Headlines

Worldwide pay and benefits

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AUSTRALIA

Legislation allows employees to split pension plan contributions with spouse

Australian employees are now able to transfer part of their pension plan contributions to separate accounts for spouses.

Under the Tax Laws Amendment (Contributions Splitting) Act 2005, employees are allowed to split their superannuation (pension) plan contributions by transferring a designated portion to their spouse's own 'super' account. The legislation, effective 1st January, 2006, is the latest step in the government's initiative to provide incentives that make it more attractive for people to save for their retirement. Since July, employees have been able to choose where their superannuation contributions are invested (and to draw their benefits while still working). In July 2003, low earners became eligible for a 'co-contribution' (currently A\$1.50) from the government for each A\$1 of their personal contribution.

The law does not require pension plans to offer the new feature. If they do, at the end of each financial year (30th June), members may elect that up to 100 per cent of their own and their employer's contributions in that financial year be transferred to an account in their spouse's name. The transfer is not reversible.

Advantages for high earners

High earners whose spouses have little or no pension fund of their own stand to gain the most from splitting. At retirement, lump sum benefits are tax-free up to a certain limit, and the remaining value is taxed at concessional rates up to a 'reasonable benefit limit'. By splitting contributions with their spouse and building up two accounts, couples will gain access to two tax-free limits and two reasonable benefit limits.

There may also be tax advantages for high earners who participate in 'salary sacrifice' arrangements (in which employees give up salary in return for contributions to the pension plan). In these situations, the ability to shift contributions to a spousal account could effectively allow the high earner to set aside more salary for savings.

Low earners may not benefit from splitting because it may not make any difference to their tax situation at retirement. In addition, there will be two sets of fees and charges to be paid for two accounts each year.

Implications for employers

Plan sponsors need to decide whether to offer the splitting feature and, if so, put in place the necessary administration systems. It is expected that most large funds will offer splitting, in due course. Employers need to bear in mind that employees now have a right to choose the pension plan into which the

mandated 9 per cent employer contribution is paid, and if they do not offer splitting, employees may have an incentive to choose a different plan.

EUROPE

European Commission proposes pensions portability directive

The European Commission (EC) is proposing new measures to protect employees' pension rights when they change jobs, either within the same country or to a different country in the European Union.

Currently, in some EU countries, employees may lose accrued pension benefits when they change jobs. The EC sees this as a restriction on the freedom of movement of workers in the EU, one of the fundamental freedoms of the European Union. After trying to persuade EU countries to deal with the issue themselves without success, the EC has issued a draft directive that also includes guidance on disability benefits and survivors' benefits.

Here are the key elements of the draft directive. These are the minimum requirements, and individual member states may adopt more favourable provisions if they wish:

- *Eligibility:* Employers that operate pension plans must allow employees to become members of the plan by age 21 or by the time they have completed one year's employment, whichever comes first.
- *Vesting period:* Employees who leave after at least two years' plan membership must be able to keep the full value of their accrued pension benefits. If they leave before vesting, then employer and employee contributions must be either refunded in full or transferred to another plan.
- *Value protection:* A pension plan must be fair when adjusting the value of each employee's pension benefit if the individual decides to leave the benefit behind when moving to a new job. The directive, which calls these 'dormant' pension rights, leaves it to each EU country to determine how this adjustment should be made.
- *Transferability:* Employees have the right to transfer their pension benefits to their new employer's pension plan within 18 months after leaving.
- *Communication:* Pension plan members must be told how leaving their job would affect their pension rights.

Member states may exempt plans financed by book reserves, support relief funds (eg *unterstützungskassen* commonly used in Germany) and pay-as-you-go plans from the transferability requirement, but not from the other requirements.

Although EC officials seek to put the new rules in place by 2008, the draft is only the start of a long approval process through the European Parliament and requires all 25 EU member states to agree the provisions. It is unlikely to have a smooth passage. Germany in particular may be one of the main opponents, given the country's predominant use of book reserve plans and five-year vesting.

GERMANY

German companies facing higher pension reserve requirements

Many plan sponsors in Germany are facing higher pension reserve requirements following the publication of new actuarial tables that show an increase in life expectancy.

The updated Heubeck tables, which cover rates of mortality, disability and marriage, are widely used in Germany

when calculating pension liabilities and determining the appropriate level of reserves. For the first time, the new 2005G tables include an explicit allowance for generational effects (ie different rates of life expectancy depending on an individual's year of birth.)

The previous set of tables, produced in 1998, had already implicitly incorporated the effects of generational improvements, so the leap to the new tables is not a large change for the overall population. Still, according to Professor Heubeck, the chief author of the new tables, the required increase in reserves for German pension funds as a whole may be around 1–2 per cent.

However, the effect of the revised tables is greater for younger employees, so the demographics of a particular workforce are important. Different employers operating in the German market are likely to see different impacts on their reserving and accounting requirements depending on the age structure of their employees. For example, employers with a predominantly young workforce could see increases in reserving requirements significantly higher than the average of 1–2 per cent, with corresponding changes in their accounting statements.

