

Pensions & Retirement Plans

Contributing editors

Steven J Friedman and Melissa B Kurtzman



2016

GETTING THE
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Pensions & Retirement Plans 2016

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Published by
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First published 2013
Fourth edition
ISSN 2052-8310

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Printed and distributed by
Encompass Print Solutions
Tel: 0844 2480 112



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Mexico

Mónica Schiaffino

Littler Mexico

Statutory and regulatory framework

1 What are the main statutes and regulations relating to pensions and retirement plans?

The main statutes and regulations relating to pensions and retirement plans are the following:

- the Federal Labour Law;
- the Social Security Law (regulates employees pensions in the private sector);
- the Institute for Social Security and Services for State Workers Law (regulates employees' pensions in the public sector);
- the Mexican Income Tax Law; and
- the Retirement Savings System Law.

2 What are the primary regulatory authorities and how do they enforce the governing laws?

The following entities are administrative authorities and enforce governing laws through binding resolutions. Such resolutions can be challenged by either party before federal trial courts or federal collegiate courts:

- the State and Federal Labour Boards;
- the Mexican Social Security Institute;
- the Institute for Social Security and Services for State Workers; and
- the National Commission of the Retirement Savings System.

3 What is the framework for taxation of pensions?

A portion of the government employees' pension is exempt from income tax, capped at 15 times the qualifying minimum wage level. Currently, the minimum wage for Mexico City is 70.10 Mexican pesos per day.

Under the social security and retirement laws, employer contributions are not considered to be part of the employees' wages, for purposes of employees' contributions to the social security system. The tax law also allows employers to claim deductions for their contributions to the mandatory retirement system.

State pension provisions

4 What is the state pension system?

In Mexico, there are two different pension schemes for private sector employees:

- the pension scheme provided under the Social Security Law (SSL) of 1973; and
- the pension scheme provided under the current SSL of 1997.

Pension system under the SSL of 1973

Employees registered with the Mexican Social Security Institute (MSSI) system prior to July 1997 are entitled to receive pension benefits from the government under the SSL of 1973 pension programme known as 'Retirement for Senior Citizens Due to Age and Unemployment'. Employees qualify for this programme if they have accrued at least 500 weeks of recognised contributions in the MSSI system and have reached the qualifying retirement age. Employees can retire at 65 or if they are unemployed after reaching the age of 60.

The benefit granted in this scheme consists of a life pension that is calculated by averaging the employee's base salary paid during the past five years of employment.

Employees who qualify under the SSL of 1973 scheme may opt to receive pension benefits under this scheme or the new pension system explained below.

Pension system under SSL of 1997 (new pension system)

Retirement pensions afforded under the new pension system are provided in the following categories: Disability and Life Insurance; and Retirement for Senior Citizens Due to Age and Unemployment.

Each employee has his or her own individual retirement account, which is managed by Pension Fund Administrators (AFOREs). AFOREs are pension fund managers that can be public, private or social institutions. AFOREs are regulated by the National Commission of the Retirement Savings System Law. Each employee is entitled to choose the AFORE that will manage his or her pension fund.

Pursuant to the new pension system, employees are entitled to pension benefits for the rest of their life once they have registered at least 1,250 weeks of recognised contributions and have reached the qualifying retirement age. The retirement age is 65 (under the retirement insurance programme) or 60 (under the retirement due to unemployment programme). The life pension will be capitalised with the funds deposited in the retiree's individual account, and a survival spouse insurance benefit that will also be paid from this account.

Additionally, under this pension insurance programme, the employee can opt to receive scheduled retirement payments in lieu of the life pension whenever the funds in his or her individual account are sufficient to pay him or her at least the minimum wage in Mexico City.

5 How is the state pension calculated and what factors may cause the pension to be enhanced or reduced?

Pursuant to the Social Security Law of 1973, the pension is calculated by averaging the salary paid to the employee during the past five years of employment, which cannot be reduced but can be enhanced if the employee retires (after turning 60 and before turning 64) but then returns to work. In this case, his or her new contribution would increase the pension amount. Additionally, employees can make voluntary contributions, which also increase the pension amount.

Under the new pension system, an employee's individual pension is funded with contributions for each of the following programmes:

- the retirement programme, which is funded with employer contributions equivalent to 2 per cent of the employee's base salary;
- the retirement programme due to unemployment and old age, which is funded with 4.5 per cent of the employee's base salary paid by the employer, the employee and the government;
- 5 per cent of the employee's base salary deriving from the employer's contributions made to the Housing Fund; and
- an additional 'social quota' paid by the federal government consisting of a contribution of 5.5 per cent of the daily minimum wage.

Additionally, the employee may opt to receive scheduled retirement payments in lieu of a life pension, whenever the employee's individual account is sufficiently funded to pay him or her at the qualifying minimum wage.

