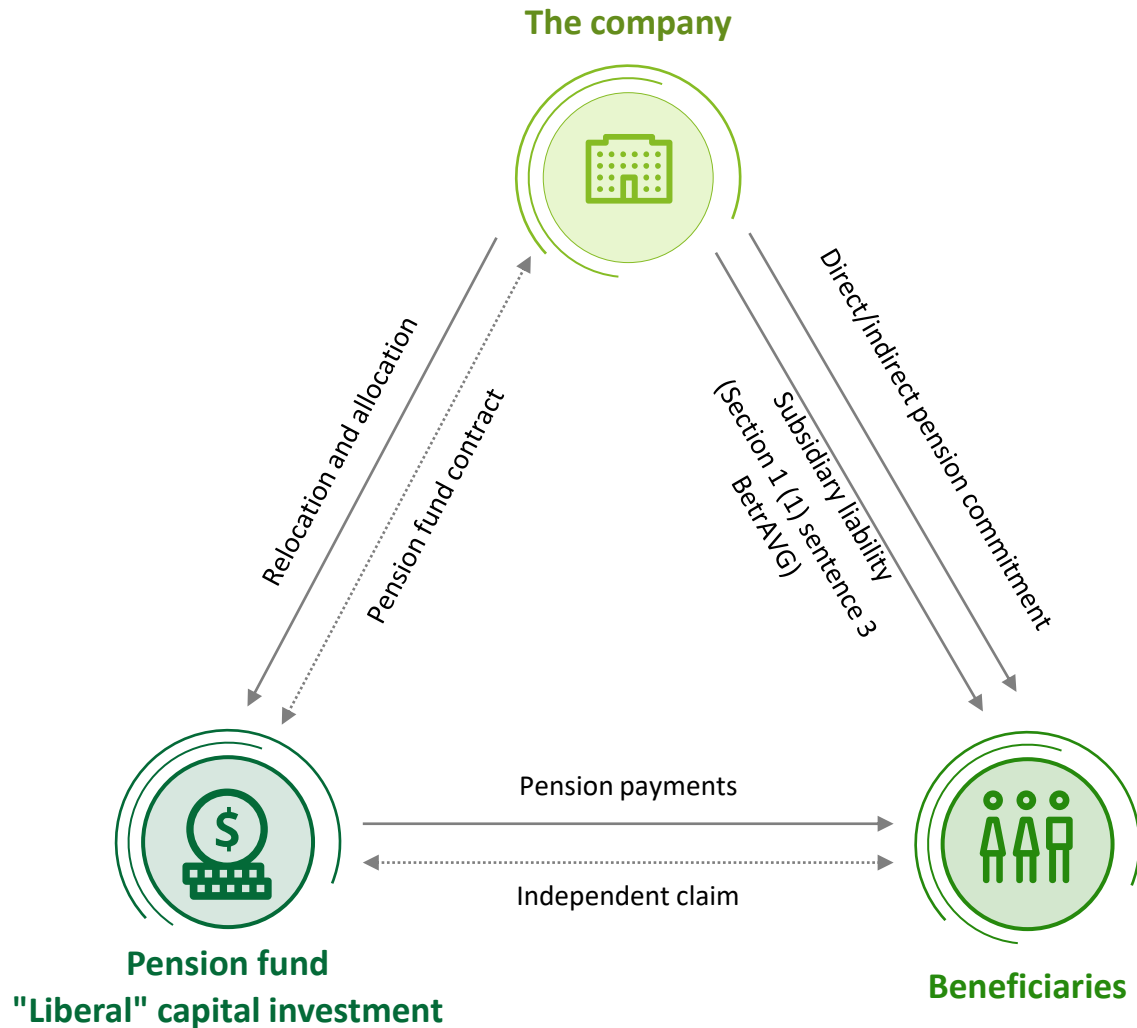


Differences with regard to:

- | | | | |
|--|--|---|---|
| <ul style="list-style-type: none"> • Liquidity requirements • Scope of persons and obligations to be covered • Individual / consolidated balance sheet effect | <ul style="list-style-type: none"> • Restrictions under labor law • Wage tax changes • Income tax effects | <ul style="list-style-type: none"> • Supervisory law • Contribution calculation • Payment method (one-off / ongoing) | <ul style="list-style-type: none"> • Asset investment • Additional funding obligations or insurance-type guarantees |
|--|--|---|---|

03 Legal requirements and implementation

Off-balance in the commercial balance sheet and balance sheet reduction under IFRS through creation of plan assets and management of pension risks through active investment management



