Headlines

Worldwide Pay and Benefits

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International

Great companies get great by doing the hard things well

A 15-country study of performance and reward management practices, culled from two related Towers Perrin surveys, produced remarkably similar findings on the reward elements that high-performing companies put in place to find, keep and motivate their employees. Human resource and compensation executives from more than 1,200 companies participated in the surveys in the USA, Canada and Europe.

The study, titled 'Meeting the Global Rewards Challenge,' found that high-performing companies (those with three-year total shareholder return in the top quartile of all companies studied) take a different approach to rewarding employees than do other companies. Specifically:

- they provide a consistent and meaningful level of differentiation in pay for their top-performing employees
- they make performance management a centerpiece of their reward efforts
- they act on the fact that today's employees want very different things from their employers than prior generations
- they communicate more often and more openly about the pay and

rewards available for strong individual contributions.

Going beyond pay and traditional benefits

The study found that today's workers have higher expectations of their workplace. In addition to their paychecks, they seek things like intellectual stimulation, the ability to master new skills, and the promise of advancement.

However, at high-performing companies, the reasons for employment decisions differ considerably. Here, base pay is relatively less important, and benefits are not in the equation at all.

For example, at these companies in Canada and the USA, factors such as challenging work, quality of top management and stock options are important variables in employees' decisions to join, stay or leave a company.

In Europe, a similar pattern appears. While base pay remains a critical aspect of the deal, respondents also ranked bonuses and organisational reputation and culture as among the most effective elements in recruiting and retaining high-calibre staff.

Using pay to reward performance

One of the hard choices that distinguishes high-performing companies from others in the survey is a willingness

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to provide higher salary increases and bonuses to top-performing individuals to encourage continued dedication. On the other side of the equation, they are also willing to send clear messages to under-performing employees through such things as reduced pay, constructive feedback and mentoring.

The study found that roughly half of the high-performing companies in the USA give their top employees increases of one-and-a-half to two times the average, while 13 per cent differentiate significantly, giving their best people between two and three times or more the average. But even among this group, fully a third provide little or no differentiation.

In Europe, where pay increase budgets have been about the same as in the USA, high performers receive greater pay differentiation. One-third of European companies give pay increases of at least twice the average to their best people, compared with only 13 per cent who do so in the USA.

Growing use of variable pay

The survey found that variable pay — in the form of a range of incentive plans — is a growing phenomenon in both regions. In North America, for instance, fully 88 per cent of the companies surveyed provide some kind of non-executive, non-sales incentive to some proportion of their workforce. In Europe, the number is even higher — 93 per cent — although that includes executive plans.

Communication

Both in North America and Europe, the top-performing companies:

- are significantly more likely to communicate employees' performance

ratings, the merit-increase determination process and ways to maximise compensation

- are more likely to feel employees have a reasonably good understanding of the key aspects of pay determination
- are more quickly mastering new communication media, including the Web and e-mail
- have been more likely to invest in rewards communications over the last few years
- are about twice as likely to measure the success of their communication activities and somewhat more likely to communicate the value of total rewards.

The survey results demonstrate that high-performing companies act in areas to which most companies pay lip service. This not only includes paying for performance and linking individual goals, but also consistently providing performance feedback and communicating not always popular information about how the pay process works. These companies not only deliver the message that performance counts, they live the message.

Australia

Superannuation policy vacuum continues

From 1st July, 2000, Australia's new taxation system will be launched, primarily focusing on the introduction of a 10 per cent GST (Goods and Services Tax), reductions in personal income tax rates and the removal of the current wholesale sales taxes (which apply on goods, but not on services). Because of its complexity and its wide but not universal application, businesses and consumers alike are struggling to come

to terms with the impact and implementation of the new GST.

Meanwhile, the Government's superannuation policy vacuum continues. The May 2000 Federal Budget was notable for its lack of policy initiatives, especially in regard to the taxation of superannuation, and the following flaws remain:

- the taxation complexity remains, with superannuation still being taxed at all three points: on contributions, investment earnings, and benefit payments
- the superannuation surcharge continues to weigh down the industry with compliance and administrative costs disproportionate to the revenue raised
- there is no reduction in tax on superannuation to mirror the income tax cuts introduced in conjunction with GST.

The last two points, in particular, mean that for most Australians there is no longer any clear incentive to contribute voluntarily to superannuation.