6 Is the state pension designed to provide a certain level of replacement income to workers who have worked continuously until retirement age?

The pension is designed to provide the necessary financial support during retirement. However, the amount of the pension payments is always less than the employee's salary before retirement.

7 Is the state pension system under pressure to reduce benefits or otherwise change its current structure in any way on account of current fiscal realities?

The pension is designed to provide the necessary financial support during retirement. However, the amount of the pension payments is always less than the employee's salary before retirement.

Plan features and operation

8 What are the main types of private pensions and retirement plans that are provided to a broad base of employees?

The main types are:

- defined benefit – the employee knows the benefit to be received at the age of retirement, but the full cost of the plan is unknown;
- defined contribution – the cost or investment of the plan is known, but the benefits that employees will receive are unknown; and
- mixed plans – any combination of both plans in order to reduce uncertainty in the retirement age or the cost of the plan over time.

9 What restrictions or prohibitions limit an employer's ability to exclude certain employees from participation in broad-based retirement plans?

The law requires that retirement plans be made available for the benefit of all employees. This requirement must be met in order to register the retirement plans with the National Commission of the Retirement Savings System.

Various rules allow employer contributions to not be considered part of the employees' wages, for the purposes of employees' contributions to the social security system. The law also allows employers to claim deductions for their contributions into the retirement system.

10 Can plans require employees to work for a specified period to participate in the plan or become vested in benefits they have accrued?

Because private pension plans are contractual benefits, the employer and the employee can freely determine the terms and conditions of plan participation and benefits.

Notwithstanding the above, the plans should be granted on a uniform basis for the benefit of all employees. It is recommended that the conditions, including the waiting period, be the same for all employees, regardless of whether they are hired for an indefinite or definite term.

11 What are the considerations regarding employees working permanently and temporarily overseas? Are they eligible to join or remain in a plan regulated in your jurisdiction?

The conditions to participate in a private pension and retirement plan can be established by the employer. As such, employers may allow their employees who are working on an international assignment to participate in the plan. However, such an arrangement can have various labour implications, including that an employee may be deemed to continue being protected under Mexico's Federal Labour Law, for the purposes of all the benefits and rights afforded under that law.

Most private pension plans establish that the employee can join or remain in a pension plan in Mexico as long as the labour relationship continues and contributions are made to a defined benefit plan or a defined contribution plan.

Additionally, tax laws allow for employees to preserve the contributions that are made into a defined contribution plan, even after the employment relationship terminates or until the employee reaches retirement age, in order for the employee to receive income tax exemptions.

Pension plans also typically include provisions affording employees the opportunity to transfer the funds from a former employer's pension plan to one with a new employer, without paying income tax.

12 Do employer and employees share in the financing of the benefits and are the benefits funded in a trust or other secure vehicle?

Generally, only employers contribute to the defined benefit plan fund and employees contribute to the defined contribution plan's fund. The fund is administered through an irrevocable trust in a credit institution authorised to operate in the Mexico, or by institutions or companies of mutual insurance, brokerage firms, mutual fund operators or pension fund managers that are authorised to operate in the country, pursuant to the general rules promulgated by the Tax Administration Service.

13 What rules apply to the level at which benefits are funded and what is the process for an employer to determine how much to fund a defined benefit pension plan annually?

The employer creates a benefit fund that must be calculated annually, using an actuarial calculation. The formula should be stated in the pension plan. Usually, the fund guarantees participants at least a severance for wrongful termination that is equivalent to:

- three months' aggregate salary; plus
- 20 days' aggregate salary per each year of service; and
- a seniority premium of 12 days per year of service, capped at twice the minimum wage.

14 What are customary levels of benefits provided to employees participating in private plans?

Under defined benefit plans, companies implement retirement plans with a benefit based on mandatory severance for wrongful termination (discussed above) set for the retirement age.

For defined contribution plans, employees contribute to the fund. Therefore, the benefit will depend on the employee's savings through the contributions and the length of service. If the employer contributes to the fund, such contributions are added to the employees' contributions. Employer contributions are common and are of two types: basic contributions (usually at 3 to 5 per cent of the employee's salary) and a match of the employee's contribution with a limit of up to 2.5 per cent of the employee's salary.

15 Are there statutory provisions for the increase of pensions in payment (pension escalation) and the revaluation of deferred pensions?

No; however, some pension plans do establish an increase in pensions depending on increases to the mandatory minimum wage levels.

16 What pre-retirement death benefits are customarily provided to employees' beneficiaries and are there any mandatory rules with respect to death benefits?

The pre-retirement death benefits available under a retirement plan depend on the type of plan involved and whether the death is natural or accidental. There are no mandatory rules with respect to death benefits, but it is common to grant the beneficiaries a portion or all of the contributions made by the employee and the employer, or even the entirety of the retirement benefits in the case of death or total disability.

