



FRESHFIELDS BRUCKHAUS DERINGER

Pensions and insolvency across Europe

January 2010

Introduction

The economic downturn has given rise to enormous activity in restructuring transactions and insolvency processes. A striking feature of this wave of restructuring is the significant role often played by defined-benefit pension liabilities.

In jurisdictions where defined-benefit pensions are common, the pension scheme is usually one of the largest creditors or obligations of a corporate group, with usually only the banks and other holders of corporate debt being of similar significance. Furthermore, pension liabilities have unique features that can be challenging in a restructuring:

- while pension liabilities are reflected on the corporate balance sheet, the accounting treatment of those liabilities is increasingly viewed as unreliable. Very often, the basis on which the liabilities are valued will be the focus of negotiations;
- pension liabilities can be highly volatile. If the pension scheme is funded, this can be the result of volatility in asset values. But even if the pension liabilities are unfunded, this can result from fluctuations in the notional discount rate used in valuing the liabilities, which under international accounting standards is based on corporate bond yields;
- if the pension scheme is managed by a separate legal entity – such as the *pensioenuitvoerder* in the Netherlands, the *pensionskasse* in Germany or the pension scheme trustee in the UK – that entity will often be subject to special legal duties and not necessarily readily equipped to negotiate and settle liabilities on a commercial basis;
- compulsory guarantee schemes for pension benefits (such as the PSV in Germany and the PPF in the UK) often assume the rights of the pension scheme as a creditor of the company. The policies and powers of the guarantee schemes can exercise a major influence on the outcome of the process; and
- pensions are a major industrial relations and political issue. Where there is a need for the co-operation of unions, employees or a government in a corporate rescue, pension liabilities may have to be addressed in a preferential way.

These unique factors mean that those who are engaged in restructuring and insolvency work – be they banking restructuring teams, insolvency practitioners or holders of corporate debt – need to be aware of the position of pension liabilities in an insolvency and the potential leverage they may have in a restructuring process.

This guide summarises the key aspects of how pension liabilities will feature in corporate insolvency in a number of European jurisdictions. We hope it will offer, to those involved in restructuring and insolvency work, a useful overview of the position in those jurisdictions and the differences between them.

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Pensions and insolvency in Austria

What are the main pension obligations of a solvent employer in Austria?

Apart from paying employer contributions and processing employee contributions to the statutory pensions insurance (part of the social security system), employers are not obliged – but may choose – to offer occupational pension schemes.

The two main types of company pension schemes are:

- pension fund and insurance arrangements; and
- direct pension promises.

Under a pension fund or insurance arrangement, employers are required to pay contributions into the fund or insurance arrangement on a defined-contribution (DC) basis, plus additional contributions on a defined-benefit (DB) basis.

Under a direct pension promise, an employer is obliged to pay the employee the contractually promised pension (which may be either DB or quasi-DC through a liability reinsurance) from an appointed date, and is required to build up reserves in respect of the promise (see below).

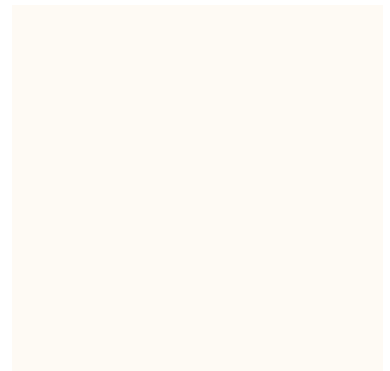
Will an employee still receive their pension if the employer becomes insolvent?

Essentially, yes – all types of pension schemes are protected by the Insolvency Remuneration Fund (Insolvenz-Entgelt-Fonds) but not to the same extent:

- the Insolvency Remuneration Fund will pay employer contributions in the original amount to the pension fund or insurance arrangement (the Insolvency Remuneration Fund can then seek to recover this from the employer). The fund or insurance arrangement will make pension payments to the employees irrespective of the employer's insolvency; and
- the Insolvency Remuneration Fund will provide limited protection in relation to direct pension promises. It will pay 24 monthly pension payments directly to the employees (the Insolvency Remuneration Fund will then have direct recourse to the employer's protected securities, which are the assets that the employer holds on a segregated basis as a reserve against its pension obligations). The protected securities are (partly) privileged in insolvency proceedings.

Will an insolvent company have any pension liabilities?

