NATIONAL REPORT FOR GERMANY

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Mainly due to the recent reform of the Social Security System ("Rentenreformgesetz 1999") several legal modifications have affected once again the conditions for company sponsored pension plans.

1. The Social Security System

With the "Rentenreformgesetz 1999" of December 16th, 1997 the additional future cost of the state pension scheme shall be shared between the active employees, pensioners and the state. The most important changes are set out in the following:

- Demographic Factor

The continual prolongation of life expectancy leads to a longer period of payment for state pensions. Therefore, a demographic factor has been introduced into the pension formula which has the function of reducing the annual pension increase by the same percentage as the general life expectancy increases. The application of this new formula will decrease the standard net pension from currently 70 % of the final average net earnings to about 64 % in 2030.

- Disability Pensions

In future, the entitlement to receive a disability pension will depend only on the state of health; the current situation on the labour market will no longer be taken into account.

On the one hand, the service projection for the calculation of the disability pension has been increased, on the other hand, actuarial reduction factors have been introduced. Therefore, future disability pensions will - when compared with the current benefit formula - decrease by approx. 5 % to 10 % depending on the actual retirement age.

- Retirement Ages

  On a long-term basis, the normal retirement age will be raised to age 65 (63 for physically disabled) for both genders. The earliest possible retirement ages are as follows (*not taking into account transition regulations*):

male born before 1.1.1949	Age 63
male born after 1.1.1949	Age 62
females born before 1.1.1952	Age 60
females born after 1.1.1952	Age 62
physically disabled persons	Age 60

  At early retirement the target pension is reduced by 0.3 % for each month of early retirement (before age 65 or age 63 for physically disabled persons respectively). There are also special transition regulations for early retirement.

- State Subsidy

  In the long-term future, the state subsidy to the social security system shall be increased in such a way, that the contribution rate (currently 20.3 %) can be reduced by 1 % in order to achieve a lower level of social security cost.

Financial Effect

The current contribution rate is 20.3 % of the earnings portions up to the social *security contribution ceiling* (1998 = DM 100,800.--). The employer and the employee each bear 50 % of the contribution amount. The aim of the reform which will become effective as at January 1st, 1999 is to diminish the continuous increase of the contribution rate and even to reduce the contributions in the near future.

The table below shows the anticipated development of the contribution rate not taking into account the reform:

Year	Contribution Rate
2000	20.7%
2010	21.4%
2020	22.7%
2030	25.5%

The forecast for development of the contribution rates with the reform is as follows:

Year	Contribution Rate
2000	19.8%
2010	19.2%
2020	20.9%
2030	22.4%

But due to the continuously increasing unemployment rate and therefore the decreasing amount of employees paying contributions, it is therefore improbable that the contribution rate will decrease in the future as planned.

For the majority of the pensioners, the state pension is the only or at least the most important income portion after retirement. It is therefore essential that this income is "safe" in the long term and that also the employees paying contributions now can rely on receiving an adequate pension from the social security system. However, private provision and particularly occupational pensions will gain more and more importance in the future due to the decline of state pensions.

2. Life Insurance

In the area of insurance the increasing life expectancy as well as the related longer period of pension payment are currently leading to reduced surplus distributions under current tariff rates or, alternatively, new insurance tariffs, which take appropriate account of the longer life expected expectancy.

In addition, lower investment returns are further reducing surplus distribution.

The Federal Insurance Supervisory Authority has fixed the maximum technical interest rate for the calculation of contributions and technical reserves at 4 % for insurance contracts with guaranteed interest rates. This interest rate is currently being reviewed by the Supervisory Authority because the maximum interest rate may not exceed 70 % of the average redemption yield on bonds over the last 10 years.

3. Health Insurance / Nursing System

The current contribution rates to the state health insurance system average at about 13.4 % for the medical and 1.7 % of gross-earnings up to the contribution ceiling (currently DM 75,600.-- p.a.). for the nursing system. It is shared equally between employee and employer.

The first stage in the state health insurance system reform in 1993 aimed at cutting down health insurance expenses in the long run. Nevertheless, further cuts were introduced to reduce benefits. For instance, the insured persons now have to pay significantly higher contributions towards prescriptions and hospitalization etc.

Several amendments of the law, especially the possibility for the employees to choose a fund freely, have been set up to stimulate competition between the different funds. It is hoped that competition will lead to a more economic administration of the funds and thus a reduction in costs in the long-term. The financial participation of the insured will increase further and certain events will not be covered by the funds any more in the future. Persons born after 1979, for example, will have to bear the total cost of tooth replacement. It can be observed from recent legislation that the trend is towards the state only providing a very basic level of medical care and that the insured will have to cover additional risks by private insurance. However, the scope of what is to be seen as a "basic level of medical care" is still under political discussion.

The contributions to the nursing insurance system introduced in 1995 have up to now been sufficient to finance the benefits for the nursing of the elderly and the handicapped. So far, considerable reserves have been accumulated. The contribution rate may thus possibly be reduced in the short term. In the longer term, however, it is expected that the contribution rates will also have to increase in this area.