Lifetime Health Cover to be introduced

The concept of Lifetime Health Cover (LHC) will apply to private hospital insurance from 1st July, 2000. This has been introduced with the dual purpose of rewarding individuals for maintaining their private hospital insurance membership, and also for joining private hospital insurance prior to age 30. LHC aims to increase the stability of private hospital insurance by encouraging younger and healthier people to take out private hospital insurance.

Currently, Australia's health insurance legislation provides for health funds to apply 'community rating'. This requires acceptance of all members regardless of health, age and marital status. The same

premium rates are to be offered to all members, for the same benefits. The only point of differentiation allowed will be between different family categories. Community rating will be varied under LHC, so that an individual who first joins private hospital insurance after 30th June, 2000 will pay a 2 per cent loading on the standard premium for each year by which his or her age at joining exceeds age 30.

Special transitional rules may apply for expatriates who are absent from Australia when LHC comes into force. Expatriates (or the employer on behalf of the expatriate) should ensure that they are covered under these transitional rules.

Belgium

New pension fund legislation introduced

The Royal Decrees applicable to self-administered pension funds since 1st January, 1986 have, at long last, been rewritten. The effective date of the new legislation is 1st September, 2000. Its main purpose is to integrate important changes that have been introduced since 1st January, 1986:

- the ones flowing through from the more general 'Colla law' applicable since 1st January, 1996 to all pension schemes, irrespective of the adopted funding vehicle (see 'Headlines' of June 1995, February 1996 and August 1997)
- the investment rules applicable to pension funds since 1st January, 1999 (see 'Headlines' of June/July 1999)
- the actuarial assumptions which must be used to meet the minimum funding requirements applicable to pension funds since 1st July, 1999 (see 'Headlines' of October/November 1999).

An ancillary purpose of the new legislation is a modernisation of the old one. This includes:

- the elimination of ‘child disease’ type problems with the old legislation
- the adoption of terminology/ vocabulary which was not in use 15 years ago
- more importantly, a timid effort to bring pension fund legislation and group insurance legislation closer together.

Some of the truly new features of the new Royal Decrees are summarised below:

- ‘*A priori*’ control by the supervisory authorities is replaced by ‘*a posteriori*’ control. This was copied from group insurance legislation and implies, for example, that the rules of the pension plan need no longer be submitted for approval. On the other hand, the control authorities must be aware of the provisions of the plan in order to review and appraise the yearly disclosures of the pension fund. A detailed description of the plan provisions must therefore be provided if the rules are not submitted.
- The investment rules are now applicable to the sum of:
 - the ‘technical reserves’ (as before) and
 - if disability and/or death-in-service benefits are provided by the pension fund, the ‘solvency margin’
 - if the pension plan includes an early retirement incentive, the ‘levelling fund’ (see next bullet).

In other words, an amount equal to the ‘solvency margin’ and the ‘levelling fund’ reduces the truly ‘free reserves’ and influences the investment strategy of the pension fund.

- If the early retirement benefits exceed

those that would result from an actuarial reduction, a ‘levelling fund’ must be created. It is equal to 60 per cent (or more) of the difference between:

- the minimum reserves based on the earliest possible retirement age
- the minimum reserves based on the normal retirement age.

The ‘levelling fund’ is unallocated and has no effect on the benefits payable upon termination of employment.

- If there is no reduction for early retirement and if service credited under the plan is limited to a maximum, the calculation of the minimum reserves must be based on a normal retirement age set equal to the lower of: the age at which no further account is taken of service and age 65.
- Lump sum in lieu of pension payments may not be lower than the minimum reserve. This was already the case in respect of transfer values upon termination of employment and has now been extended to retirement and, if applicable, death-in-service.
- If disability and/or death-in-service benefits provided by the pension fund are reinsured with a direct insurer (supervised by the same authorities as the pension fund), the ‘solvency margin’ to be accrued may now be reduced to less than 50 per cent of its value. The extreme will be no ‘solvency margin’ in case of full reinsurance with a direct insurer (versus same maximum reduction of 50 per cent as in the past for all other reinsurance contracts).

Employers will need to make sure that the rules of their self-administered pension plans are in agreement with the provisions of the new Royal Decrees. Moreover, the establishment of a ‘levelling fund’ for plans with subsidised early retirement benefits will require

more actuarial work since it can have a significant effect on the funded status of the plan. In some cases, this effect will be further enhanced through the mandatory introduction of a normal retirement age assumption.

