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PENSIONS ASPECTS OF
CORPORATE TRANSACTIONS
IN THE EUROPEAN UNION

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Pensions Aspects of Corporate Transactions in the European Union

Over the past decade companies making acquisitions outside of their own country have been taking an increasing interest in the pension and retirement benefit liabilities of the company being acquired. The recent evolution of the financial markets with the dramatic impact on the financial situation of pension funds highlights even more the importance of pension aspects in a corporate transaction.

Acquisitions are made for business reasons; to secure additional markets, products, production facilities, distribution channels and competencies and not for the purpose of acquiring a pension plan. However, any financial assessment of the target company will need to consider the appropriate allowance to be made for both past and future pension costs. Disagreement over such assessments due to the different funding and accounting approaches used for pension plans can cause disagreements between the vendor and purchaser and have been a significant factor in the failure of a number of potential deals to be completed.

This situation has brought into sharp focus the different approaches that have historically been adopted for the funding and accounting of pension benefits.

The purpose of this article is to compare how the liabilities in respect of retirement benefit arrangements are typically valued when considering pension scheme liabilities in a corporate transaction. There exists variation within each country as to the method and assumptions that are used. The article seeks to highlight the key issues and does not cover every approach used in each country. In any transaction the price paid is always a matter for commercial negotiation between the parties.

A summary of the key actuarial methods and assumptions typically used is shown in the attached table.

Although significant differences exist between the countries covered in this survey, a certain convergence of methodology is observed.

The Projected Unit Credit actuarial cost method is the most commonly applied method; undoubtedly this evolution is due to the increasing influence of accounting standards.

For the valuation of pension assets in corporate transactions the market value is the most commonly applied approach.

The economic assumptions used to determine the pension liability are usually fixed in the corporate transactions; in many countries however the resulting liability cannot be lower than the minimal legal requirements.

In some countries there is a practice of selecting a separate economic assumption for the development of each of the various factors that may affect the level of the benefits paid, such as salary, social security ceiling and price inflation. In other cases a single 'net' rate of discount is used with no separate allowance for these factors.

As far as demographic assumptions are concerned, there is again a distinction between those countries where standard general assumptions are adopted as opposed to other countries where scheme specific demographic assumptions are utilised. The key area of difference is whether explicit allowance is made for employee turnover and early retirement.

Conclusion

The approach adopted by actuaries when calculating the value of liabilities within the context of an acquisition varies across Europe. A certain convergence in the choice of the actuarial method and of the assumptions is observed. However the influence of legal requirements and “generally accepted practice” in each country is still important.

Companies considering a cross border transaction would be well advised to give due attention to the situation of the pension plan and seek appropriate professional advice in this respect.

Konrad Niklewicz

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	Belgium	Denmark	Finland	France
Determination of the actuarial method in a corporate transaction:	By general accepted practice, but subject to negotiation and minimal legal requirements. The liability can not be less than statutory amount	By general accepted practice	Actuarial basis is given by the Supervisory Authority	By general accepted practice
Most frequently usted method:	PUC or insurance reserve for insured plans		Current Unit Method	PUC (straight forward or service prorate)
Method of valuation of pension assets:	Market value	Market value	Book value; but as maximum market value.	Market value or value of insurance policy
Are the leaving and the remaining groups treated in the same way ?	Yes	Yes	Yes	Yes with exceptions
If no, what are the main differences ?				
Who has to accept the conditions ?	The authorities		The Supervisory Authority	The companies, an implication of the employees or unions is possible in the future.
How often are the conditions challenged ?	Not frequent		Unusual	
How are the assumptions used in the calculation defined ?				
Discount rate	Defined in the corporate transaction (subject to legal requirements)		Corresponds to statutory discount rate	Defined in the corporate transaction
Salary inflation	Defined in the corporate transaction		as above	as above
Pension indexation	Defined in the corporate transaction (At least as prescribed by the plan rules)		as above	Defined in the corporate transaction, but respecting legal requirements
Demographic assumptions	Defined in the corporate transactio		Coresponds usually to statutory; in exceptional cases defined in the corporate transaction	Defined in the corporate transaction

	Germany	Italy	Luxembourg	Netherland	Portugal
Determination of the actuarial method in a corporate transaction:	By general accepted practice	By general accepted practice		Actuarial method part of the commercial negotiation	By law
Most frequently usted method:	PUC			Project Unit Method	Project Unit Method
Method of valuation of pension assets:		Market value		Market value	Market value
Are the leaving and the remaining groups treated in the same way ?	Yes	depends on the negotiation		No	Yes
If no, what are the main differences ?				The liabilities are not calculated with the same method and assumption as the transfer method.	
Who has to accept the conditions ?	The companies involved in the transaction	Employees		Employees and the supervisory authorities	The companies involved in the transaction
How often are the conditions challenged ?					
How are the assumptions used in the calculation defined ?					
Discount rate	Defined in the corporate transaction	Defined in the corporate transaction usually 3%-5%		Defined in the corporate transaction usually long term bonds	Statutory
Salary inflation	as above	Defined in the Corporate transaction usually 2%-2,5%		Defined in corporate transaction	Statutory
Pension indexation	Defined in the corporate transaction, but respecting legal requirements	Defined in the corporate transaction usually 1,6%		Defined in corporate transaction	Statutory
Demographic assumptions	Defined in the corporate transaction	Defined in the corporate transaction		Defined in corporate transaction	Statutory

	Spain	Switzerland	United Kingdom
Determination of the actuarial method in a corporate transaction:	By generally accepted practice	Part of the commercial negotiation, but subject to minimal legal requirements	By general accepted practice; it is part of the commercial negotiation
Most frequently usted method:	Project Unit Method	PUC or sum of statutory individual rights	Projected unit
Method of valuation of pension assets:	Market value or value of insurance policy	Market value	Market value
Are the leaving and the remaining groups treated in the same way ?	Yes	Varies, no legal requirement to do so, the accrued benefits have to be guaranteed	Varies, no requirement to do so
If no, what are the main differences ?		Leaving employees covered by new employers plan; "mirror" plan requirement is an exception. Surplus if any not transferred; deficit is transferred	Leaving employees will often have the plan of the new employer; however some transactions require"mirror image" pension benefits. Any surplus in the fund will generally not be transferred.
Who has to accept the conditions ?	The companies involved in the transaction, however accrued benefits have to be guaranteed	The employees and the supervisory authorities	The involved companies
How often are the conditions challenged ?		10%	Unusual
How are the assumptions used in the calculation defined ?			
Discount rate	Defined in the Corporate transaction (4%-5% 2002 values)	Defined in Corporate transaction subject to legal requirements	Defined in the Corporate transaction (5.25%-6.75% 2002 values)
Salary inflation	Defined in the Corporate transaction, usually inflation plus 0.5%-2%	Defined in Corporate transaction	Defined in the Corporate transaction, usually inflation plus 1% 2%
Pension indexation	Consistent with other assumptions	as above	Defined in the corporate transaction (2002 values 2,25-2.75%)
Demographic assumptions	GRMF95 OR PERM2000	as above	Defined in the corporate transaction