4. Other

It is now certain that the common European currency "Euro" will be introduced as at January 1st, 1999. Although the switch to the new currency system will certainly result in a considerable increase of administration cost, companies will doubtlessly benefit in commercial terms,. It is expected that the Euro will also have a positive impact on consumer prices.

5. Pension Arrangements for professional Associations

Doctors, dentists, lawyers, architects etc. have the possibility of contracting out of the state retirement system if they become a compulsory member of a Pension Arrangement of a professional association.

Up to now, these funds had developed no own actuarial decrement rates for the determination of future benefits and costs. However, recent surveys have shown that in particular the mortality rates of members of professional association funds are significantly different from those of the remainder of the population. The Association of Professional Funds

and the Heubeck Richttafeln GmbH have set up special tables for professional funds which also take into account the considerable differences concerning the incidence of disability and the probability of being married at the time of death.

6. Partial Retirement

Partial retirement is based on a law encouraging a phased transition into retirement and also grants reimbursement to employer under certain circumstances if the payments to the employee going on partial retirement lies above the proportionately reduced earnings of the employee. Various collective agreements have been reached in various industries areas regulating conditions for partial retirement. Currently, partial retirement can be applied for at age 55 at the earliest for a maximum period of 5 years. There are two different basic types:

The employee can be employed on a part time basis during the whole period of partial retirement. However, his regular working hours must equal at least half of the total working hours of comparable full time employees (this is commonly referred to as Type I Partial Retirement).

The employee can also be employed on a full time basis for the first half of this partial retirement period covering a maximum period of 5 years. The payments he receives are largely the same as under Type I for the entire period (Type II Partial Retirement).

In most cases, Type II contracts are concluded. During the period of partial retirement the employee only draws a proportionately reduced 50 %-salary but also receives additional payments so that his total earnings amount to approx. 80 to 90 % of his last net income. The Labour Office reimburses part of the additional payments to the employer if he hires an unemployed person specifically for the work which was formerly performed by the employee now being partially retired. The employer also has to make additional contributions to social security so that the employee's social security benefits are not significantly reduced.

As employees being partially retired are able to draw retirement benefits from the state pension scheme upon attaining age 60, they are also entitled to benefits from occupational pension plans as from this age, thus affecting pension entitlements of company sponsored pension systems.

At least under Type II arrangements, cost accruals must be recognized from such partial retirement contracts, because service rendered and remuneration received are not carried out simultaneously. Employers thus often seek the advice of a consulting actuary.

2. Company sponsored pensions

As part of the Rentenreformgesetz 1999 the German Pensions Act was also amended. Section 1 has been extended by an additional legal definition. As deferred compensation arrangements become more and more important, legislation has now included such arrangements in the definition as occupational benefits within the meaning of the Pensions Act. Since these arrangements are covered by the Pensions Act in future, it follows that they are also covered by the insolvency insurance. It is expected that this employee-financed arrangement will become even more important in the future because of the insolvency guarantee.

So far, it was only possible to settle a vested pension entitlement under special circumstances. In future, employer or employee can agree on a settlement if the lump sum amount does not exceed a specified amount (currently the amount equals a monthly pension of DM 43.40). If the employee agrees, the employer can settle a vested entitlement which equals twice this amount.

The ominous indexing feature in the Pensions Act, section 16, states that effectively - the employer has to increase the pensions in payment every three years. Rulings of the Federal Labour Court since 1975 have now been included in this section. In future, the employer fulfills his obligation if the pensions in payment are increased at least according to the development of the standard cost of living index of or, if less, of the net earnings of comparable employees.

In future, this obligation is waived completely if an indexation of 1 % per annum is guaranteed in the pension plan. However, this can only be applied for new pension arrangements introduced as from January 1st, 1999 onwards. The definition of a "new" pension arrangement under section 16 of the Pensions Act is currently under discussion. Concerning direct insurance and pension fund arrangements, the obligation is fulfilled if as from the beginning of the pension payment onwards the surplus distribution of the insurance is used to increase the pension.

Until 1995, an employee contributions were only possible under direct insurance or pension fund arrangements. In 1995, the tax authorities explicitly approved deferred compensation arrangements. This method has positive aspects for both employee and employer: the employee can participate in financing his occupational pension or he can top up future benefits. This method is especially advantageous for higher income earners because of its tax deferral effect.

The employee pays less income tax because his income is reduced during active employment and the pension at retirement is typically taxed on a considerably lower level. Furthermore, the interest accruals on the pension expense only become taxable when the benefit is actually paid. As this type of arrangement is now also covered by the Pensions Act and is subject to insolvency insurance, the employers are expected to expand the offers to their employees.

The legal integration of deferred compensation systems gives the employer the opportunity to introduce new occupational pension arrangements and also to make the total retirement income more attractive. The Consulting Actuary will have to offer complete deferred compensation arrangements suitable for the individual employer which best meet the objectives of the employer's compensation strategy.

The Rentenreformgesek 1999 itself influences occupational pension plans in several ways. Firstly, the new reduced early retirement ages have an impact on the financing period of the plans. Secondly, the reduction in social security pensions results in higher company benefits under the fully integrated plans (i.e. where the social security pension is deducted from the defined target pension).