Description

- The **pension fund** takes over the earned portion of the pension commitment ("**past service**") and receives assets in return.
- Economic **outsourcing without risk transfer** or debt relief, i.e. if there are insufficient assets in the pension fund in the future, additional assets must be contributed.
- The pension provision in the commercial and tax balance sheets must be reversed accordingly. Under **IFRS**, **there are no changes to the defined benefit obligation**. The assets in the pension fund **qualify as plan assets**.
- In the commercial balance sheet, future effects from changes in interest rates are shown in the notes from the time of outsourcing, i.e. **no charge to the income statement**.
- **In accordance with Article 28 of the Introductory Act to the German Commercial Code (EGHGB)**, there is an **option to recognize** any shortfalls only in the notes.
- Depending on the structure, there are differences in terms of liquidity requirements, asset investment and labor, tax and regulatory implications.
- Reduction in PSV costs of approx. 80%.

03 Legal requirements and implementation

Relevant aspects of transferring to pension funds

IFRS

- Differentiation of the commitment according to defined contribution and benefit plan
- Outsourcing does not change the character of the pension plan
- Pension funds qualify as plan assets under IAS 19

Commercial balance (HGB)

- Provisions are only to be derecognized to the extent that the company is relieved of its direct obligation
- Any unfunded portion of the pension obligation must be recognized in the balance sheet
- Changes in the value of transferred provisions (e.g. interest effects) will no longer be recognized in profit or loss in the future
- Future shortfalls are to be shown in the notes

Capital investment/ supervisory law

- One-off contribution for transferred obligations
- Contribution of assets and SAA
- Additional funding obligations
- Bank regulations (e.g. CRR)
- Reduction of the PSV contribution

Tax law

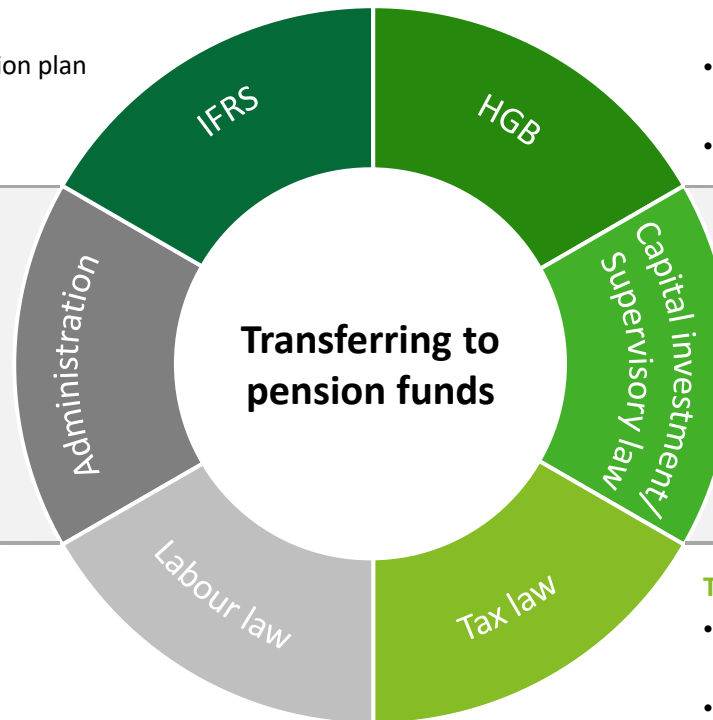
- Pension provision must be derecognized for outsourced obligation components
- The one-off contribution is deductible as a business expense
- After submitting an application in accordance with § 4e EStG, the excess part of the one-off contribution can be recognized as a business expense in the following 10 financial years
- Taxation of income in the benefit phase in accordance with § 22 EStG

Administration

- Payroll accounting
- Interfaces to the pension fund
- Employee/pensioner administration
- Changes to status notifications