Brazil

Wider investment opportunities for termination indemnity funds (FGTS)

Brazilian employees can now use up to 50 per cent of their FGTS account balance to invest in the stock market. FGTS is part of the Brazilian termination indemnity system in which companies have to contribute 8 per cent to individual accounts on all cash compensation elements, except union profit sharing. Individual employee accounts are managed by a federal bank which guarantees a 3 per cent return on investments plus inflation. If employees are terminated without due cause, they are eligible to withdraw the accrued account plus an additional 40 per cent, paid by the employer.

This opportunity to invest in the stock market will give employees potentially higher returns on their FGTS-related investment.

Petrobras shares are the first to be authorised by the Brazilian government.

Colombia

Social Security Corporation to be created

A new Social Security body is being set up that will compete with private funds and combat the current system's negative image, which has been caused by corruption and inefficient practices.

The new body will be called the Social Security Corporation. It will have four lines of business: health, pensions,

professional risk and customer service. These will have full administrative and financial autonomy. However, this is not a privatisation exercise, since the money allocated for this body is separate from private funds.

Each line of business will manage its money independently. This will not affect the members' entitlements. However, it is expected that it will result in more efficient and enhanced services through the creation of 400 customer service locations, where people will be able to receive information about their contributions, obtain affiliation identification cards and, in future, pay their pensions.

This change will involve investments of almost 500,000 million pesos.

Costa Rica

New social security law enacted in Costa Rica

A new social security law in Costa Rica will introduce a mixed private and public social security system. It will extend coverage to an additional 500,000 workers and unemployed and low-income elderly without pensions.

Under the old system, workers paid into a common pension fund. Under the new law, they will also pay into mandatory individual accounts, which are expected to amount to more than \$150m a year. The individual pension accounts will be administered by authorised public and private institutions known as 'operators'.

Italy

Tax rules governing pensions and termination indemnities (TFR) overhauled

Employers will need to review their benefit arrangements in the light of new

far-reaching legislation regarding the fiscal treatment of private pension funds, termination indemnities (TFR) and other benefits.

Although a number of details still need to be clarified, the new rules will be effective from 1st January, 2001. The main items covered are:

- The tax deductible limit on employee and employer contributions will be increased to 12 per cent of gross annual salary. However, such contributions will be deductible within the lower of either twice the annual amount of TFR accrual paid into the pension fund or the overall limit of 10m ITL.
- Employees who joined a pension fund before 28th April, 1993 currently enjoy virtually complete tax deductibility. The new law effectively takes away this privileged status for future contributions. (However, a temporary five-year transitional period is in place.)
- Investment income will be taxed at a rate of 11 per cent a year.
- Other tax change relating to annuities, lump-sum payments and excess contributions have also been made.

Employers should assess the effect of these rules on existing or proposed future arrangements.

Netherlands

Important changes to pension provisions introduced (Part II)

The Act on Fiscal Treatment of pensions brings into force a number of changes to pension provisions. The May 2000 issue of 'Headlines' discussed the changes relating to pensionable service, pensionable salary, and currency criteria. In this issue, the changes regarding the

tax qualification rules, and concurrence of different pension systems will be summarised.

Tax qualification

A number of changes relating to tax qualification have already been implemented. Previously, pension provisions could be either completely tax-qualified or not tax-qualified at all. If not, contributions were not tax-deductible, and entitlements were subject to income tax. Since 1st June, 1999, a pension provision can be divided into a tax-qualified and a non-tax-qualified part. Contributions, as well as entitlements, are then divided in a tax deductible/non-taxed, and a non-tax-deductible/taxed part. Ultimately, the pension will be subject to pro-rata income tax, as well as to capital gains tax.

When exceeding the statutory benefit limits, the employer may request the tax inspector to determine which part of the entitlements is tax-approved and exempt from income tax, and which part is not. The employer must then administer the different sections accordingly.

Concurrence

Rules have been made concerning the concurrence of different pension systems in one pension plan. In determining whether the pension scheme is based on a final pay system, an average salary system or a defined contribution system, a number of elements are taken into account; for example, method of financing, nature of the pension promise, investment strategy, and character of individual elements.

For example, a defined contribution pension scheme which provides and guarantees a pension related to final salary, is considered to be based on a final pay system.

Each section of a pension scheme which incorporates different pensions systems is subject to the tax rules that apply to that particular system. The employer may request the tax inspector to determine upon which pension system the pension scheme (or part) is based.

In the case of a change from a defined contribution design to a final pay or average pay system, the rules of a defined contribution must apply with respect to the accrued pension rights up to the date of change.