The Insolvency Remuneration Fund will pay pension contributions and pension payments into the pension fund or to the employees (see above). However, it can seek to recover this from the company.





Do liabilities to provide a pension and/or pay contributions have priority in insolvency?

Occupational pension schemes will not generally have preferential treatment in insolvency, but securities held to cover pension reserves for a direct pension promise are privileged in insolvency proceedings.

Can a parent company (or any other third party) be made liable for the pension obligations of an insolvent subsidiary?

Only under extraordinary circumstances – eg if a contractual liability of the parent company (or the third party) exists or financial assistance rules have been violated.

Pensions and insolvency in Belgium

What are the main pension obligations of a solvent employer in Belgium?

In principle, employers are not required by legislation to fund a complementary pension plan to a minimum level in the course of an employment relationship (unless the pension plan is terminated).

However, in practice an employer may be required to fund the plan to a minimum level in accordance with insurance contracts and/or the contractual relationship between the employer and the pension fund.

Belgian law also sets out minimum funding levels that need to be satisfied on termination of employment.

Will an employee still receive their pension if the employer becomes insolvent?

The main protection against employer insolvency is the external financing requirement for complementary pensions. As a consequence, employer insolvency may not be detrimental to an employee's complementary pension entitlements.

If an employer has not actually funded a pension plan to a sufficient level, an employee's pension entitlement will be reduced and the state closure fund may intervene.

Will an insolvent company have any pension liabilities?

To the extent that a complementary pension plan is underfunded, an employee's pension entitlements under the complementary pension plan will be reduced. Employees can make a claim against an insolvent company in respect of the loss suffered as a consequence of the underfunding.

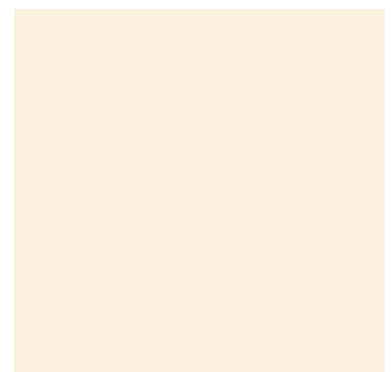
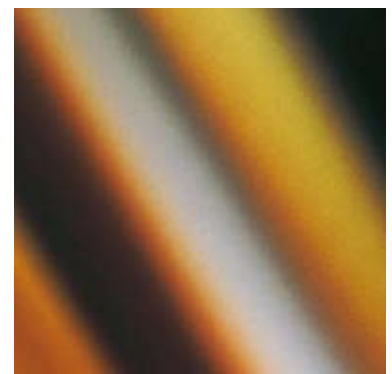
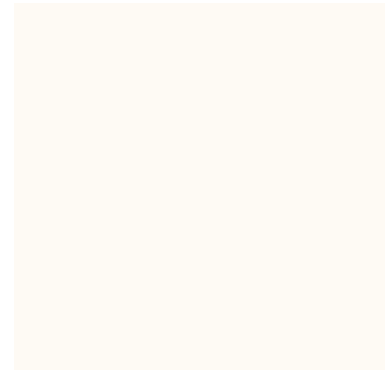
Do liabilities to provide a pension and/or pay contributions have priority in insolvency?

Employee claims, including claims in relation to the funding of a complementary pension scheme, have priority in insolvency proceedings. However, this priority relates only to an employer's movable assets.

Can a parent company (or any other third party) be made liable for the pension obligations of an insolvent subsidiary?

Because pension entitlements are externalised, the beneficiary continues to have a claim against the pension fund (to the extent that it is funded) or insurer.

Other types of recourse against third parties or against the parent company are unlikely.



Pensions and insolvency in France

What are the main pension obligations of a solvent employer in France?

Employers are required to pay employer and employee contributions to statutory pension schemes. Employers are not obliged to offer additional pension benefits unless this is provided for under a collective bargaining agreement.

There are two main kinds of additional pension schemes:

- defined-benefit (DB) pension schemes; and
- defined-contribution (DC) pension schemes.

Will an employee still receive their pension if the employer becomes insolvent?

Employees should still receive their statutory pension if their employer becomes insolvent. However, the level of their statutory pension may be reduced because of the employer's insolvency. Even if contributions to the statutory pensions are guaranteed by the state fund, this guarantee, which is not specific to pension contributions and covers all the sums owed to employees in respect of their employment contract, is capped (at €68,616 per employee for 2009). The state fund was created in 1973 to protect employees' salary rights on their employer becoming insolvent (Association pour la gestion du régime d'assurance des créances des salaires or AGS).