Labour law

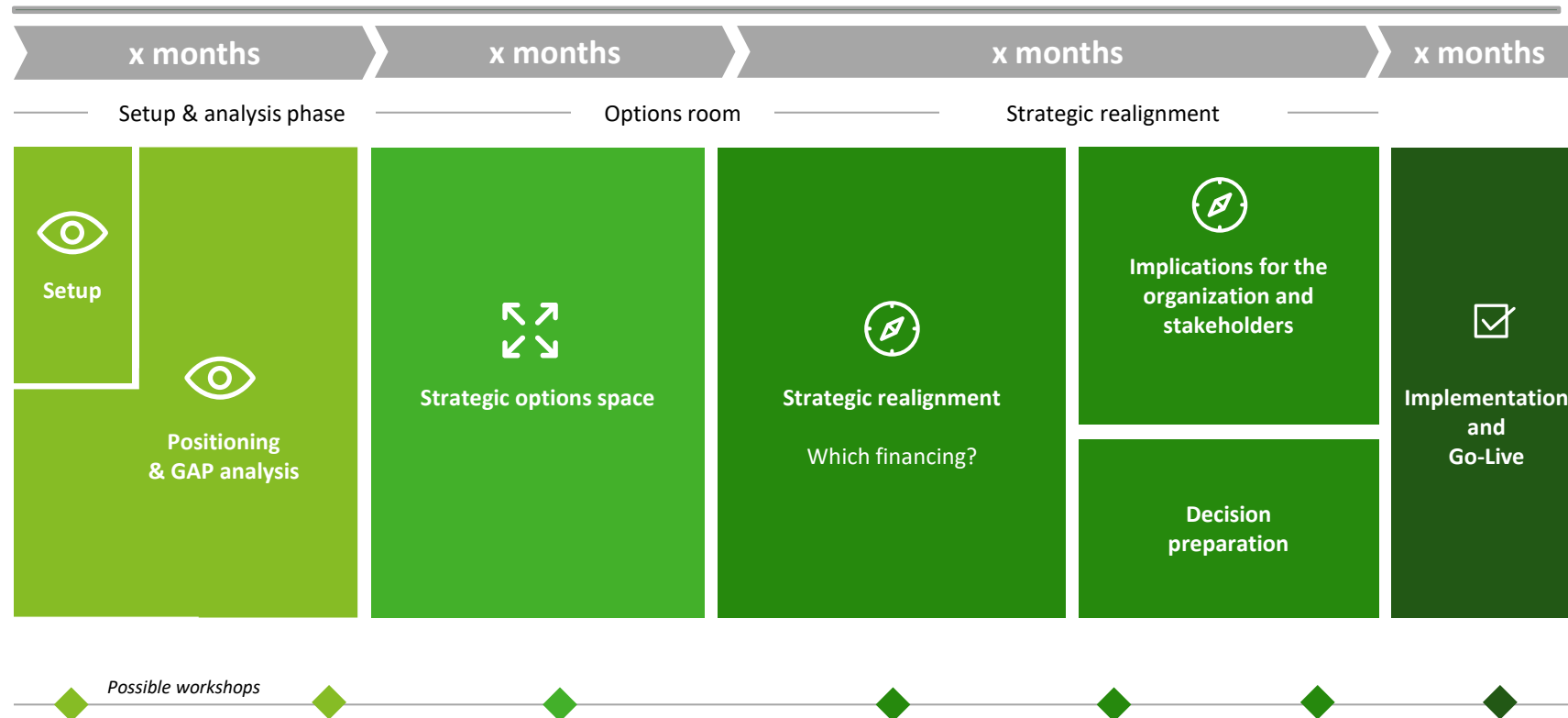
- Consent requirement of the employee/
Participation rights of the works council
- No tax disadvantages for pensioners. Consent requirement not legally clear.
- Possible disadvantages for employees due to change of taxation type
- Employer's statutory obligation to assume liability under Section 1 (1) sentence 3 BetrAVG remains in force



03 Legal requirements and implementation

Timetable: The duration of the project depends on the complexity of the supply structure; the work packages are accompanied by workshops and result in a results document that serves as a decision document for implementation

TIMELINE



DEVELOPMENT

- **Data inventory** based on the documents provided on the supply landscape and current financing concept
- **In-depth as-is analysis** and **GAP analysis**, taking into account **market trends and drivers**
- **Prioritization** of the options for action with regard to the achievement of objectives and identification of the implications for the affected areas of the company and stakeholders
- Derivation of **concrete measures** for implementation of the prioritized action option and proposal for a suitable project structure
- Preparation of the results for the decision **paper**
- Support during **implementation** and **Go-live**

Possible potential for a strategic realignment of the occupational pension scheme can be identified in a non-binding initial consultation.

04

Labour law framework and ...further options



04 Labour law framework

Preliminary considerations for outsourcing existing occupational pension commitments to a pension fund

occupational pension scheme within the meaning of Section 1 (1) sentence 1 BetrAVG

In accordance with Section 236 (1) No. 1 VAG, pension funds can only provide occupational pension benefits

- Old-age pension
- Survivors' pension
- Occupational pension
- Endowment insurance
- P! Social allowance for children
- P! Temporary continued payment of wages to widows/widowers (death benefit)



(No) modification of content

Deteriorating interventions require proportionality in accordance with the three-stage theory of the BAG in order to be effective (judgment of 17.04.1985, 3 AZR 72/83).

