



JONES DAY
COMMENTARY

CLOSING EUROPEAN PENSION PLANS TO FUTURE ACCRUAL

Many employers are exploring options for closing (or “freezing”) their defined benefit pension plans to cease future benefit accrual as the costs, volatility, and risks associated with these types of plan have reached unprecedented levels. Whether closure is possible without incurring significant costs or triggering employee relation issues requires an understanding of the issues that may apply.

This *Commentary* outlines those issues and, in particular, the restrictions that need to be considered when closing plans established in Belgium, France, Germany, Italy, Spain, and the United Kingdom. Many employers are looking to replace defined benefits with defined contribution benefits, wherever this is possible, but the complexity of such closures, and issues such as consultation with employees and their representatives, can outweigh the advantages of reducing the cost and uncertainty inherently connected with generous defined benefit plans.

EMPLOYEE AND WORKS COUNCIL OR TRADE UNION CONSENT

Generally, employees have a contractual right to the benefits provided under the plan, and closure would constitute a breach of contract in the absence of consent. As a result, the first step in a closure exercise should always be to check employees’ terms of employment.

It is rare that this is an obstacle in the UK, as most pension plans are offered subject to the terms of the plan, which will in the vast majority of cases provide for their amendment and termination. In a minority of cases, a UK defined benefit plan’s governing documentation may contain restrictions that prevent the closure of the plan and give employees an ongoing right to the benefits provided under it, or limit the extent to which future accrual can be stopped. In these cases, employees will need to give their consent to the cessation of benefit accrual, and it is unlikely that consent would be forthcoming.

Employee consent is also required in Germany, where employees have a contractual right to the benefits, and if the right is contained in a collective bargaining agreement, works council consent will also be required. In either case, unless objective reasons for the closure acceptable to the Labour Courts can be shown to exist, there is a risk that employees could successfully seek continued participation in the relevant pension plan.

In France, employee consent is required if the employee has a contractual right to the pension benefits. Collective bargaining agreements or arrangements provided through custom and practice may be modified without employee consent, although a prescribed modification procedure must be followed involving notice and, in respect of collective bargaining agreements, works council consultation.

In Spain and Belgium, consent must be given by the pension plan's governing body and by the relevant employees because a reduction in benefits is considered to be a substantial modification of the employment conditions. However, if the employees refuse consent, it may still be possible to close the plan if the employer has valid grounds (for example, economic, technical, organisational, or productive reasons for the closure).

Industry-wide plans in Italy may be closed only with the consent of the parties that set up the plans, usually the employer associations and the trade unions. Pension plans operated at the company level can be closed only with the consent of the relevant trade union, unless closure occurs in the context of a company insolvency or as a result of the termination of the business.

Replacement Benefits. In most jurisdictions, the consent of at least one interested party (i.e., employees or their representatives) will be needed for a closure. This consent is unlikely to be forthcoming unless employees are provided with a benefit of an equivalent value.

In the UK, as already mentioned, most pension plans are offered subject to the terms of the plan, which will often provide for their termination. Although trustees must generally consent to the closure of a pension plan, trustees usually take the view that their duties to plan members are confined to protecting past service benefits. They do not, as a result, tend to get involved in negotiating the level of future benefits. It is therefore possible to replace a defined benefit arrangement with a defined contribution arrangement in the UK because the consent of the employees or their representatives is not required.

Dealing with a Refusal to Consent. If employees or their representatives refuse to consent to a closure, an employer may wish to consider other options, most often the "dismissal and rehire" route. By this method, the employee is dismissed and then reemployed on different terms that do not include the right to accrual of further benefits in the pension plan.

This approach has been used with some success in the UK. Although employees who are dismissed can bring claims for unfair dismissal, the costs to the employer may well be lower than the costs of retaining a defined benefit plan, and depending on the market sector and seniority and skills of the affected employees, many employees might accept reemployment rather than bring a claim, particularly in the current economic climate. Of course, this may give rise to employee relations and reputational issues for the employer.

"Dismissal and rehire" is not an option in many other EU jurisdictions. In Germany, the dismissal would be ineffective to terminate employment. In Belgium, the employee can claim damages and also request the Labour Court to reinstate the original pension plan. In Spain, the employer could try to stop making contributions to the plan on economic, technical, or organisational grounds, but this would not have the effect of closing the plan, and this approach is susceptible to challenge. In France, the grounds for dismissal would not be the refusal by the employee to consent but the necessity for the company to close the plan, notably for economic reasons (under the French criteria), which is more difficult to establish.

CONSULTATION

In addition to consent, consultation with certain parties is often required. Consultation must be conducted before any clear decision to close can be made so that the issues raised by the consulted party are properly considered before any final decision. Consultation can be time-consuming and add to the uncertainty on any closure. Consultation does not require an employer to obtain agreement to the closure, but it does mean that the employer must give employees and their representatives an opportunity to share their views on the proposed closure. The employer should take those views into account when reaching a final decision. However, the employer is generally not prevented from going ahead with the closure, except in Belgium, where the decision to close without valid consultation may lead to the annulment of that decision.

As noted above, consultation with works councils and unions may be necessary in most jurisdictions, depending on the agreements entered into. In addition, specific consultation with employees is required in the UK and France. In the UK, closure of a pension plan to future accrual is a “listed change” requiring 60 days’ consultation with the affected employees or their representatives. In France, the length of time for works council consultation is not regulated. Depending on the number of meetings necessary to obtain an opinion from the employees’ representatives, the consultation would take between 15 and 60 days for benefit arrangements set up as a result of a collective bargaining agreement.

PAYMENTS TO THE PLAN ON CLOSURE

Although the closure of a pension plan reduces long-term uncertainty and cost for the employer, it may not have such an effect in the short term. In fact, the closure itself often results in an immediate payment becoming due to the plan.

In the UK, if trustee consent is not obtained, closure of the plan may require the employer to buy out members’ benefits with an insurance company. The cost of doing this is likely to be very significant. Often trustees will seek something from the plan employers (for example, a lump sum contribution to the plan or a guarantee in favour of the trustees) in return for giving their consent.

In Spain and Belgium, the employer will be required to guarantee the level of benefits accrued under the plan and will need to cover any shortfall in the plan funds in order to meet this obligation. In Italy, the members’ accrued benefits will need to be transferred to an insurance company, and there will be an administrative cost to the employer in purchasing the necessary insurance policy.

CONCLUSION

Closure of a defined benefit pension plan is an attractive option for many employers in the present climate, given the ever-growing costs of providing pension benefits. However, the need for consents and consultation, as well as the costs occasioned by such a change, mean that any proposed closure requires careful planning.

LAWYER CONTACTS

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