New Zealand

Tax incentives for retirement savings to be introduced

Following the increase in the top marginal tax rate from 33 per cent to 39 per cent, there is a high level of interest in salary sacrifice arrangements which see an employee foregoing salary to invest in a superannuation scheme. Such contributions into a scheme are only liable to tax at the 33 per cent rate. As there are no existing lock-in provisions for schemes in New Zealand, the Government has a bill before the House of Representatives which will see either any extra contributions to existing arrangements or new contributions subject to a withdrawal tax if the employee leaves before completing two years' service. While the legislation has been criticised by those parties who are wedded to a tax regime with no incentives, other parties are welcoming the move as a sign that New Zealand can expect more tax incentives for retirement savings in the future.

Employers who currently do not have a scheme are reviewing the different group schemes available to select the one with the best fees, best investment

options and the one which provides the best financial advice to employees on an ongoing basis. While the interest has been triggered by the potential tax savings for higher paid employees, it is leading to employers putting in place a scheme which is available as a salary deduction exercise for lower paid employees as well.

Workers' compensation returns to State provision

As discussed in the January/February 2000 edition of 'Headlines', from 1st July, 2000 all workers' compensation insurance will again be provided by the State insurer, ACC. The State insurer is offering a number of new options for cover which need to be assessed for their value to an employer. They range from full self cover, with a high-stop loss level to total cover for a higher premium. In all cases the State insurer will provide free of charge a safety management programme audit which can deliver a minimum 10 per cent and maximum 20 per cent premium discount.

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United Kingdom

Part-timers win victory in Europe

The European Court of Justice (ECJ) has delivered its verdict in the case of *Preston v. Wolverhampton Healthcare NHS Trust*.

The principal result of this decision is that Shirley Preston and some 60,000 other part-time employees are to be awarded backdated pensionable service, without a two-year limit, possibly as far back as 1976 or when their part-time employment commenced, if later. All of these employees had lodged claims,

alleging indirect sex discrimination, with industrial tribunals six years ago.

Does the ruling affect you?

- Do you have part-time employees?
- If so, are any of them excluded from the pension plan?
- Were any excluded in the past?
- Do you have significantly more part-time employees of one gender than the other?
- Is your plan non-contributory?
- Have any discrimination claims already been lodged?

If you answered 'yes' to any of these questions, the Preston case is likely to affect you — the more 'yes' answers you gave, the more significant the ruling is likely to be for you.

In its ruling, the Court said that:

- the two-year limitations on backdated service is contrary to EU law and should not be imposed, but
- it is not contrary to EU law to require employees to bring their claim within six months of leaving employment.

The ruling will now be referred to the House of Lords for a decision on how it should be put into effect.

The practical implications of backdating also have to be worked out. For example, what are the implications for contracting-out of SERPS entitlements? What action should be taken if the part-timer has already retired, or died? In a contributory scheme where members elect to pay contributions for the past, how will these be calculated? Can interest be added?

The present indication from the Inland Revenue is that there will be no easement to the 15 per cent

contributions limit, so contributions in excess of that may not attract any tax relief.

Part-time employees now fully protected

The government has announced that regulations designed to implement the European Union's Directive on part-time work will come into force from 1st July, 2000. The government had previously asked the European Commission for an extension to the deadline for introducing these provisions into the UK. Their effect will be to make it unlawful to discriminate against part-time employees in the terms of their employment such as provision of pension or other benefits, unless there is objective justification. It will no longer be necessary for part-time employees to show that discrimination against them constitutes indirect sex discrimination, but this will only apply to future service.

United States

CEOs identify key factors to survival and success

What keeps CEOs of financial services companies up at night? The overwhelming answer is solving the challenges of distribution effectiveness and increasing competition, according to the Tillinghast-Towers Perrin *2000 Financial Services Industry CEO Survey Report*.

'Distribution effectiveness/productivity' was the top concern among CEOs of investment management companies (93 per cent ranked it among their top three strategic issues), life (selected by 85 per cent) and property/casualty insurance companies (selected by 76 per cent), followed by 'increased competition, restructuring and consolidation.' For CEOs of banking

institutions, however, competition (selected by 75 per cent as one of their top three issues) was the number one concern. Distribution came in third (selected by 44 per cent).

The study surveyed CEOs of more than 800 of the largest banks, investment management companies, life insurers and property/casualty personal lines insurers in the USA and Canada. More than 137 CEOs responded.

Among both life and property/casualty insurance executives, competition came in second overall (selected by 63 per cent and 64 per cent, respectively). For

investment managers, competition earned the number three spot (selected by 50 per cent).

As the financial service sectors converge, Tillinghast-Towers Perrin felt it was critical to look beyond the boundaries of each industry sector.

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