The permissibility of the intervention is assessed on the basis of a balancing of interests:

Reasons for change by the employer



Interest of the employees benefiting from the pension in protecting their continued existence

Three-stage proportionality test:

Entitlements already earned

Pro rata temporis earned momentum

Unvested entitlements dependent on length of service

1.

2.

3.

Intervention only permitted for **compelling reasons.**

Intervention (only) permitted for **valid reasons.**

Intervention permissible for **objective and proportional reasons.**

04 Labour law framework

The participation rights of the works council/staff council

Initial question:	Required involvement of the works council/staff council in accordance with the applicable legal framework conditions
In particular in the event of non-compliance with mandatory co-determination: ineffectiveness of the change of implementation channel	

Starting point for participation rights of the works council:

The right of co-determination under Section 87 (1) no. 10 BetrVG (questions of company pay structure) generally (also) extends to modifications of occupational pension commitments for active employees if the employer has scope for regulation with regard to the modification.



No statutory right of participation of the works council

- (1) If pension obligations are outsourced to pension funds of active pension beneficiaries without changing the benefit catalog
- (2) With equivalent net salary commitment, if beneficiaries are not (or no longer) represented by the works council
- (3) For occupational pension commitments based on individual contractual agreements

Statutory right of participation of the works council

- (1) If the content of the BAV is affected by changes to the benefit plan (Section 87 (1) no. 10 BetrVG)
- (2) Specific implementation method expressly agreed without reservation in the pension commitment

04 Labour law framework

Further options – Labour law requirements for (partial) suspension of pension adjustments

Initial question:	Effectiveness of the (partial) suspension of pension adjustments
Consequences of the ineffectiveness of the (partial) suspension: (1) Catching up on the adjustment in accordance with Section 16 (4) BetrAVG, (2) Necessary readjustment of the present value of the pension obligations to pensioners	
Prerequisite	Concrete requirement
Adjustment due to special legal basis	In particular, case groups of Section 16 (3) BetrAVG (e.g. effective promise of a guarantee adjustment)
Formal requirements	(1) Proper notification of the pension recipient about the omission of the adjustment, § 16 para. 4 sentence 2 BetrAVG (2) Written explanation of the economic situation, information on legal remedies, no objection
Material requirements	(1) Successful demonstration that employer cannot make the adjustment payments from the company's earnings and increase in value due to <ul style="list-style-type: none"> • inadequate return on equity/interest, or • inadequate equity base (2) Reporting date-related consideration: future-related economic situation of the employer on the reference date of the adjustment review
No Group view	(1) Group-wide consideration of the economic situation (i.e. employer obliged to make adjustments if the economic situation of the parent company permits, "calculation pass-through") if <ul style="list-style-type: none"> • Profit transfer and control agreement exists between the Group (parent) company and the employer • Parent company demonstrably adversely affected employer in such a way that employer was demonstrably unable to achieve a sufficiently good economic situation (2) Concrete evidence of negative influence: profit transfer and domination agreement alone not sufficient

04 Labour law framework

Further options: Labour law requirements for switching from pension to lump-sum benefits

Initial question:

Legal requirements for the modification of the benefit content from pension to lump-sum benefits

Requirements relevant for: (1) effectiveness of the replacement, (2) cohort of pension benefits covered by the adjustment test pursuant to section 16 BetrAVG

BAG (judgment of 15.05.2012, 3 AZR 11/10): Capitalization of a commitment to later pension payment requires justification in accordance with Section 242 BGB

1. Current pension benefits have a special value for the beneficiary employee and the employee can rely on receiving current pension payments in return for their loyalty to the company in old age. The replacement of current pension benefits with a capital payment therefore requires special justification by the employer.
2. However, the justification is not to be assessed according to the proportionality test in accordance with the 3-step theory, as the modification of the benefit content from a pension to a lump-sum payment does not involve any interference with pension entitlements.
3. Rather, an economic assessment must be made which, in addition to the additional tax burden for the employee resulting from the changeover (progression effect), takes into account the employer's economic capacity to grant a premium for the lump-sum benefit to compensate for the employee's higher economic burden.