17 When can employees retire and receive their full plan benefits? How does early retirement affect benefit calculations?

The retirement plan establishes the terms and conditions for the employee to retire and receive his or her full plan benefits. Generally, the retirement age is 60 or 65 and the early retirement age 50 or 55. Pension plans also include a length of service requirement, which is typically 10 years.

While early retirement is possible, it affects the pension amount, depending on life expectancy and actuarial studies.

18 Are plans permitted to allow distributions or loans of all or some of the plan benefits to members that are still employed?

Because of tax deduction requirements, loans to employees from pension plan and retirement contributions are not permissible. However, other programmes called savings funds require employers and employees to contribute to a fund that grants low interest loans to participants. Loans may be granted only once per year and contributions are distributed to participants on a yearly basis.

19 Is the sufficiency of retirement benefits affected greatly if employees change employer while they are accruing benefits?

For defined contribution plans, employees are entitled to the contributions they made and the fund will not be affected by a change of employers. However, the contributions will be subject to the income tax, unless the employee keeps the funds deposited in the plan until he or she reaches retirement age.

Defined benefit plans have various specific plan requirements, which the employee must satisfy to be entitled to the plan benefits.

20 In what circumstances may members transfer their benefits to another pension scheme?

If the pension plans of the former and new employer allow for fund transfers, the employee can roll over their benefits to the new employer's pension fund through institutions or companies authorised by the retirement and tax laws (eg, insurance companies, brokerage firms, mutual fund operators or retirement fund administrators authorised by the government).

21 Who is responsible for the investment of plan funds and the sufficiency of investment returns?

The plan funds are administered by the employer through an irrevocable trust managed by credit institutions (eg, insurance companies, brokerage firms, mutual fund operators, retirement fund administrators, etc) authorised by the government and regulated by the Tax Administration Service.

22 Can plan benefits be enhanced for certain groups of employees in connection with a voluntary or involuntary reduction in workforce programme?

No. Plan benefits must be granted under the same terms to all employees and cannot be enhanced, in order to comply with social security requirements and qualify for tax deductions. However, the employer can offer other types of benefits (subject to income tax) to encourage participation in a voluntary workforce reduction programme.

23 Are non-broad-based (eg, executive-only) plans permitted and what types of benefits do they typically provide?

Although non-broad-based plans are permitted, the benefits would not be tax-deductible. Non-broad-based plans are uncommon in Mexico, although they can be established by the employer.

24 How do the legal requirements for non-broad-based plans differ from the requirements that apply to broad-based plans?

The requirements are the same for both, but a non-broad-based plan cannot be registered with the National Commission of the Retirement Savings System and the contributions cannot be tax-deductible.

25 How do retirement benefits provided to employees in a trade union differ from those provided to non-unionised employees?

Tax laws in Mexico allow an employer to have different plans for unionised and non-unionised employees. At one point, retirement plans were more common in the unionised workforce than in the non-unionised workforce, because the retirement plans were included in collective bargaining agreements. The current trend is that an increasing number of companies are adopting pension plans for non-unionised workers and that their benefits generally are at higher levels than for employees in a trade union.

26 How do the legal requirements for trade-union-sponsored arrangements differ from the requirements that apply to other broad-based arrangements?

From a tax perspective, the requirements for trade union-sponsored arrangements are the same as for other broad-based arrangements. However, while a trade union-sponsored arrangement is jointly agreed between the employer and the union, the non-union arrangement can be unilaterally determined by the employer.

Enforcement

27 What is the process for plan regulators to examine a plan for periodic legal compliance?

The National Commission of the Retirement Savings System keeps a record of the pension plans established by employers and monitors the plans to ensure that benefits are granted according to the plan terms. In addition, if an employer does not comply with obligations included in the plan, the participants are entitled to file a complaint with the Conciliation and Arbitration Labour Board.

28 What sanctions will employers face if plans are not legally compliant?

For non-compliant employers, their plan contributions will not be deductible for federal income tax purposes. Additionally, employers that do not comply with a plan established under a collective bargaining agreement are subject to a fine of 250 to 5,000 times the minimum wage per employee, and the union may file a call to strike to enforce the terms of the collective bargaining agreement. Further, employees are entitled to file a complaint with the Conciliation and Arbitration Labour Board to exercise their rights under the plan.

29 How can employers correct errors in plan documentation or administration in advance of a review by governing agencies?

There are no legal provisions or requirements regarding the correction of errors. Nevertheless, the employer can submit a written brief clarifying the errors, which must be taken into consideration by the governing authority. With respect to pension or retirement benefits included in collective bargaining agreements, the employer and the union can execute a modification agreement and file it with the Conciliation and Arbitration Labour Board.