On the other hand, the effects of increased life expectancy may be offset to some extent by reduced rates of disability and marriage. Therefore, the precise impact on the total change in liabilities will depend on the structure of a particular employer's plan in terms of disability and spouse benefits. Some companies with large disability liabilities could actually see a slight reduction in reserve requirements.

Implications for employers

Employers should seek an assessment of the impact of the new tables based on

their own German workforce and consider the implications of any changes in reserving or accounting requirements.

Where segregated pension assets are in place to cover German retirement benefits (eg through a contractual trust arrangement) the revised tables may affect decisions by multinational employers on targeting of any additional year-end contributions across countries.

NETHERLANDS

Tougher pension plan funding rules delayed until 2007

Relief and some criticism followed the Dutch Central Bank's (DNB) decision in September to postpone new and tougher funding rules for pension plans until 1st January, 2007.

The new financial assessment framework, *Financieel Toetsings Kader* (FTK), was due to take effect 1st January, 2006. However, the DNB, which earlier this year replaced the *Pensioen & Verzekeringskamer* (PVK) as the government's top pension supervisor, decided more time was needed to implement the new framework after discussion with the Ministry of Social Affairs.

Pension fund managers that have already made preparations for the new funding rules may be frustrated by the delay, but many employers have welcomed the extension. (In the Netherlands, pension funds are managed jointly by employer and employee representatives or, more commonly, by an independent third party that answers to both.)

Pension fund managers have expressed concerns about the FTK in two major areas. One is the new minimum funding test, which gives only a one-year recovery period if a pension plan's funding level falls below 105 per cent.

The other is the requirement to value liabilities at market interest rates based on the interest-rate swap curve rather than at the current fixed rate of 4 per cent. At many Dutch pension funds, there are hopes that a rise in interest rates over the next year will improve pension plan funding levels.

New solvency tests

In addition to the tougher minimum funding test, the FTK requires plans to pass two further interrelated tests:

- a solvency test, which aims to ensure that pension funds have a 97.5 per cent probability of remaining above the 105 per cent funding level during a one-year period; and
- a new 'continuity' test (or continuity analysis), to be used in specific situations only. This is an analysis of future assets and liabilities, and should show that the fund is capable of surviving adverse conditions.

Employers developing customised tests

While pension plans can use a DNB standardised model and methodology, they can also seek DNB approval for their own customised tests based on their own specific asset-liability strategies. Many larger plans are currently doing so. In developing these tests, they can assess how the new method of valuing liabilities will affect their solvency position and review their investment strategies to assess how mismatches of assets and liabilities may affect financial performance and future benefit levels.

SWITZERLAND

Switzerland tightens rules for executive pensions

Beginning 1st January, 2006, employers in Switzerland must comply with a third

set of revisions to the BVG (Swiss occupational pension law). The changes provide greater flexibility in plan design while restricting some tax advantages, particularly for high earners. Pension plans have up to 31st December, 2007 to amend their rules accordingly.

Current regulations

Current rules restrict total pension from all sources to 100 per cent of earnings, but there is no specific limit on pensionable salary. A single pension plan must provide the same benefits to all members, but employers may operate different plans for different groups of employees.

Revisions

Under the revised rules:

- Pensionable salary is restricted to ten times the annual BVG salary ceiling of SF77,400 excluding death and disability benefits for plan participants who were over 50 years of age on 31st December, 2005
- Annual pension from a plan is limited to 70 per cent of the member's last pensionable salary
- Total employee and employer contributions are restricted to 25 per cent of pensionable salary.
- Annual pension from the plan and social security taken together is limited to 85 per cent of pensionable salary for earnings above the annual BVG salary ceiling of SF77,400.
- At least 6 per cent of total plan contributions must be used to provide for death and disability benefits.
- Minimum retirement age will become 58 by 31st December, 2010, with exceptions in the event of a business restructuring.
- Additional restrictions are placed on buyback contributions (ie voluntary contributions to cover missing past

years of service). If plan members have withdrawn part of their pension plan assets under the home ownership ruling, they must reimburse this amount first before making buyback contributions. The reimbursement is not tax deductible.

- For plan members coming from abroad who have never been affiliated with a Swiss pension plan, the annual buyback cannot exceed 20 per cent of the pensionable salary — as defined by the pension plan rules — during the first five years of enrolment.

Opportunities for plan redesign

Despite the new restrictions, employer-sponsored plans are given greater flexibility to:

- provide different benefit levels for different groups of employees within the same plan;
- provide choice from up to three different benefit designs for each group of participants;
- adopt different asset allocations for earnings in excess of 1.5 times the annual BVG salary ceiling;
- allow members to pay additional voluntary contributions to recover any reduction on early retirement.