Consequence:

Capitalization requires objective justification, which is given if the employer can cite significant reasons for capitalization from an economic perspective. The employer must specifically state the economic reasons for the capitalization.

04 Labour law framework

Further options. Alternatively: supplementing the occupational pension commitments with a lump-sum option (as a one-off payment or in installments)

Starting point: Granting of pension benefits as lifelong pensions from the time the insured event occurs.

Opportunities of a capital option right for employers

- Reduction of the longevity risk
- no more provisions for pension obligations to individual beneficiaries after the capital payment has been made
- Elimination of administrative costs in the pension phase (incl. costs for actuarial reports)
- Elimination of hedging costs (PSV contributions) in the pension phase
- Depending on the structure of the offer, balance sheet advantages (P&L-effective obligation reduction in accordance with IFRS)
- No adjustment (audit) obligation pursuant to Section 16 BetrAVG for lump-sum benefits

Challenges of a capital option law

- Higher outflow of liquidity compared to pension benefits and associated liquidity requirement if capitalization is chosen; liquidity requirement can be cushioned by payment in installments (for a maximum period of 10 years)
- Full assumption of the short-life risk (= death of individual beneficiaries (far) before the actuarial expectation) through a lump-sum benefit as opposed to an alternative pension benefit
- Lump-sum payment for pension beneficiaries in individual cases less favorable from a tax perspective due to progressive income tax system; also causes uncertainty regarding the number of pension beneficiaries exercising the capital option right

Opportunities of a capital option right for employees

- Immediate inflow of liquidity for individual life planning, e.g. for the repayment of real estate loans
- No risk of loss (in the event of death without surviving dependants entitled to benefits such as children older than 25 or siblings)
- Transparency about the value of the supply
- No loss in the event of shortened life expectancy due to illness or hereditary predisposition
- Capitalization of non-usable benefit components (e.g. survivors' benefits without surviving dependants)

04 Labour law framework

Further options: Supplementing occupational pension commitments with a lump-sum option (as a one-off payment or in installments): Permitted group of persons

The addition of a genuine capitalization option to occupational pension commitments is possible for active and vested pension beneficiaries.
retired beneficiaries (UVA).

Active beneficiaries

Introduction of a capital option right for pension beneficiaries who are in active employment is permissible

No violation of the prohibition on severance payments under § 3 BetrAVG:

- In its ruling of 15.05.2012 (3 AZR 11/10), the Federal Labour Court recognized, among other things, the permissibility of granting employees an unrestricted right to choose between current pension benefits and lump-sum payments

UVA

From a legal perspective, there are material arguments in favor of introducing the lump-sum option right for pension beneficiaries who have left the company with a vested pension entitlement:

- To date, as far as can be seen, no supreme court rulings have been issued on the question of the admissibility of such a right of choice for UVA
- Material arguments that speak in favor of admissibility (and thus do not include a violation of the prohibition of severance payments under Section 3 BetrAVG):
 - Capitalization on retirement no settlement, as no compensation for the beneficiary for giving up his entitlement
 - Pension entitlement is fulfilled by alternative payment option after retirement (= condition precedent for the accrual of the pension entitlement)

Pensioner

Introduction of a capital option right **inadmissible**; violation of the prohibition of severance payments under § 3 BetrAVG, provided there are no trivial benefits

- Capitalization for current benefits only permissible within the limits of § 3 BetrAVG; therefore only for minor benefits

