aba – Arbeitsgemeinschaft für
betriebliche Altersversorgung e.V.

aba priorities regarding the former Portability Directive

referring to the amended proposal for a Directive
on minimum requirements for enhancing worker mobility by improving the
acquisition and preservation of supplementary pension rights
- General approach[1]

About the aba

The aba (Arbeitsgemeinschaft für betriebliche Altersversorgung e.V.) is the German industry association representing all matters concerning occupational pensions in the private and public sector. The aba has 1,300 members including corporate sponsors of pension schemes, IORPs, actuaries and consulting firms, employer associations and unions, as well as insurance companies, banks and investment managers. According to the aba statute, our mission is to represent existing schemes as well as to expand coverage of occupational pensions independent of vehicle.

[1] All articles and recitals cited in this position paper refer to the proposed text from 17 June 2013.

What we call for

- Rather than enhancing "worker mobility between Member States", the attractiveness and thereby coverage of occupational pensions should be increased. In particular the conditions for German occupational pensions should not be worsened. The title of the Directive should make clear that it is not covering all supplementary pensions. We therefore suggest referring to "occupational pensions".
- To enhance worker mobility between Member States and at the same time increase the attractiveness of occupational pensions, it should be examined whether there is a possibility for mutual (tax) recognition of occupational pensions, at least for periods when workers are posted abroad. This could be included in the proposed Directive.
- The Directive's scope of application should be limited to new pension promises. National legislatures should define what constitutes a new pension promise.
- A limitation of the scope of application to employees changing their employers across Member States should not only be mentioned in Recital 5, but also be included in the title of the Directive. We suggest adding "worker mobility *between Member States"* to the title. This limitation should also be mentioned in Art. 2, which defines the scope of application.
- Considering small and medium sized enterprises (SME) as well as sectors where coverage has not reached the desired levels, minimum age and vesting period should be guided by the average length of vocational training or similar programmes.
- We advocate a maximum length of vesting period and/or waiting period (in the German translation it is called "Wartezeit", but following German law it should be called "Vorschaltzeit") of five years. If the maximum length is lowered to three years, we call for this change to be accompanied by tax advantages.
- To give the social partners flexibility when implementing the Directive, the Directive should refer to "comparable protection" or "if everything is considered no less favourable" than set out in the Directive.

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1. **Objective of the Directive: A comprehensive long-term perspective for occupational pensions should be added**

The proposed Directive text as of 17 June 2013 aims to increase the mobility of workers between Member States by introducing EU standards for the acquisition of vested pension rights and the protection of deferred pension rights.[2]

- Occupational pensions are the most efficient form of funded retirement provision. They are particularly beneficial for employees if employers / companies or social partners organise an occupational pension as a social benefit with no or only low costs to the beneficiaries. It cannot be expected that the coverage of occupational pensions will increase as a result of this Directive.

  The title of the proposed Directive should fit its content. The current title of the proposed Directive refers to “supplementary pension rights”. This is not new – the Commission proposals from 2005 as well as from 2007 and the Directive 98/49/EC refer to supplementary pension rights. In Art. 3b of the current proposal a "supplementary pension scheme" is defined as “any occupational retirement pension scheme established in conformity with national legislation and practice and linked to an employment relationship, intended to provide a supplementary pension for employed persons”. To clearly distinguish between second and third pillar and to emphasise the importance of an employment contract for the second pillar, we suggest using the term “occupational pensions” in English and “betriebliche Altersversorgung” in German.

  All relevant EU law should seek to use a consistent terminology which emphasises the link to an employment contract (key characteristic and motor of efficiency) in regard to occupational pensions.

- The demographic developments make a strengthening of occupational pensions – that is an increase in coverage as well as an increase in individual benefits – necessary. Rather than creating an extra burden for occupational pensions with this new Directive, economic growth, functioning labour markets and better conditions for occupational pensions would be necessary in the EU.

- The proposed Directive with its regulations regarding vesting periods and the protection of deferred pension rights will limit **the established function of occupational pensions to retain employees** in a company. So far occupational pensions have been used in countries like Germany to retain mostly qualified employees and strengthen their ties to their employer. Occupational pensions therefore contribute to the strategic competitive advantage and the long-term success of a company. Very high mobility of workers, which inhibits the creation and preservation of company specific human capital, negatively impacts the medium and long-term economic success and is therefore neither in the interest of individual companies nor the overall economy.

- Existing tax obstacles should be addressed to facilitate employee mobility between Member States and enhance the attractiveness of occupational pensions at the same time. From our perspective, a mutual recognition of occupational pensions systems, at least if posting a worker abroad, is necessary. Art.

[2] See Recital 5: „The objective of this Directive is to facilitate worker mobility between Member States by improving the acquisition and preservation of supplementary pension rights of scheme members who, after their employment in one Member State, engage in employment in another Member State.“

18A (Pension plans) of the double-tax-agreement with the US[3] is a good example of mutual recognition.[4] Abuse is prevented with the limitation to posted workers.