In recent years, employers - if at all - have typically only amended their pension plans in response to changes in the legal framework. But as the economic situation as a whole has become more difficult, employers no longer simply accept increasing cost for retirement benefits; because of reductions in state pensions. In many cases, the employer reviews his pension plans with the Consulting Actuary in order to create a modern system and to adopt the legal regulations. When doing this, it has proved advisable to consider taking the following points into account:

- external factors should have no influence on the amount and development of pensions,
- the cost of pensions should be as low as possible,
- the pension cost has to be reasonably foreseeable,
- net benefits should be maximized while minimizing net cost,
- clear communication to employees in order to establish a clear (see dead) understanding of the type and amount of benefits,
- occupational pensions can motivate employees.

- Essentially, there are three financing methods for company sponsored pensions in Germany:

  - direct pension promises (financing by internal book reserves)
  - support funds (Unterstützungskassen)
  - direct insurance / "pension funds" (Pensionskassen).

  A fourth financing method is currently under discussion; namely the Pension Fund in the Anglo-Saxon tradition. However, several legal conditions, especially labour and tax legislation, have to be amended significantly before this method can be established in Germany.

  To date, Pension Funds do not exist in Germany. The features of such a Pension Fund are clearly defined:

- financing of both defined benefit and defined contribution plans must be possible through a Pension Fund,

- · the Pension Fund investment earnings must be exempt from taxation,

- the asset allocation of investments of the Pension Fund should not be subject to restrictions,

- the payment of the benefits promised - especially those resulting from a cash balance type plan - have to be guaranteed at any time. The Pension Fund should thus be subject to regular actuarial reviews,

- it is essential that the benefits are covered by the insolvency insurance and

- the employees should not have to subject employer contributions to personal income taxes.

A detailed description of the two Pension Fund types discussed by interested would exceed the scope of this report, but the current discussion seems to indicate the need for this financing method. Nevertheless, Pension Funds can only be introduced in Germany after a reform of labour and tax legislation. Currently, it is uncertain whether politicians will take this chance of introducing an attractive financing method for occupational benefits, because the state lacks in the short-term tax revenues.

Increasingly, German companies regarded as Global Players are preparing a second set of financial statements according to the International Accounting Standards (IAS) or in accordance with US-GAAP. In Germany, IAS is currently the most commonly used accounting standard. With the approval of the new standard applicable to employee benefits, IAS 19, and the hopefully imminent

recognition by the International Organization of Securities Commissions (ISCO), this standard is set to expand in influence. The requirements of IAS 19 differ substantially from those applicable under German GAAP.

Since the level of state retirement pensions continues to decrease, it seems urgent to improve the framework for company pensions in Germany. Nevertheless, due to the increasing number of unemployed persons and jobless university students, employers typically do not feel obliged to offer company pensions to newly hired employees.

In order to take full advantage of the existing tax regulations, company benefits should be related closely to the private provisions of the employees. Therefore, in many companies the employees participate in financing the company retirement plans. By doing this, they increase their own efforts towards an adequate retirement income. Nevertheless, as the framework and legislation of company sponsored pension plans underlie constant changes more and more companies charge their Consulting Actuary with the review of their pension arrangements.

The tax authorities consider pension promises for managing partners of private limited companies (GmbH) as particularly critical. According to current legislation company pensions together with the social security benefits may not exceed 75 % of final active earnings. Now, the tax authorities investigate whether the occurrence of prior disability or death the book reserve to be recognized for this event leads to excessive levels of debt for the company. If deemed so, the pension arrangement is regarded as unreasonable and hence the tax deductibility is disallowed. In order to avoid this, it is advisable to conclude a re-insurance contract which covers the risk of disability or death before retirement so that heavy indebtedness cannot occur. Alternatively, the pension arrangement can be modified in such a way that the beneficiary will only receive a moderate pension if the covered event occurs at a relatively young age. The liabilities will then not lead to a difficult economic situation of the company.

The changes in the Pensions Act are a step in the right direction. but it is necessary to amend them further to achieve a stimulation in this area, especially in the Eastern States. An important feature is the modification of the Income Tax Act in such a way that tax advantages are also granted to the employer if he only pays a single premium (perhaps profit-related) to the plan. Furthermore, company pension schemes would become more attractive if employer contributions to Pensionskassen or direct insurance were not subjected to personal income tax for the beneficiary.

8. Other

As from January 1st, 1998 federal and community taxes on net assets were abolished. The solidarity surcharge for the Eastern States has been reduced from 7.5 % to 5.5 % of the income tax amount at the same date.

General Information

During the last 1 1/2 years the following statistics were recorded in Germany:

a) Exchange rate

1 US $ = between DM 1.50 and DM 1.90

b) Inflation rate

between 1.0 % and 2.0 %

c) Average gross earnings increases

between 1.5% and 2.5% p.a.

d) The capital market interest rate for 10 year bonds fluctuated

between 6.5 % and currently 5.0 % p.a.

e) Rate of unemployment in January 1998:

11.6 % (1995: average of 9.5 %) with a slowly rising trend