There is no equivalent state guarantee for additional pension benefits. The employees may well not receive their additional pensions in full if their employer becomes insolvent, especially in the case of DB pension schemes.

Will an insolvent company have any pension liabilities?

Contributions to the statutory pension schemes are privileged insolvency credits and may be guaranteed by the AGS. However, this guarantee will apply only if the liquidation of the employing company's various assets is insufficient to cover the employer's liability.

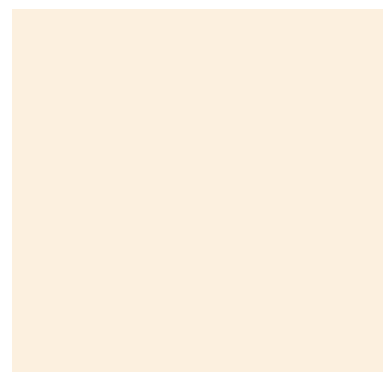
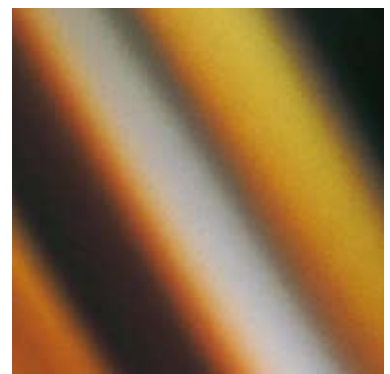
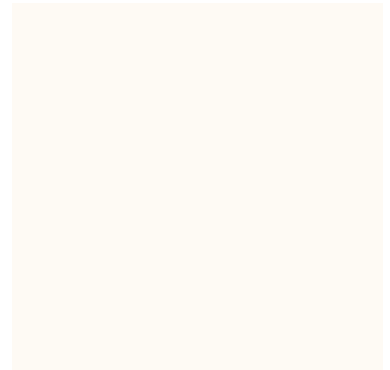
Do liabilities to provide a pension and/or pay contributions have priority in insolvency?

Unpaid contributions to the statutory schemes have a privileged status in insolvency.

By contrast, unpaid contributions to additional pension schemes are not privileged.

Can a parent company (or any other third party) be made liable for the pension obligations of an insolvent subsidiary?

No but a court may require a parent company to indemnify the employees if it has contributed to the employer's insolvency.

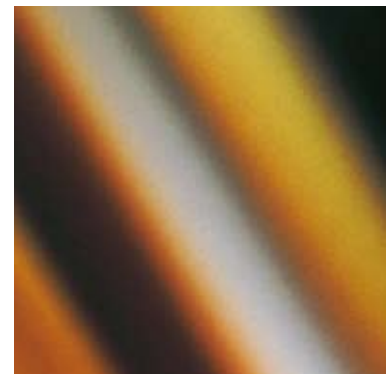


Pensions and insolvency in Germany

What are the main pension obligations of a solvent employer in Germany?

An employer's obligations depend on the nature of their pension scheme.

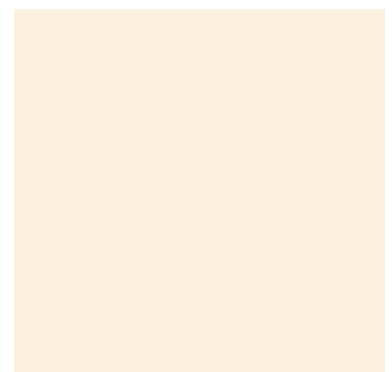
- In the case of an unfunded direct pension commitment, an employer has to make pension payments to employees when they fall due. Therefore, the pension payments have a direct impact on the employer's cash flow. Until a beneficiary draws a pension right, an employer must build up book reserves in its balance sheet that reflect its future obligations. But an employer is not required to set aside any funding assets. For all unfunded pension schemes, contributions to the statutory pension protection fund (*Pensionssicherungsverein* or PSV) must be paid by the employer.
- If the pension scheme is funded through a support fund (*Unterstützungskasse*), pension insurance fund (*Pensionskasse*), direct insurance (*Direktversicherung*) or a pension fund, the employer is liable to these funding vehicles for making appropriate contributions. If a funding vehicle is not able to pay the entire pension to the beneficiaries, the employer (depending on the type of funding vehicle and the contractual relationship) may be liable to pay additional contributions to that vehicle.
- In any event, irrespective of the scheme type, an employer remains always co-liable to the beneficiaries and has to make good any shortfall in the funding vehicle.
- In addition, contributions to the PSV must be made if pensions are funded by a support fund or a pension fund.