- Rather than enhancing "worker mobility between Member States", the attractiveness and thereby coverage of occupational pensions should be increased. The proposed Directive does not achieve this.
- The title of the Directive should already make clear that it is not covering all supplementary pensions. We therefore suggest referring to "*occupational* pensions". This term is also used in Directive RL 2003/41 of 3 June 2003 regarding the activities and supervision of institutions for *occupational* retirement provision (IORP Directive).
- To enhance worker mobility between Member States and at the same time increase the attractiveness of occupational pensions, it should be examined whether there is a possibility for mutual (tax) recognition of occupational pensions, at least for periods when workers are posted abroad. This could be included in the proposed Directive.

2. Scope of application: Limitation to new pension promises

The proposed text as of 17 June 2013 stipulates in Art. 2 (3) an application of the Directive "**to periods of employment falling after its implementation** in accordance with Art. 8." Futhermore, even if the Council statement on equal treatment from June 2013 sets a different objective[5], its scope of application is limited to **employee mobility between Member States**.

- The aba supports limiting the scope of application to future pension promises which will be made after the implementation of the Directive (new pension promises). Any introduction of higher minimum standards should only apply to future pension promises and have the least possible effect on the existing stock of pension promises, so that employers know what to expect when allocating their resources. National legislatures should define what constitutes a new pension promise, because this can only be done considering national labour law. This should also apply with the following in mind:

  Since the Directive does not include invalidity and survivors' pensions (Art. 2 (2d) and Recital 12, last sentence), in most Member States only retirement provisions will be affected. However, in Germany invalidity and survivors' pensions are part of occupational pensions and therefore would be affected as a consequence of Art. 7. Otherwise new pension promises would require a specific design to avoid different vesting periods for the different types of benefits.
- The Directive's scope of application should be limited to new pension promises.

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[3] Convention between the United States of America and the Federal Republic of Germany for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income and capital and to certain other taxes

[4] See aba-Stellungnahme zum Weißbuch Rente, Dez. 2012, („Überprüfung der Steuervorschriften (M 18)", page 17 onwards, text in German).

[5] "This Directive does not provide for the acquisition and preservation of supplementary pension rights of workers moving within a single Member State. However, Member States are encouraged to ensure the equal treatment of scheme members who change employment within a single Member State and those who exercise their right to free movement from one Member State to another."

- The aba generally welcomes that the **scope of application** (limited to employees changing employers across Member States) spares national systems and allows specific success-factors to persist. This takes into account the concerns already raised in 2005/2007 that the proposed Directive could contravene the principle of subsidiarity, because only a very small number of employees in the EU seeks work in another Member State. The Commission's Impact Assessment from 2005 showed that this was the case for only 0.2% of employees (p. 12). In addition, the text from 17 June 2013 addresses the objection made in the assessment of the legal service of the Council, that the Recitals of the proposed Directive need further additions when citing Art. 46 as the basis for authority, and that internal cases, which are likely to be the vast majority, are also covered. However, we would like to point out that the proposed limitation of the scope of application is legally not viable (principle of national treatment). In addition this limitation will be difficult to follow in practice.
- The limitation of the scope of application to employees changing their employers across Member States should not only be mentioned in Recital 5, but also be included in the title of the Directive. We suggest adding "worker mobility *between Member States"* to the title. This limitation should also be mentioned in Art. 2, which defines the scope of application.
- It should be avoided that the scope of application the Directive stipulates introduces expensive differentiations which are difficult to administer. It is therefore important to find a clear and unambiguous definition of "outgoing worker" (Art. 3g). The proposed requirement that the worker "within two years, becomes engaged in employment in another Member State", is therefore adequate. The time limits given to employers to inform their employees about their vested pension rights need to be adjusted accordingly.

3. **Vesting period: three years is the absolute minimum**

The proposed text as of 17 June 2013 stipulates in Art. 4a that vesting periods and / or waiting periods (for the German system: qualifying periods, defined in Art. 3f) can together last up to three years. The future minimum age for the acquisition of vested pension rights should only be 21 years (Art. 4b).

- Before an EU-wide maximum vesting and/or waiting period as well as a minimum age are fixed, it is worth considering the rules in other countries. Companies operating within the EU are in competition with companies in the US, India, Japan, Brazil, China and Russia. None of those countries have rules for employers who make a pension promise to their employees regarding the minimum age or the revaluation of vested pension rights after the beneficiary has left the company (Overview by Towers Watson, Annex 1). In addition, there are no rules regarding vesting periods in China, India, Japan and Russia. In the US rules around vesting periods depend on the type of pension plan. For plans where the employer bears at least some of the risk, minimum vesting periods are three years. However, it often takes six or seven years for the whole pension promise to vest.
- A study by the German IAB[6] (Research Institute of the Bundesagentur für Arbeit in Nürnberg) shows significant differences regarding the **average length of employment** with the current employer among the analysed EU Member States. However, a general downward trend cannot be seen in these figures.