Q&A





**Thank you very
much**
for your attention

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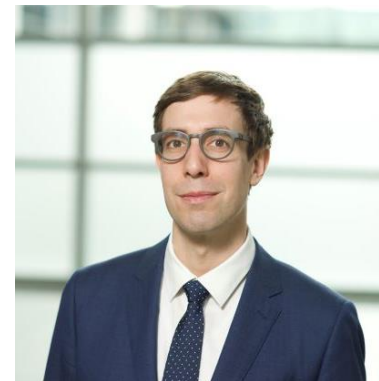
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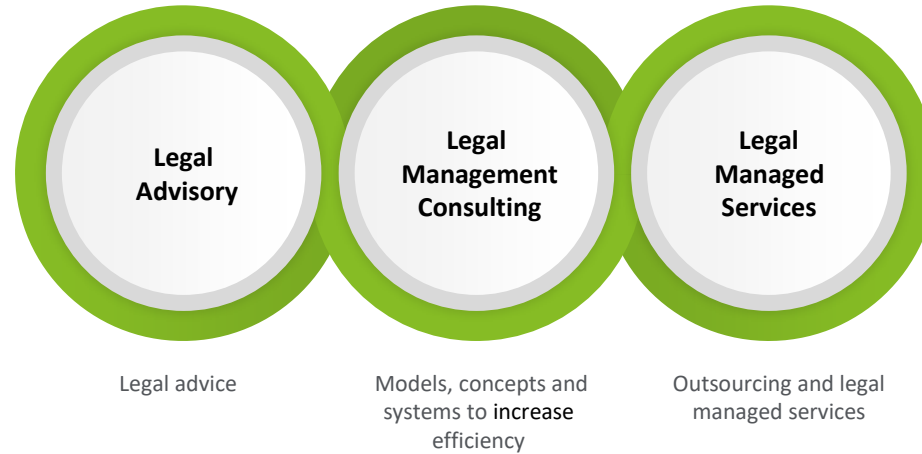
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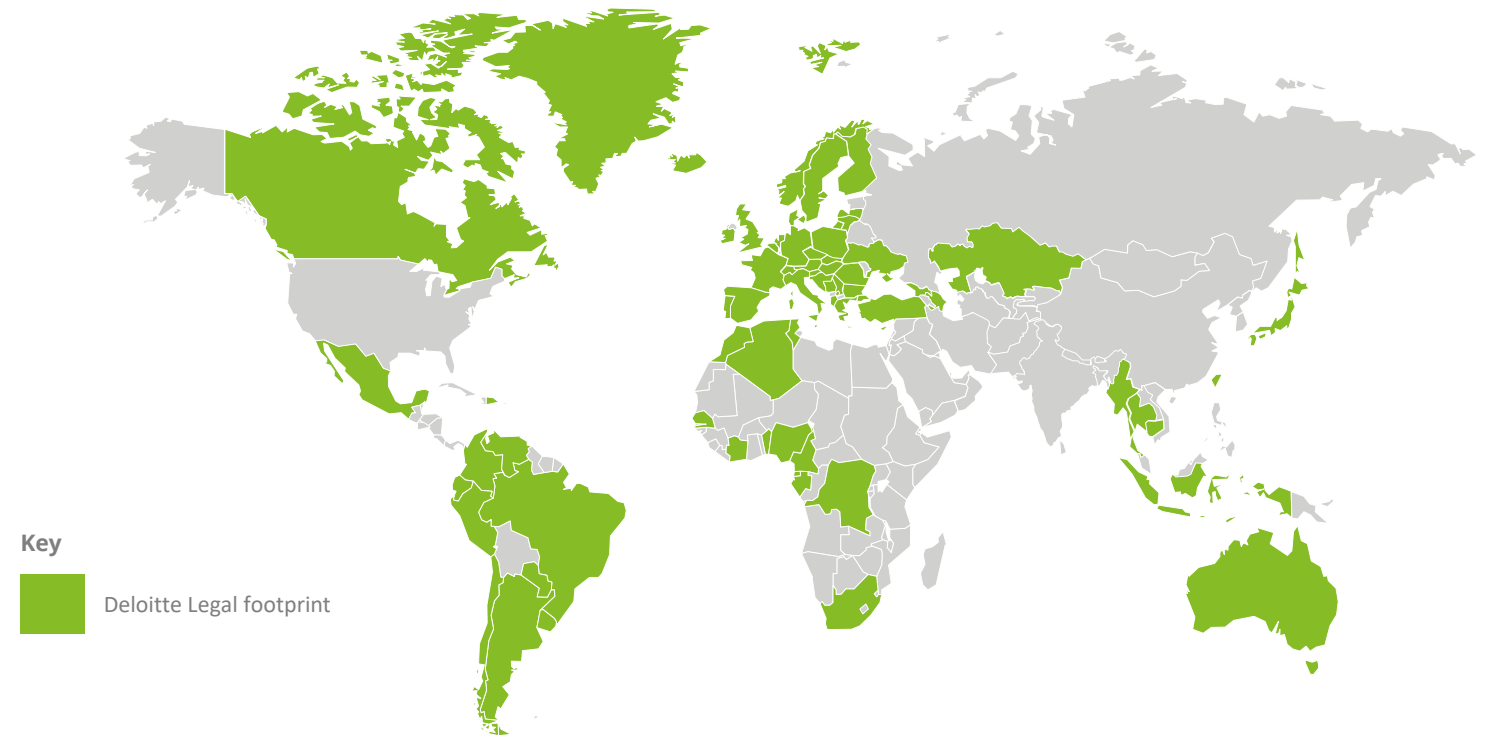


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