30 What disclosures must be provided to the authorities in connection with plan administration?

Every employee who decides to participate in a plan must provide a written authorisation. The employer must file a list of all plan participants with the Treasury Ministry by 15 February of every year. Additionally, an actuarial calculation for the fund reserves must be filed with the Treasury Ministry and the plan must be registered with the National Commission of the Retirement Savings System once per year.

31 What disclosures must be provided to plan participants?

Employers are not required to provide disclosures to plan participants, except that the terms and conditions of the plan should be disclosed to employees prior to their joining the plan, for the purposes of obtaining their full, informed consent.

32 What means are available to plan participants to enforce their rights under pension and retirement plans?

Employees can file a complaint with the Conciliation and Arbitration Labour Board to demand the enforcement of their rights under the pension and retirement plan.

Plan changes and termination

33 What restrictions and requirements exist with respect to an employer's changing the terms of a plan?

In Mexico, labour relationships are bilateral. Therefore, employers cannot unilaterally change the terms of a plan, unless, through the plan document itself, the employer reserves the right to modify, suspend or eliminate the plan or the benefits received thereunder. Such 'reservation of rights' typically includes language to the effect that the benefits provided under the plan are 'rights in expectancy' and not acquired (or vested) rights.

If the plan is included in a collective bargaining agreement, the union's consent will be required in order to modify or terminate the plan.

34 What restrictions and requirements exist with respect to an employer terminating a plan?

See question 33. Additionally, because the plan is not a vested right, but rather a conditional benefit, the employer may terminate the plan without any restriction. Nevertheless, employees can seek recognition of

their rights by filing a complaint with the Conciliation and Arbitration Labour Board.

Any acquired right under the plan shall be honoured and the pension plan funds distributed to employees who have met the required conditions. Employers can keep any surplus amounts as long as they pay the appropriate income taxes.

35 What protections are in place for plan benefits in the event of employer insolvency?

As discussed above, the funds are administered through an irrevocable trust managed by credit institutions (eg, insurance companies, brokerage firms, mutual fund operators, retirement fund administrators, etc) authorised by the government and regulated by the Tax Administration Service. The contributions made to the fund are invested and protected against employer insolvency, in which case the contributions shall be refunded with interest to the employees.

36 How are retirement benefits affected if the employer is acquired?

How retirement benefits are affected if the employer is acquired depends on the form of the takeover. In the case of a share acquisition, the plan will continue under the same terms, as the employment relationship does not change by virtue of the share acquisition. If the employer is acquired through a transfer of assets, the new employer must abide by the same terms and conditions of the employment relationship that existed before the employer substitution. If the employees are dismissed by the company before the acquisition and rehired by the new employer, the new employer is entitled to establish new benefits under new terms and conditions. The former employer will have to distribute the funds of the plan to employees with vested rights. The former employer can keep any surplus amounts by paying the applicable income tax.

37 Upon plan termination, how can any surplus amounts be utilised?

The employer is entitled to use any surplus funds as long as it has complied with its obligation to pay employees according to their vested rights and has paid the necessary income tax.

Fiduciary responsibilities

38 Which persons and entities are 'fiduciaries'?

Fiduciaries include credit institutions (insurance companies, brokerage firms, mutual fund operators, retirement fund administrators, etc) authorised by the government and regulated by the Tax Administration Service.

39 What duties apply to fiduciaries?

Fiduciary duties include defending vested rights; enforcing the plan terms; filing disclosures concerning fund reserves; filing reports concerning plan administration; and complying with various fiduciary responsibilities, including preventing any transfer of their responsibility to third parties and administering the estate in the best interests of the beneficiaries.

40 What are the consequences of fiduciaries' failing to discharge their duties?

Fiduciaries are responsible for the damages and lost profits they cause by failing to discharge their duties. If trust properties are lost or damaged, fiduciaries can be removed from their charge.

Legal developments and trends

41 Have there been legal challenges when certain types of plans are converted to different types of plan?

If the new plan complies with the legal requirements, there are no legal consequences. However, as labour relationships in Mexico are bilateral, changing from a defined benefit plan to a defined contribution plan requires the employee's or union's consent.

42 Have there been legal challenges to other aspects of plan design and administration?

There are complex formulas and strict accounting rules that tend to harmonise with International Standards. At present, the percentage of employers with private pension plans is not high and regulations and governing laws have not been developed. Effective 1 January 2014, the maximum deduction of employer contributions to private pension plans was reduced from 100 per cent to 47 per cent (in an aim to protect employee's benefits plans, tax law indicates that if no changes are made to an existing benefit plan, the maximum deduction of employer contributions to private pension plans was reduced from 100 per cent to 53 per cent).

43 How will funding shortfalls, changing worker demographics and future legislation be likely to affect private pensions in the future?

Funding shortfalls and worker demographics have led existing pension plans to change from defined benefits to defined contribution plans. This trend will continue in the coming years.



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Pensions & Retirement Plans
ISSN 2052-8310



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