

Insurance for old age: pension benefits following mergers and acquisitions in the Netherlands



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PENSIONS IS BECOMING AN increasingly important issue during due diligence investigations resulting from mergers and takeovers.

Following the introduction of the Dutch General Old Age Pensions Act ('*Algemene Ouderdomswet*' or AOW), every resident of the Netherlands who has worked in the country, or for a Dutch employer outside the Netherlands, is, in principle, insured for old age, and is entitled to a state pension.

In addition, employees may be entitled to pension benefits through a scheme run by their employer. There are two types of such schemes available:

- 1) the defined contribution retirement pension schemes ('defined contribution scheme'); and
- 2) the defined benefit pension schemes ('defined benefit scheme').

DEFINED CONTRIBUTION SCHEME

A defined contribution scheme is characterised by the fact that the eventual pension entitlements depend on the contributions made by the employer to an insurance company or, if applicable, to a pension fund.

Usually, such payments include a contribution by the employer of a fixed percentage of the employee's salary, combined with a contribution by the employee.

DEFINED BENEFIT SCHEME

A defined benefit scheme differs from a defined contribution scheme in that the amount of the employee's pension benefits at retirement is not dependent on contributions paid, but is specified at the moment the employee enters into the scheme.

A defined benefit scheme may be set up in several ways. The final amount may be based on the salary and years of service of the employee. Such a 'salary/years of service' pension scheme can be subdivided into two different types:

- a) an average pay scheme ('*middelloonregeling*'); and
- b) a final pay scheme ('*eindloonregeling*').

As far as an average pay scheme is concerned, the level of benefits accrued in a particular year depends on the salary earned in that particular year. The amount of pension benefits to be eventually paid out is based on the average salary earned by the employee during their career.

In a final pay scheme, the level of pension benefits depends on the years in service and the final salary earned before retirement. A combination of the average pay scheme and a final pay scheme is also possible, and in this context can best be described as a moderate final pay scheme ('*gematigde eindloonregeling*').

A moderate final pay scheme prevents the final pay scheme from operating once an employee reaches a specified age or salary. After that, an average pay scheme becomes applicable. In this way, the costs of the scheme can be controlled.

OPERATION OF PENSION SCHEMES

Pursuant to Dutch law, an employer must choose between the following systems to provide employees with pension benefits (see Article 2.1(a), (b) and (c) in conjunction with para 4B and C of the Pensions and Savings Funds Act):

- a) joining a (mandatory) industry-level pension fund;

- b) setting up a company pension fund;
- c) effecting insurance contracts with an insurance company or enabling its employees to effect such contracts (note that an insurance company is only allowed to provide for such insurance contracts if it holds the necessary permits).

EFFECTS OF A CHANGE IN OWNERSHIP OF THE COMPANY

The effects of a change in the ownership of a business on employees' pension benefits depends on the structure of the transfer and the way in which the pension liabilities are 'secured' outside the company.

Share transfer

A share transfer will generally have no effect on the retirement benefits of the employees. As the employer, being the 'transferred out' company, does not change, the entitlement of the employee to accrue pension benefits remains intact.

However, if the vendor operates a pension scheme through a group-company pension fund and, as a result of a share transfer, a subsidiary leaves the group of companies, the subsidiary's retirement benefit scheme can no longer be executed by the original pension fund. This is because a company pension fund is, in principle, not allowed to execute the retirement benefit schemes of several subsidiaries within a group unless they are organisationally and/or economically interrelated.

Asset transfer

An asset transfer implies that some or all assets and liabilities of a company are transferred to a new owner, resulting in the automatic transfer of employees. Such a transfer of undertaking is regulated by Article 7:662 et seq of the Dutch Civil Code.

If the assets and liabilities of a company are transferred, (in principle) all rights and obligations arising from the employment contract and applicable collective bargaining agreements, rules and regulations, including the pension entitlements of the employees, will be transferred to the acquiring company by

operation of law. Thus the continuity of the employees' employment conditions is secured.

If the transferring party and the acquiring party have different pension plans, the acquiring party is normally required to continue both plans. However, the acquiring party is also given the option to apply its own pension plan to the acquired employees. Special provisions should be provided if the employees of the acquiring party and/or the transferring party are required to participate in an industry-wide mandatory pension fund scheme.

