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# NEWSLETTER

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## "SUPPLEMENTARY PENSION SCHEME" BILL

The government recently tabled a bill in Parliament which would amend the law of 8 June 1999 relating to supplementary pension schemes with effect from 1 January 2018.

This bill has three main aims:

1. to widen the scope of application of the law to include the self-employed and liberal professions.
2. to adopt certain provisions of the social chapter of the law dated 8 June 1999, in light of experience gained since its entry into force in 2000.
3. finally, to adopt the fiscal framework of the law, following in particular the opening up of the second pillar to the self-employed.

### I. Opening up of the second pillar to the self-employed

Up until now, a significant part of the working population – the self-employed – have remained excluded from the second pension pillar. In order to permit those who are self-employed to also build up a supplementary pension, the law will rely on an already-existing similar structure: duly authorised schemes ("régimes dûment agréés") which to date have been restricted to a structure responsible for vested rights. The new schemes will be known as: ***"authorised supplementary pension schemes"*** *(or "régimes complémentaires de pension agréés")*.

It will consist, by definition, of a purely individual approach on the part of the self-employed person incorporated into a legal framework that is particularly flexible. To be able to collect contributions, these schemes, which insurance companies or pension funds will be able to set up, will be subject to prior approval by the supervisory authority (the "Inspection Générale de la Sécurité Sociale").

### II. Adaptations to the social chapter of the law of 8 June 1999

Without going through all of the details of the bill (which could still change following the parliamentary debates), we have identified below the main areas affected by changes:

#### 1. Vesting period

As regards the time-frame for vesting pension rights, the total length of time, e.g. the waiting period before joining the scheme and the period of active membership, may no longer exceed **three years** of service. Transitional measures have however been laid down for employees who are already members of a pension scheme.

A distinction will be drawn up between the two distinct categories of employees:

- **Employees entering the workforce from 1 January 2018 on**
  The new time limit will be immediately applicable: after a maximum of three years of service, employees will benefit from the pension rights (in relation to the part funding by employer contributions).
- **Employees entering the workforce prior to 1 January 2018**
  Their pension rights will be vested
  - after the end of the period defined in the pension scheme if this date is prior to 1 January 2021;
  - if the vesting period expires after this date, rights will however be automatically acquired on 1 January 2021, e.g. three years after the new law has entered into force.

#### 2. Allocation of vested rights in case of departure

In the case of departure from a pension scheme, the possibilities of allocating vested rights have been amended:

- **1st option: maintaining of vested rights**
  This option must still be accessible to members. Nothing will change in this regard: this option was already provided for by the current law and has also been upheld by an EU "Mobility" directive (which enforced the new vesting period). However, two new provisions have been introduced under this framework:
  - **Indexing of former member's rights in defined benefits schemes**
    The Mobility directive requires equal treatment for active and former **members.** The sponsors of the bill have reflected this

requirement by enforcing an indexing of the vested rights of former members-, (e.g. salaries) until retirement age.
An exception is however made insofar this indexing will not be applicable to schemes closed on or before 20 May 2014 (or indeed if the company is in liquidation or facing insolvency proceedings).

➢ *In our opinion, a reading of the Mobility directive shows that such an indexing is not required. Moreover, in the bill, contrary to the directive, a retroactive effect would be attached to this measure.*

In defined contribution schemes however, former members with vested rights would continue to benefit from the guaranteed rate of interest or, alternatively, from the financial performance of the scheme, as active members do.

- **Coverage in the case of death**
The bill provides for death coverage until retirement age for the former member who chose this "Maintaining of vested rights" option, up to a maximum of the reserves accrued calculated at the time of death. This provision will only be applied however to members exiting a scheme from 1 January 2018 onwards. But how would this death coverage be financed? The bill is silent on this point.

- **2nd option: the individual transfer of vested rights**
The bill confirms that the individual transfer of vested rights to a new employer's scheme or an authorised supplementary pension scheme is possible at any time but will still be subject to the consent of the various parties.

The transfer of such vested rights to another authorised scheme may be enforced by the employer. But in the case of defined benefits schemes, the bill specifies that such a transfer must be made to a scheme which guarantees benefits at least equal to those vested in the original scheme.

- **The 3rd option is deleted: surrender is excluded**
Any opportunity to surrender vested rights will now be repealed, including in cases of "minimum" amounts. The aim is to facilitate the building of retirement savings and not for these funds to be used for other purposes. In principle, the sponsors of the bill are right in relation to this point, but not necessarily when the sums in question are truly derisory like, for example, a pension of EUR 100 or 200 each year. This abolition is in particular justified under the Mobility directive which, however, is by no means opposed to surrender in the case of "minimum" amounts (to be defined by each State concerned).

## 3. Changes to a supplementary pension scheme

Employers are still prohibited from unilaterally changing their pension schemes beyond specific circumstances. By contrast, changes arising from a joint agreement between members and an employer are now expressly allowed.