Will an employee still receive their pension if the employer becomes insolvent?

Yes. The PSV will assume the liabilities resulting from direct pension commitments, in relation to the beneficiaries, if the employer enters into formal insolvency proceedings. The same applies with regard to pension support funds or pension funds if they are unable to fulfil their obligations because of the employer's insolvency. In general, no protection under the PSV exists for direct insurance and pension insurance funds. However, given the character of these institutions (as insurers), it is unlikely that an employer's insolvency will have a detrimental effect on the pension payments granted by these schemes.

The PSV will pay out the pensions directly as if the relevant pension scheme continued to apply. However, the PSV's payments are capped. In 2009, the maximum protection threshold amounts to €7,560 per month for beneficiaries in western Germany.





Will an insolvent company have any pension liabilities?

If the PSV assumes the payment obligations in respect of the beneficiaries, the beneficiaries' rights against the employer are transferred to the PSV by operation of law. The PSV therefore replaces all beneficiaries as creditors of the employer and becomes a major creditor. In return, any securities or funds that are linked to the protected pension obligations are transferred to the PSV by virtue of law, to the extent that the related pension obligations have been transferred to the PSV.

If a pension claim is not protected by the PSV (in particular, pension claims above the maximum protection threshold, currently €7,560 per month for beneficiaries in western Germany), the employer remains liable to the beneficiaries.

Do liabilities to provide a pension and/or pay contributions have priority in insolvency?

Pension liabilities do not have any priority in insolvency proceedings, unless collateral has been granted to the beneficiary.

Can a parent company (or any other third party) be made liable for the pension obligations of an insolvent subsidiary?

Only in very exceptional circumstances can a parent company or a third party be made liable for the pension obligations of an insolvent company.

This may be the case if the parent company has caused its subsidiary's insolvency by abusing its powers or if it has granted securities. Furthermore, if a parent company has spun off its pension liabilities under the German Conversion Act it stays liable to the beneficiaries for 10 years following the spin-off.

Pensions and insolvency in Italy

What are the main pension obligations of a solvent employer in Italy?

The two main pension obligations in Italy are:

- statutory pension entitlements; and
- non-statutory pension entitlements.

In regards to statutory pension entitlements, all employers are required to pay mandatory social security contributions to the Italian Social Security Body (Istituto Nazionale per la Previdenza Sociale or INPS). This is paid on a monthly basis. Employers must also deduct the employees' social security contributions from their payroll.

In respect of non-statutory pension entitlements, a collective bargaining agreement (if the employer has agreed one) may require the employer to make supplementary social security contributions to the relevant supplementary private pension fund (eg Fondo Cometa for the metal mechanic industrial sector or Fonchim for the chemical sector).

Since 1993 it has been possible to set up only defined-contribution pension schemes (and not defined-benefit pension schemes). As a consequence, pension liabilities are usually less of an issue in Italy.

Will an employee still receive their pension if the employer becomes insolvent?

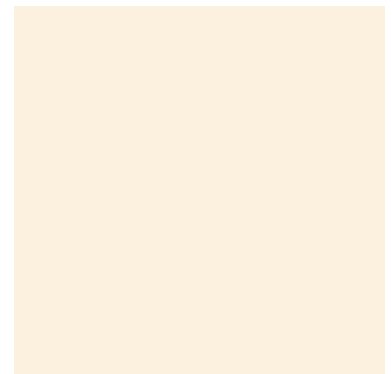
An employee will still receive their full statutory pension entitlement from the INPS even if their employer failed to pay the mandatory social contributions (eg fraudulently, negligently or due to insolvency). The employee shall receive their pension benefit on the basis of the social security contributions that the employer was required to pay.

This is because article 2116 of the Italian Civil Code guarantees that the subordinate employee will receive their pension payments in any event (see article 38, second paragraph of the Italian Constitution). Therefore employees will not lose their pension or have a reduced pension because their employer breached its obligation to pay contributions – the risk of an employer breaching its obligations does not fall on the employees.

In insolvency, employees are not required to retrieve unpaid pension contributions from their employer. But employees may need to start proceedings to claim other remuneration (other than pensions) that they are owed.

