

National Report for Germany

1. State of the profession

- 1.1 All 20 members of the German IACA section take keen interest in the board's professional work. The members convene twice a year.
- 1.2 The German Institute of Pensions-Actuaries (IVS), in which IACA members play a leading part, is gaining ever increasing importance. It has 143 members. Recently the institute, together with the representatives from the Internal Revenue and the IACA agreed on a paper setting out certain standard contents and minimum requirements that actuarial valuation reports for book reserved pension plans should meet.
- 1.3 Various court rulings have increased the significance of accountability for mistakes in actuarial valuation reports. We are currently negotiating with insurers on the extent of coverage and premium levels for professional indemnity insurance.
- 1.4 In recent years more IACA-members founded joint ventures or entered into cooperations with US or European consulting actuaries in order to be able to provide international services to their large multinational clients.

2. General Information

- 2.1 During the last two years the following statistics were recorded in the Federal Republic of Germany:
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| average gross earnings increases between | 3 and 4% p.a. |
| average cost of living increases (currently approximately nil) | 1.5% p.a. |
| the average gross increase in social security pensions was | 3% p.a. |
| after allowing for an increase of 1% in the medical insurance premium for pensioners the net increase was | 2% p.a. |
- The increase in net take-home pay has continued to lag behind the increase in gross earnings, because of increases in income taxes and social security deductions. The increase in net take-home pay has, however, exceeded the average increase in the cost of living.
- 2.2 Interest rates for loan capital have decreased from a level of 8% p.a. two years ago to 6% p.a. today. The real rate of interest – after allowing for cost of living increases – is around 5 to 6% p.a., which is the highest level for real rates of interest in the last 20 to 30 years.
- ## 3. The Social Security System
- 3.1 The contribution to the medical insurance fund for pensioners was increased to 5.2% of the state pension as at July 1st, 1986. Since its introduction in 1983 the contribution rate has steadily increased and will reach its maximum of 5.9% on July 1st, 1987.
- 3.2 Increases in state pensions were statutorily reduced by the increasing medical contribution. This resulted in an average effective gross increase in state pensions of 2% p.a. Because of the low cost of living increases, state pensions – for the first time since the 1970s – actually increased in real terms.

Politicians and experts agree that future state pension increases should be in line with net, not gross, earnings increases.

- 3.3 The Social Security Act was amended to increase pensions for women by an average of DM 25 per month for each child raised.
- 3.4 To finance the increasing pensions burden the combined employer and employee contribution rate, borne equally by both, was increased from 18.5% to 19.2% of relevant earnings with effect from June 1st, 1985. As from January 1st, 1986 the Social Security Contribution Ceiling was raised to DM 67,200 p.a. The active population, by means of increased contributions, and pensioners, by means of reduced pension increases continued to meet the financial deficit created by the increasing population of pensioners. Not least because of the dramatically reducing birth rate over the past 20 years the ratio of pensioners to actives is expected to double by the year 2030.
- 3.5 The government finally enacted equal treatment of spouses in the social security system after the Federal Supreme Court had, in 1974, pronounced the then existing inequality as unconstitutional. For deaths occurring after January 1st, 1986 all spouses will be entitled to a 60% spouse's pension, subject however to partial subtraction of "deductible income". Company pensions do not fall into the catalogue of deductible income types.

40% of all deductible income in excess of (currently) approximately DM 900 p.m. is subtracted from the state spouses's income. This means for example, that if the state pension of the deceased amounted to DM 2,000 p.m. and that of the surviving spouse was DM 1,500 the spouse's pension would be calculated as follows:

60% of DM 2 000	= DM 1,200
40% of (DM 1,500 – DM 900)	= DM 240

Spouse's pension = DM 960

It is expected that an undramatic structural reform in the Social Security System will take place during 1987.

4. Unemployment and pre-retirement

- 4.1 Unemployment continues to be a serious problem in Germany too. The contribution to the unemployment fund currently totals 4.1% of earnings up to the Social Security Contribution Ceiling (DM 67,200 in 1986). The state must nonetheless continue to grant substantial subsidies to meet the deficit.
- 4.2 It is hoped that the unemployment rate currently lying unchanged at nearly 10% of the working population, can be reduced by a combination of measures, in particular by the early retirement of the older members of the workforce. An Act, in force since May 1st, 1984, sets a framework of certain minimum conditions relating to pre-retirement

terminations. Several private sector agreements have been reached by employer associations and the trade unions, which enable retirement after attainment of age 58. Employees that decide to retire early receive an average pre-retirement income from the employer of 70% of final active earnings until the possible commencement of the state retirement pension (age 63 for males, 60 for females). The state reimburses the employer with approximately 23% of final gross earnings provided that the employer re-hires a registered unemployed person or an apprentice for the terminée.

The purpose of the Act is primarily aimed at improving the employment chances of the large number of school leavers expected up to 1988 and is therefore limited to those employees born before 1931. Employers of different industries have reacted differently to the Act, depending on whether alternative measures, such as the reduction in working hours per week from 40 to 38.5, were chosen or not. The employees too have not reacted in unison either, so that the desired effect on the level of employment did not occur.

5. Company pensions

5.1 The introduction of a widower's pension – without a means test – in the social security system has raised the question of equal treatment of spouses in company pension plans too.

How can one now, in company pension plans, meet the quest for equal treatment of spouses in a practical manner? One may, for the moment, suppose that for all existing pensioners there is no requirement to introduce equal treatment. Thus, for example, if pension commencement (because of old age, disability or death) occurred before January 1st, 1986 the spouse's pension can be granted or refused in accordance with the state of the law prior to January 1st, 1986.