Moreover, in order to specify the principle of non-retroactivity of the changes introduced, the law clearly prohibits any reductions in vested benefits. In practice, it has been observed that this is not always the case, in particular in relation to the introduction of a collective insurance “Defined contribution” scheme which replaces a “Defined benefit” scheme that is internally financed. In the case of transferring vested rights to another scheme, the application of a lower interest rate means that it is no longer possible to guarantee the former employer’s commitment. This change, even if it does not have a retroactive effect on the vested reserves, will still mitigate the level of vested benefits. As a consequence, a company may not transfer the vested reserves of its members to a “Defined contribution” scheme without any compensation of any kind.

## 4. Transfer of undertakings

As it has been observed that some transfers of undertakings occurring within the framework of the law of 1999 had the effect of reducing members' rights vested or in the course of vesting. The bill now purports to compel the transferee to guarantee at a minimum the same rights vested or in course of vesting arising from employment with the transferor undertaking. However, unless expressly agreed otherwise, this transferee may not be obliged to continue the financing of the transferor's pension scheme.

## 5. Members' access to information

The right of access to information as currently laid down by law has also been adapted to comply with the Mobility directive requirements which provided for a wider obligation of information.

First of all, no distinction is made between active members and former members maintaining vested rights: these two distinct categories will now have the right to access annual information.

The new approach to annual information will relate to:

- the value of vested or in course of vesting reserves as well as the date on which they will be definitely vested;
- the amount of vested benefits and the grant date for all schemes, excluding “Defined contribution” schemes without performance guarantees;
- the impossibility of calculating a pension since the value of investments in funds without a performance guarantee will fluctuate over time in “Defined contribution” schemes without performance guarantees. However, in such cases, the bill intends to include a projection of the value of the savings already built up by retirement age by applying an assumed rate of return. Proceeding in this way may be hazardous as even if it is made clear that this is intended as a guide only, such information still risks generating expectations on the part of members which cannot be met. Generally speaking, it could be asked whether in terms of members' access to information it would not

be more opportune to now include the specifications laid down in this regard by the new EU directive on pension funds which is to be implemented into Luxembourg law by 13 January 2019 at the latest. It provides for the disclosure of detailed information to members of a pension scheme funded within the framework of a pension fund. As a consequence, why not now use this adaptation of the law of 8 June 1999 to standardise the information to be provided, regardless of the chosen financing vehicle? It would be difficult to justify that members receive disparate information based on the financing vehicle (insurer, pension fund or internal pension schemes) chosen by their employer.

### 6. New mortality tables

It was decided to adapt the technical bases for determining minimum funding so that it would be in line with more recent biometric monitoring. This adaptation and its terms will be set out in a Grand Ducal Regulation. It concerns companies which have put in place a supplementary pension scheme funded by an internal pension scheme or pension fund. And in order to spread the deficit amortisation resulting from the introduction of these new mortality tables over several years, the provisions relating to minimum funding will be adopted as a consequence.

## III. Adaptations to the fiscal chapter of the law of 8 June 1999

The fiscal framework of the law had to be revised for a number of reasons:

### 1. The opening up of the second pillar to the self-employed will have an impact on the schemes for employees

The tax system governing the self-employed has been closely modelled on the one concerning employees:

- The self-employed will benefit from tax deductions on contributions of up to 20% of net annual income, but income must not exceed five times the minimum annual social salary (or EUR 119,915.40 as of 1 January 2017).
- HOWEVER, surprisingly, this same limit on deductibility will now apply to supplementary pension schemes for employees too, without any specific transitory measure. The opening up of the second pillar to the self-employed does not necessarily require an amending of the regulations currently governing employees: it relates to various categories of workers who benefit from supplementary pensions that are also structurally of different nature.
  Furthermore, changing tax regulations without any transitory measure in this way also risks, calling into question pension schemes made long before the entry into force of these new dispositions.
- Just like employer contributions benefiting staff, payments made by the self-employed to an authorised scheme will also be subject to an "entry" tax rate of 20%. And as happened to employees in 2000, non-residents also risked being subject to double taxation at the time of receiving their benefits. For employees, some tax agreements (like those concluded with Belgium or Germany) were adapted, but by definition, these did not extend to the self-employed.

### 2. Abolishing inequalities between internal and external pension schemes in terms of tax treatment

At present, internal pension schemes are fiscally discriminatory: their tax base consists of an annual allowance, i.e. the difference between provisions at the start and end of the year, while as far as external pension schemes are concerned, only the insurance premiums or pension fund contributions are subject to tax, the returns on them are not. From now on, the base at which withholding tax would apply within the framework of an internal pension scheme will correspond to the allowances, less the theoretical annual return currently standing at 5% of provisions built up at the end of the previous year (this rate being equal to the technical rate laid down in relation to minimum funding).

### 3. New mortality tables

The new provisions in relation to minimum funding will also be the subject of a fiscal framework permitting companies to amortize the deficit deriving from the introduction of the new mortality tables over several years and to deduct the related financing as operational expenses.

All of these provisions are now being debated in parliament. We will closely follow these debates and will keep you informed of any developments.