In relation to non-statutory social security contributions, paid by an employer to a private pension fund under a collective agreement, the company's insolvency may lead to the relevant employee:

- receiving only a portion of their relevant additional pension entitlement (if sufficient contributions have been paid); or



- not receiving any additional entitlement (if contributions have been insufficient). But the fund will generally return to the employee any contributions that have been paid by the employer and deducted from their payroll.

Will an insolvent company have any pension liabilities?

In respect of both statutory and non-statutory pension entitlements, an insolvent company has no pension liabilities towards its employees (who in any case receive their pension as described above). However, the INPS or the relevant supplementary private pension fund can file a claim against the employer for payments that it has failed to contribute.

Do liabilities to provide a pension and/or pay contributions have priority in insolvency?

The INPS's claim for omitted or circumvented statutory pension contributions is given preferential treatment in insolvency.

According to article 2753 of the Italian Civil Code, these claims (with the employees' claims for salaries and the Tax Agency's claims for omitted or circumvented tax payments) must be satisfied from the value of the insolvent employer's assets (excluding real estate assets) before all other claims.

The supplementary private pension fund's claim for the omitted or circumvented non-statutory pension contribution has preferential treatment in insolvency.

According to article 2754 of the Italian Civil Code, 50 per cent of the total claim (with the Italian Social Security Body's claim for omitted or circumvented contributions, the employee's claim for salaries and the Tax Agency's claim for omitted or circumvented tax payments) must be satisfied from the value of the insolvent employer's assets (excluding real estate assets) before all the other claims.

Can a parent company (or any other third party) be made liable for the pension obligations of an insolvent subsidiary?

For both statutory and non-statutory pension entitlements, a parent company (or any other third party) can be made liable for the pension obligations of an insolvent subsidiary's pension liabilities to the Italian Social Security Body or the relevant supplementary private pension fund only if the subsidiary is an unlimited liability company (*società di persone*).

Pensions and insolvency in the Netherlands

What are the main pension obligations of a solvent employer in the Netherlands?

There is no general obligation for employers to provide an occupational pension (on top of the state-provided pension that is mandatory for all Dutch citizens) to their employees. However, in some industries employers are required to ensure that their employees participate in mandatory industry-wide pension plans.

Except in exceptional circumstances, Dutch pension law requires pensions to be administered by an external pension provider (*pensioenuitvoerder*). Pension providers can be either pension funds or insurance companies.

The main pension obligation of a solvent employer is to pay the pension contributions to the pension provider on time and in full. In the case of defined-benefit plans, the employer may have contractually agreed in the administration agreement with the pension provider to make additional contributions if the pension plan is underfunded (though this is uncommon).

Will an employee still receive their pension if the employer becomes insolvent?

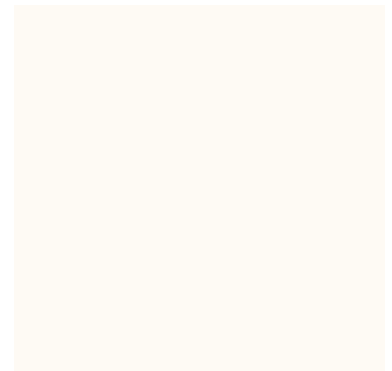
Yes. Regardless of the insolvency of their employer, employees will still have a pension claim against the pension provider. The Dutch requirement that pension promises be administered by an external pension provider is aimed at protecting employees against a loss of accrued pensions due to insolvency of the employer.

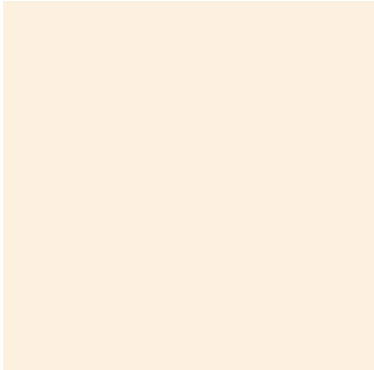
Will an insolvent company have any pension liabilities?

The insolvency of the company does not release it from its contractual obligation to make pension contributions in accordance with the plan rules. Pension contributions will have to be made until the plan is validly terminated or all participants in the pension plan employed by the insolvent company are dismissed.

Do liabilities to provide a pension and/or pay contributions have priority in insolvency?