If the change to equal treatment for actives is to have as little an effect on costs as possible, then the definition of the groups concerned must satisfy labour law as well as intra-company criteria. One can, for example, consider to introduce an unconditional widower's pension for females and simultaneously reduce the spouse's fraction for all in order for the actuarial cost to remain unchanged. Alternatively, an appropriate amendment to the pension formula may be sought. Another solution would only involve the female beneficiaries: The cost of a widower's pension could be offset by the saving involved in extending the normal retirement age from what is usually age 60 to 63 or 65 and in addition perhaps in introducing actuarial deductions for early retirement.

A general "unique solution" to the spouse's pension problem cannot exist not least because of the multiplicity of company pension arrangements. The cost question is usually not given too much weight though, since the cost of a widower's benefit is only approximately 10% of a similar widow's benefit. This is because of the higher life expectancy of females and the positive average age difference between husband and

wife. The 60% widower's pension collectively costs an additional 3 to 6% of the usual old-age and disability benefit package if one considers only a female population.

What specific additional costs will be incurred upon the introduction of a widower's pension will depend primarily on the sex, age and service distribution of the relevant beneficiaries. For a normal group of beneficiaries and benefit structure the introduction of an unconditional 60% widower's pension will result in a book reserve increase of between 1 and 2%.

It is expected that the Federal Supreme Court will pass judgement during 1986 on whether the different retirement ages in the Social Security System for males and females is constitutional or not. It thus seems appropriate to simultaneously attain at least a pro-forma equality in retirement ages when introducing equal spouse's benefits.

5.2 Since 1977 German law provides for an equalisation of pension payments upon divorce. Accordingly, the spouse with the higher pension income has to compensate the other appropriately. The compensation took the form of splitting or of a contractual claim on the benefit payments themselves. The Federal Supreme Court decided on April 8th, 1986, that the contractual claim method was unconstitutional.

Parliament is currently preparing an amendment Act, which will alter this aspect as well as other unsatisfactory parts of the existing law.

5.3 A new law, the Bilanzrichtlinien-Gesetz, amending the Companies' Act lays down new rules for the disclosure of information in companies' financial statements. The new disclosure requirements are mandatory for fiscal years beginning in 1987.

Significantly, the new law introduces a mandatory general disclosure of reserves for uncertain liabilities and therefore also for pension liabilities (mandatory book reserves).

Mandatory disclosure only applies for pension promises made after January 1st, 1987 (new promises). For old promises including subsequent increases thereof the voluntary nature of reserving is preserved.

For pension promises made via an intermediary (e.g. a support fund) mandatory disclosure of liabilities in excess of the available funds does not apply.

However, commercial corporations will, in the notes to the accounts, have to reveal the amount of undisclosed liability in respect of old promises as well as funding deficits for pension promises made via an intermediary.

This disclosure in the notes to the accounts also applies to similar company benefits if they were not adequately reserved for. Benefits for which such disclosure will have to be made include long service gratuities and other benefits which are wide-spread in Germany because of existing tax incentives.

Many companies will be expected to provide pensions to an ever increasing extent by direct promise and thereby reduce or nullify their support fund arrangements, since support funds – because of tax restrictions – will often give rise to deficits. It is to be expected that the combination of a direct promise and one via a

support fund will gain increasing popularity because of certain advantageous tax effects.

Several large accounting companies have hitherto, apart from the auditor's statement, carried out both the book reserve valuations as well as the audit itself. This practice of being involved in the drawing up and the auditing of the accounts will not be allowed in future.

- 5.4 Two years ago we had already reported on the pre-retirement arrangements (see also section 4 above). Today we can add that the tax authorities have since issued regulations on the valuation of these liabilities. In effect, the method corresponds to that used for the calculation of book reserves for pension liabilities. In addition to the full present value for already-commenced pre-retirement payments the accrued entry age normal liability must be multiplied by the probability of future availment of the pre-retirement benefits by the active employees.
- 5.5 In its judgements of December 1981 the Federal Labour Court (BAG) had set up certain possibilities under which employers were permitted to update their pension plans. Since then these possibilities have been continually restricted. Thus the BAG decided in 1985 that the pension accrued under a final-pay plan as at the date of amendment, must be preserved in real terms (expressed as a percentage of pay) and not only in absolute DM-terms. A detachment from the previous type of accrual is merely permissible within reasonable and justifiable limits for future service only.
- 5.6 The number of insolvencies continues to be relatively high, although no large corporations wound up during the last two years. The contributions to the Pension Benefit

Guarantee Corporation (PSV), initially set at a level of 1,5 permille (with a peak of 6,9 permille in 1982), has now been decreased to 1,4 permille of the present value of pensions in payment and the accrued liabilities of vested benefits.

- 5.7 Many IACA-members used to be primarily involved in actuarial work in the past. In recent years the proportion of consulting work has – especially in large offices – continually increased. The primary objective here is the optimisation of labour and tax law issues, minimising cost and maximising flexibility for the companies. We advise with the purpose of designing systems which are tax efficient both for the employer and the employee. Because of the complex tax legislation, which also differs from funding vehicle to funding vehicle, our recommendation is often a combination of pension and lump sum payments as well as a division of funding via book reserves, support fund and direct insurance including Pensionskassen (pension funds).

As a result of §404A of the US Internal Revenue Code German subsidiaries of US-multinationals show a discernable trend towards the financing of pensions via re-insured support funds. Re-insurance, which enables both the full deduction of contributions as well as an outside funding, can be entered into either with an insurer or with the own captive Pensionskasse.

The new US-disclosure requirements detailed in FAS87 and 88 will lead to investigations into what combination of funding vehicles will be most tax efficient and which will allow for highest recognition of the pension expense as determined under US rules.