This situation is covered by Article 7:664 of the Dutch Civil Code, which states that the rights and obligations of the transferring party arising from a pension commitment, as described in the Pensions and Savings Funds Act, will also transfer to the acquiring party in the event of a merger or if a company is divided up.

As a result of the asset transfer, the employment contracts between the vendor and its employees are terminated and the employees are employed by the company from the transfer date. Although the pension entitlements of the former employees of the vendor also transfer to the company, this does not mean that after the transfer their pension scheme can still be executed by the original company pension fund or pension insurance company. As a result of the termination of the employment contracts with the vendor, the original administrator of the vendor's pension scheme is no longer able to continue the administration of the scheme.

In principle, the administrator will only be allowed to execute pension schemes on behalf of the employees of the vendor

and after the transfer these employees are no longer employed by the vendor.

Exceptions

The automatic transfer of pension entitlements takes place unless one of the following exceptional situations applies. First, the existing rights and obligations are not automatically transferred if the acquiring party offers the transferring party's employee the same pension commitment already given to its own employees before the transfer date. In that case, the old pension plan does not automatically transfer, but another comes into effect for the employees, namely, the pension plan that has already been set up for the employees of the acquiring party.

Secondly, the automatic transfer will fail if the acquiring party is required to participate in an industry-wide mandatory pension fund scheme and the transferring party's employees will also be participating in that fund. The same applies if there is a deviation from the transferring party's pension commitment resulting from a collective labour agreement or by an authorised administrative body.

If the employees of the transferring party are required to participate in a sector-specific pension fund under the terms of the Company Pensions Fund Act (*Wet Bpf*) before the company is transferred and their participation continues to be required following the transfer, the acquiring party will not be permitted to offer the transferring party's employees a different commitment. In this case, in accordance with the main ruling in Article 7:663 of the Dutch Civil Code, the acquiring party will be required to continue the existing rights and obligations arising from the participation in the industry-wide pension fund.

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Past service rights

In both situations the vendor/company has, in principle, to secure the retirement benefit scheme with another pension fund or insurance company. The 'transferred out' company, depending on the applicable retirement benefit scheme, is liable to finance, at the time of transfer, possible past service rights with the original 'insurer'.

Note that if a (moderate) final pay scheme is applicable, an increase in pensionable salary (*'de pensioengrondslag'*) will also lead to an increase in the pension entitlements for past years of service. This means that the increase in entitlements, in principle, is backdated to the date of participation in the pension scheme. These amounts can be quite considerable, if one takes into account that the salary can rise over, for example, 20 years or more.

These pension entitlements with regard to past years of service are known as back service or past service rights. Past service rights could (and used to) be financed gradually during the years between the date on which the increase of entitlement occurred and the pensionable age. The result of financing past service rights in this way is that, before the pensionable age is reached, the accrued pension benefits have not been, in principle, fully financed. The gap between the actual accrued entitlements and the actual financed entitlements is known as 'the back service obligation'.

'If a (moderate) final pay scheme is applicable, an increase in pensionable salary will also lead to an increase in the pension entitlements for past years of service.'

From 1 January 2000, new past service rights must be financed immediately. The vendor has to include this liability to fully fund the accrued retirement benefits in its balance sheet. This provision is likely to influence the balance sheet ratio as of the transfer date (as well as the profit and loss account over the preceding period of time).

Collective transfer of value

Should accrued pension rights at the transfer date be transferred from the former administrator (company pension fund or insurance company) to the new administrator of the pension scheme?

There is no legal right for collective transfer of value. According to Dutch pension law, an individual employee has

the right to transfer accrued pension entitlements after termination of their employment contract and/or the participation in a pension fund/pension scheme. A request for transfer of value by the group of employees involved after the transfer of assets of liabilities has been effected is regarded as a request for collective transfer of value regulated by Article 32ba of the Pensions and Savings Act.

The collective transfer of accrued pension rights depends on the co-operation of the Dutch Pension and Insurance Supervisory Board, and the result of negotiations regarding the terms and conditions of a possible transfer of value between the former and new pension fund. Furthermore, all participants and their partners have to agree to a collective transfer of value.

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