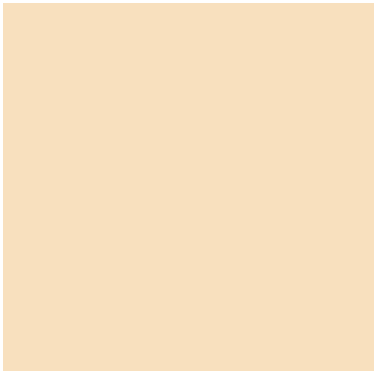
Under the Dutch Bankruptcy Act, pension contributions falling due after the bankruptcy order have a priority in the insolvency. They are considered estate debts (*boedelschulden*). Unpaid pension contributions from before the bankruptcy date are unsecured debts ranking equally with other unsecured debts. Depending on whether an employee was dismissed before or after the bankruptcy order was made, back-service obligations may be considered an estate debt (if the dismissal was effected after the date of the bankruptcy order) or an unsecured debt (if the dismissal was effected before the date of the bankruptcy order).





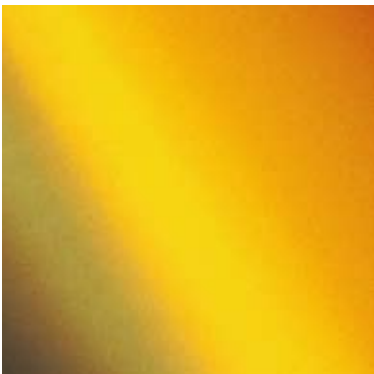
In the case of an employer's insolvency, the Dutch Employee Insurance Agency (Uitvoeringsinstituut Werknemersverzekeringen or UWV) will take over some of the employer's financial obligations towards the employees, including:

- the payment of salary and benefits over a maximum of 19 weeks; and
- holiday allowance and pension contributions that have remained unpaid over a maximum of one year.

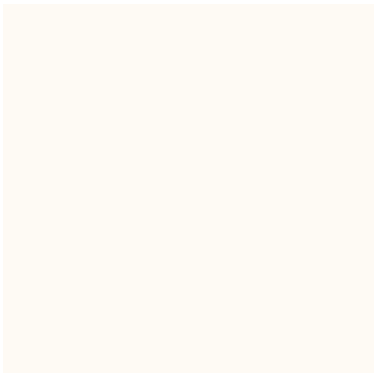


The concept of 'insolvency' for the purpose of this arrangement is broader than just bankruptcy (*faillissement*), which arises where a bankruptcy order has been sought to declare that the company or person is bankrupt. It also includes a moratorium of payment and situations in which the employer can demonstrate that it has severe financial problems. The UWV will have a preferred claim in the bankruptcy process for the amounts it paid to employees and third parties (eg the pension provider).

Can a parent company (or any other third party) be made liable for the pension obligations of an insolvent subsidiary?



Dutch law requires a company's management to report any expected inability to pay pension contributions to any mandatory industry-wide pension fund in which it participates. Non-compliance with this obligation may lead to members of the management board being personally liable for unpaid pension contributions.



Beyond this, there are no specific rules in Dutch law making parent companies or other third parties liable for the pension obligations of an insolvent subsidiary. Liability can arise, however, as a result of parent guarantees or acts of tort. Furthermore, in some group-wide pension plans the pension contribution is levied for the entire group at the level of the parent company and then cross-charged to participating subsidiaries. In this situation, the parent of a bankrupt subsidiary will have to file its claim against the subsidiary's bankrupt estate.

Pensions and insolvency in Spain

What are the main pension obligations of a solvent employer in Spain?

The main pension obligations of a solvent employer in Spain are to pay:

- social security contributions; and
- contributions to a private pension plan (if one is in place). These are voluntary and the employer may have agreed to provide one as part of an agreement with its employees or in a collective bargaining agreement. Among other things, these plans may contain provisions for retirement, permanent incapacity, disability, death of the beneficiary or dependence.

In Spain both defined-benefit and defined-contribution pension schemes are permitted.

Will an employee still receive their pension if the employer becomes insolvent?

Yes, in principle.

Employees should receive a social security pension if they comply with the relevant legal requirements.

As for private pension plans, employers are required by law to externalise their liabilities – ie companies are required to fund their pension liabilities through assets held separately from the employer, which means they cannot use internal funds to fund private pension plans. Therefore employees should still receive their pension from this external fund even if the employer becomes insolvent. Royal Decree 1588/1999 of 15 October 1999 implements article 8 of Directive 80/987/CEE to protect employees from an employer's insolvency.