[6] Rhein, Thomas (2010): Beschäftigungsdynamik im internationalen Vergleich -Ist Europa auf dem Weg zum „Turbo-Arbeitsmarkt"? (IAB Kurzbericht 19/2010), text in German.

In the analysed time period (1992-2008) the average length of employment of employees (between the age of 15 and 64) in Germany fell from 1993 onwards as a consequence of the labour market crisis, however, **since 2001 it is back up at over 10 years**.

- A different IAB-study[7] shows that in Germany the average length of employment for those starting out on their career is 28.17 months (average over all 110 professions analysed). This varies significantly with the profession chosen.
- Currently the vesting period for employer-sponsored occupational pensions in Germany is five years (no vesting period for salary sacrifice). The period of five years is an efficient instrument not only for employers, the overall economy also benefits from it. Changing employers and having to build up new company specific human capital is neither in the interest of employers nor of the economy as a whole.

  aba calculations regarding the costs of a general curtailment of vesting periods in Germany show that for contribution-oriented defined benefit plans (beitragsorientierte Leistungspläne) a curtailment from five to three years, as suggested by the Council text from 17 June 2013 would lead to an increase in costs for active members in the order of 1% to 4% (assuming average fluctuation). If employee fluctuation was high, this could rise up to 15%.[8] Reducing vesting periods to two years would lead to an increase in cost of 1% to 5% for those with average fluctuation, for companies with higher fluctuation up to 20%.
- The minimum age for employer-sponsored occupational pension is 25 years in Germany. The high fluctuation in the age group up to 25 years would create an immense administrative burden. The aba therefore suggests a minimum age of at least 23.
- Future EU minimum standards for occupational pensions in the area of labour law which exceed the national level of regulation **need to be accompanied by changes in national tax law**. It should be avoided that a curtailment of vesting periods and the minimum age is again not properly met with a change in tax rules.

➢ Considering small and medium sized enterprises (SME) as well as sectors where coverage has not reached the desired levels, minimum age and vesting period should be guided by the average length of vocational training or similar programmes.

➢ We advocate a maximum length of vesting period and/or waiting period (in the German translation it is called “Wartezeit”, but following German law it should be called “Vorschaltzeit” and potentially starts together with the vesting period) of five years. If the maximum length is lowered to three years, we call for this change to be accompanied by tax advantages.

[7] Stumpf, Felix; Damelang, Andreas; Schulz, Florian (2012): Die berufliche Strukturierung der frühen Erwerbsphase * Ereignisanalysen zur Beschäftigungsstabilität. (IAB-Forschungsbericht, 12/2012), text in German.

[8] In addition there will be additional Past Service Costs (which are likely to be moderate) if the changes also apply to past service. If the Directive is limited **to periods of employment falling after the transposition of the Directive** according to Art. 8 there will be no additional past service costs.

4. **The future role of the social partners in occupational pensions: Flexibility regarding the planned minimum requirements (Art. 4d and Art. 5 (4))**

In the future the Member States should – according to Art. 4 d and Art. 5 (4) – give the social partners the opportunity "to lay down different provisions by collective agreement, to the extent that those provisions provide no less favourable protection and do not create obstacles to the freedom of movement for workers."

- The social partners should have the opportunity to develop packages of benefits which overall offer the same protection. This mirrors the approach of the Commission such as in Recital 29, which acknowledges the special position of the social partners.
- To give the social partners flexibility when implementing the Directive the Directive should refer to "comparable protection" or "if everything is considered no less favourable" than set out in the Directive.

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Annex 1: Overview: Legal requirements regarding vesting periods outside of the EU

Country	Vesting period	Minimum age?	Revaluation of deferred pension rights
Brazil	Company plans which are closed: 3 years Open plans: more flexibility, but dependent on the provider – legal situation not entirely clear	No	No
China	No provisions	No	No
India	No provisions	No	No
Japan	No provisions	No	No
Russia	No provisions	No	No
US (DB & Profit-Sharing Plans)	100% after 5 years of service, or 20% after 3 years of service + 20% after each following year, that is 100% after 7 years	No	No
US (Cash Balance/ Pension Equity / Hybrid Plans)	100% after 3 years of service	No	No
US (employee contributions)	Immediately vested	No minimum age	No provisions
USA (matching contributions made by the employer)	100% after 3 years of service, or 20% after 2 years of service + 20% after each following year, that is 100% after 6	No minimum age	No provisions

Country	Vesting period	Minimum age?	Revaluation of deferred pension rights
	years		
US – exceptions	Immediately vested if waiting period for members is less than 1 year (max. 2 years, not possible for 401k plans)	No minimum age	No provisions

Note: Voluntary earlier vesting can lead to immediate tax liabilities for beneficiaries. These rules were not checked.

Source: Towers Watson CompSource - Retirement & Risk Benefits Reports 2013