Implications for employers

With greater restrictions being placed on pension benefits for executives and other higher earners, employers should consider alternative means of compensation and prepare for the possibility of new benefit negotiations.

In addition, employers should consider whether to make use of the greater flexibility offered. Those with multiple Swiss plan designs may wish to consider some consolidation, while the extra freedom on asset allocation may present some opportunities to adjust the employer's pension accounting position.

NEW ZEALAND

National work-based savings plan taking shape

Within two years, employers in New Zealand will be required to give employees access to a new national work-based savings plan launched by the government, provided the plan is adopted by lawmakers.

The 'KiwiSaver', announced by the government in its May 2005 budget, is intended to help employees save for retirement and a first home deposit, with subsidies from the government. Employers will be required to give employees access to the new plan whether or not they already operate a pension plan.

Following the general election in September, draft legislation is now not expected until early in 2006, although the start-up date is still targeted to be 1st April, 2007. Other key features include:

- All new permanent employees must be automatically enrolled in the plan, unless they opt out. Other employees can choose to join.
- Employees will be able to select one of two authorised contribution rates — either 4 per cent or 8 per cent of gross earnings. After three months' contributions, they may take a contribution holiday of up to five years at a time.
- Employers can make additional contributions to individual accounts if they wish.
- Employees can choose an investment fund manager from a list of approved providers. A default provider will be chosen on a random basis unless the employer chooses a provider.
- The government will pay an up-front contribution of NZ\$1,000 (US\$704; Ç570) into the KiwiSaver account of each new plan participant. A fee

subsidy to the provider will also be paid.

- For first-time home buyers, a home deposit subsidy of NZ\$1,000 per year will be available for individuals who save at least NZ\$1,000 a year over a three-year period. A maximum subsidy of NZ\$5,000 will be available after five years.
- Eligibility will depend on household income and purchase price.
- The savings are normally locked in until age 65, but are available after a minimum of three years for a deposit for a first home.

Impact on existing plans

Employers will be able to obtain an exemption from the KiwiSaver automatic enrolment requirement if they sponsor a retirement plan that meets certain conditions. The plan must be open to all permanent employees; the combined employee and employer contribution must be at least 4 per cent; savings must vest immediately, and the savings must be portable. Both new and existing members of the plan will be eligible for the home deposit subsidy.

To enable new members to qualify for the NZ\$1,000 up-front contribution, an existing employer-sponsored retirement plan can be converted into a KiwiSaver plan by meeting all the requirements for an approved KiwiSaver provider.

Implications for employers

While most of the administrative tasks to set up the KiwiSaver accounts will be carried out by the tax authorities, employers will need to provide information to all new employees, deduct contributions from salary and pass them on to the tax authorities to pay to the chosen provider.

Once more details are known, employers with existing retirement plans may wish to take the opportunity to

review their pension plan arrangements and decide whether they wish to gain exemption from automatic enrolment and convert their plan into a KiwiSaver.

USA

Future of pension reform still uncertain

Reforms of US pension funding and some related matters are being actively debated, but there is still much uncertainty around the outcome.

While a lot of progress has been made, significant differences still remain between reform bills passed by the Senate and the House. The House and Senate must now name a conference committee to resolve the differences between the two bills, and the resulting compromise must be passed by both houses of Congress. If and when this happens, the President would then have to sign the compromise bill for it to become law. However, the President has voiced strong objections to each of the bills being considered by Congress and, with the USA currently operating under its second set of temporary funding rules within the last four years, recent history points to the difficulty of reaching a consensus.

The primary drivers of pension reform are the critical needs to shore up plan funding and to stabilise the deteriorating finances of the Pension Benefit Guarantee Corporation (the PBGC is the US pension insolvency protection fund). Although the PBGC was in the black just a few years ago, it now claims to have a deficit of around US\$23bn.

All of the proposals being considered would address these issues by:

- strengthening the funding rules that apply to qualified defined benefit plans to require increased contributions and faster recognition of market conditions; and

- raising premiums that plans must pay to the PBGC to be insured.

It is also anticipated that pension reform will clarify the status of cash balance plans, which have been in a state of legislative, judicial and regulatory limbo for the past several years in the USA. Such clarification is sorely needed following the increase in the number of cash balance plans in the USA in recent years. However, the cash balance provisions included in the bills being considered are highly controversial and arguably do not provide strong enough support for cash balance plans, particularly those that were converted in the past.

While there continues to be significant disagreement on the specifics of pension reform, both Congress and the President

seem committed to making the effort needed to build consensus. Thus, it still seems likely that some version of reform will be adopted in 2006, although it is possible that we could see another temporary set of rules.

Implications for employers

Many companies have already started to assess the potential impacts of the proposed reforms in their particular situation. For companies with headquarters outside the USA, this assessment is likely to involve considering the implications in terms of the pension accounting standards under which they report globally (eg IAS 19) as well as under US funding and accounting rules.

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