Will an insolvent company have any pension liabilities?

No, in principle. Only employer social security contributions are privileged insolvency credits.

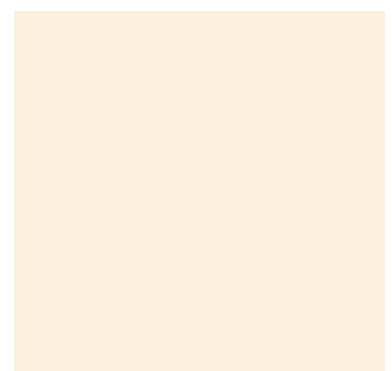
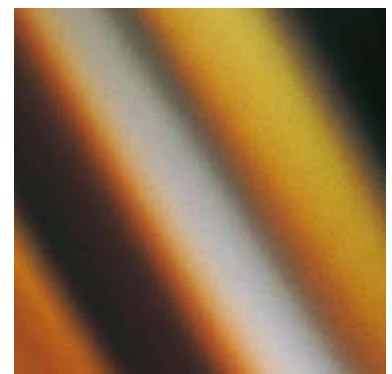
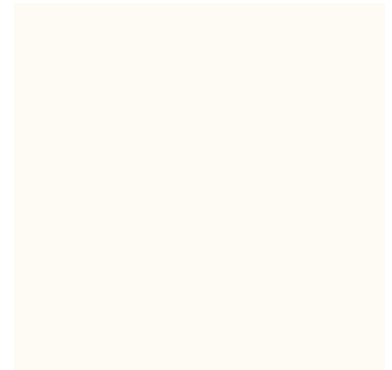
Private pensions should have been externalised (see above).

Do liabilities to provide a pension and/or pay contributions have priority in insolvency?

The employer social security contributions are privileged insolvency credits. However, contributions to private pension plans are not privileged.

Can a parent company (or any other third party) be made liable for the pension obligations of an insolvent subsidiary?

No, in principle, unless otherwise decided by a relevant court.



Pensions and insolvency in the UK

What are the main pension obligations of a solvent employer in the UK?

Employers that participate in a defined-benefit (DB) pension scheme are required to fund it on an ongoing basis. The scheme's rules and overriding statutory requirements will determine the amount they must contribute. This amount will depend on the value of the scheme's liabilities and assets.

Section 75 of the Pensions Act 1995 also imposes a debt obligation on employers if (broadly) the pension scheme starts to wind up or the employer enters liquidation or ceases to participate in the scheme. The debt (known as a section 75 debt) is the shortfall in the scheme funding measured on a buyout basis, which tests whether there would be sufficient assets to secure liabilities with insurance policies. In most occupational pension schemes the funding deficit on a buyout basis will be substantial.

Will an employee still receive their pension if the employer becomes insolvent?

The statutory Pension Protection Fund (PPF) will assume responsibility for an eligible DB scheme and compensate scheme members if:

- their employer enters into a formal insolvency process on or after 6 April 2005¹ and cannot be rescued, and the scheme cannot be maintained by another person; and
- the pension scheme does not have enough assets to provide its members with at least the amount of benefits they would receive from the PPF as compensation.

The PPF compensation benefits will broadly replicate some scheme-specific characteristics for a member's basic benefit, but limits apply to the compensation it provides. The maximum compensation members will receive will be a pension of £31,936.32 per annum (for 2009-10) if they are below the scheme's normal pension age (usually 65) and have not retired early as a result of ill health.

The Financial Services Compensation Scheme may also make payments to cover a proportion (usually 90 per cent) of scheme members' benefits if an insurance company has been used to secure those benefits and there has been a failure or default by the insurance company.

Will an insolvent company have any pension liabilities?

If the employer becomes insolvent this will usually trigger a section 75 debt that will be owed to the pension scheme (see first question above). If the PPF assumes control of the scheme it will pursue the claim against the employer on behalf of the scheme.

¹ The Financial Assistance Scheme may protect members of DB schemes that began winding up on or between 1 January 1997 and 5 April 2005.



The PPF has the power to participate, on behalf of the pension fund, in the restructuring or rescue of an insolvent company. As part of this process, it may in some circumstances agree to reduce or settle the employer's section 75 debt.

Do liabilities to provide a pension and/or pay contributions have priority in insolvency?

The pension scheme will not generally have preferential treatment in respect of amounts it is owed under a section 75 debt. Unless the employer has given the pension scheme security over any of its assets or some other form of collateral, the pension scheme will be an unsecured creditor, ranking equally with other unsecured creditors and below secured and preferential creditors.

Can a parent company (or any other third party) be made liable for the pension obligations of an insolvent subsidiary?

The UK Pensions Regulator has broad powers to make 'connected' or 'associated' third parties liable for the pension scheme deficit of an employer (including an insolvent employer) in certain circumstances. 'Connected' or 'associated' parties include any other company in the employer's corporate group (such as the parent or sister company) and can extend to companies in foreign jurisdictions and the directors of controlling entities.

The Regulator's powers are aimed at discouraging the use of transactions or corporate structures that aim to avoid pension liabilities, and minimising the risk of the PPF having to take responsibility for too many underfunded pension schemes. To put the significance of these powers into context, at the end of November 2009 the 200 largest UK privately sponsored pension final-salary schemes had a total deficit of approximately £88bn, as measured on an FRS17 or IAS19 accounting basis².

² Aon200 Index update.

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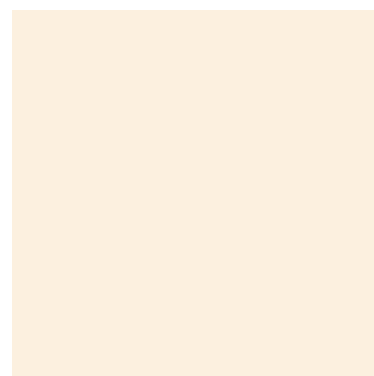
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Our EPB practice

Freshfields Bruckhaus Deringer is a leader among international law firms, providing business law advice of the highest quality throughout Europe, the Middle East, Asia and the US. With over 2,500 lawyers in 27 key business centres around the world, we provide a comprehensive service to national and multinational corporations, financial institutions and governments.

The employment, pensions and benefits (EPB) team advises on domestic and international employment law, pensions, share plans and other employee benefits. Our team comprises 21 partners and over 100 lawyers worldwide.

We are experienced in cross-border advice and have an excellent record in delivering tailored multi-jurisdictional advice, having very strong working relationships with local lawyers in countries in which we do not have offices.

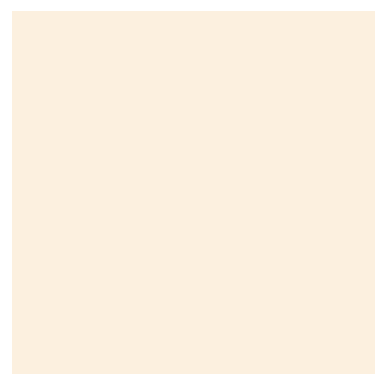
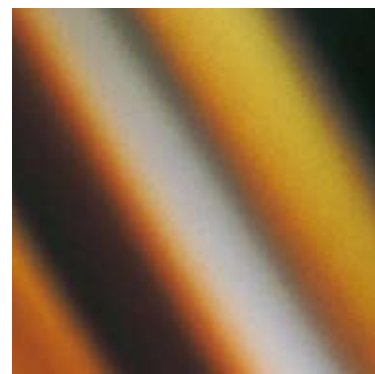
We advise on all the legal aspects of establishing and operating pension schemes, either in individual countries or on a cross-border European basis, as well as on how employers' pension obligations affect corporate transactions, restructurings or insolvency. We also provide legal advice on funding pension schemes, merging and winding up pension schemes, changing pension benefits, resolving pension scheme disputes through court litigation or alternative procedures, discrimination issues, investing pension scheme assets and risk management transactions such as insurance buyouts and buy-ins.

We also assist employers on:

- all aspects of employment and industrial relations law, including: the individual and collective employment aspects of mergers and acquisitions (public and private, listed and unlisted), joint ventures, demergers and all manner of corporate re-organisations (including redundancies); executive remuneration and related regulatory and disclosure obligations; service contracts and related documents; confidentiality and restrictive covenants; works councils; individual and group severance arrangements; and contracting out of services; and
- designing, drafting and implementing share plans; corporate governance issues and senior executive remuneration and incentive arrangements (including the share plan and benefit aspects of senior executive terminations); age discrimination issues affecting share plans; and related tax, company and securities laws.

'For international pensions matters, the firm has a strong complementary offering in key jurisdictions.'

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