Headlines

Worldwide Pay and Benefits

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International

Human resources takes on a more strategic role to support increased globalisation of business

Now that doing business around the world is routine for many companies, their human resources (HR) organisations are redefining themselves as well, shifting their focus and activities to support more complex and strategic assignments from Singapore to Chicago. Typically, this means addressing key areas such as HR service delivery, talent management and pay-for-performance programmes in a global context, according to a new Towers Perrin survey.

The survey, completed late in 2002, is based on information from HR executives at more than 70 companies headquartered around the world, plus follow-on interviews with executives at another 20 organisations.

Organisation and HR service delivery

Almost all companies interviewed described service delivery improvement as one of their major goals for the future. Not surprisingly, almost three-quarters of the US survey respondents said they are already using shared services or planning to implement shared services in the next 18 months.

Roughly half of the respondents in other parts of the world said they had no intention of implementing shared services. This hesitation seems largely due to factors such as regional differences, language barriers and continuing cultural

resistance. Indeed, a number of HR executives from outside the USA who were interviewed made a point of saying that they did not believe that the US approach to shared services was appropriate in their region.

Outsourcing, too, has not taken hold to the extent some originally anticipated. About half of all companies based in the Americas said they outsource their HR programmes, and significantly fewer outside the USA have done so. Moreover, few companies had plans to outsource in the next 18 months. While the reasons for companies' lack of enthusiasm for outsourcing — particularly outside the USA — are not clear, companies that do outsource HR services continue to report cost-savings and efficiencies.

In terms of the HR reporting structure, the findings were markedly divergent. Almost 50 per cent of respondents moved or planned to move their reporting relationships directly to their line operations, while 40 per cent planned to move reporting relationships to corporate headquarters. Some respondents said that shifting reporting to the line helped support the move to a more global HR approach, while others said a global HR unit, with centralised reporting, was essential.

Rewards

Almost three-quarters (74 per cent) of the organisations surveyed said they have worldwide incentive plans for senior and middle management, and almost

Source: HR Globalization Today: A New Chapter

Figure 1: Status of reward programmes at global companies

two-thirds (65 per cent) have worldwide base compensation rules (see Figure 1). In addition, more than half of all companies indicated that they have, or expect to have, worldwide incentive plans and base compensation rules for professional, non-management positions before the end of 2003. Moreover, 71 per cent said they have a worldwide stock option programme.

More than half of the respondents also indicated they were bringing more consistency to regional compensation systems, and another 26 per cent said they planned to do so.

Talent management

For global organisations, talent management has come a long way in a relatively short time, moving beyond succession planning to a far-reaching set of activities that focuses on building skills and making better use of people within the organisation. According to respondents:

- 66 per cent have stepped up

cross-border transfers of senior and middle management talent, and another 19 per cent plan to do so in the next 18 months

- 62 per cent have created a worldwide talent identification system for senior and middle management leadership, and another 24 per cent plan to do so in the next 18 months.

Global training programmes and global competencies are also solidly entrenched and growing among the companies surveyed. Specifically:

- 61 per cent have created global training programmes, and another 21 per cent have plans to do so
- 60 per cent have upgraded HR talent by hiring individuals with global competencies, and 21 per cent plan to do so
- While only half (50 per cent) said they have created or revised a company-wide competency framework, 36 per cent said they intended to have one (see Figure 1).

Clearly, many companies are recognising the value of having people with skill sets that transcend national practices, and they are taking steps to seed their organisations with global talent.

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The Headlines section in the next issue of *Pensions* will have an article on the use of technology to deliver HR services and on performance metrics and communication at global companies.

Global companies step up use of international retirement plans

Global companies are increasingly using a single retirement plan for their internationally mobile employees (IMEs), according to a new survey by Towers Perrin and Citco International Pension Services.

The survey, which collected information from 102 major multinationals in 13 countries, updates a Towers Perrin study published in 2000 that examined how global companies design and deliver benefits to their IMEs. Of the more than 30,000 IMEs covered in the latest study, 70 per cent are traditional (long-term) transfers, 20 per cent are globalists (international career employees) and 10 per cent are permanent transfers.

While global companies have relied on IMEs for a long time to help deliver improved business results, there is an increasing recognition of the need to have a robust reward and benefit structure to support their needs. At the same time, companies are looking for ways to deliver benefits to these employees more efficiently while allowing as much individual flexibility as possible.

In this year's survey, 32 per cent of the participating companies said they

have an international retirement plan, and 29 per cent expect to have one in the next five years. Therefore, more than half the survey participants are likely to have an international retirement plan within five years. The survey also found:

- The main factors driving companies to implement an international retirement plan are to create a more consistent and simple approach toward IMEs, which should encourage more mobility for these individuals. Few companies expect to achieve cost reductions
- The global shift from defined benefit (DB) to defined contribution (DC) plans continues. About 60 per cent of survey participants currently have a DC plan, and 40 per cent of these companies converted from a DB plan in the last ten years. A further 19 per cent expect to change within five years. Companies generally said that they were focusing on DC plans because of their simpler and more flexible design — unlike in 2000 when cost savings were the main attraction.
- Most international plans are separately funded and have their assets managed externally. The financing method is mostly influenced by a desire for benefit security and minimal administration, with less emphasis on tax considerations. Most hold their assets in a trust, and few use a captive insurance company.

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International Accounting Standards Board preparing new rules for company stock plans and pension plans

The International Accounting Standards Board (IASB) is reviewing the

accounting treatment of company stock plans and pension plans.

Company stock plans

The IASB is proposing to change the accounting treatment of stock compensation arrangements sponsored by employers. This proposed rule is similar to, but slightly tougher than, its counterpart (FAS 123) in the USA.

Under the proposal, the compensation cost for a stock-based award would be measured when the award is granted, using an option-pricing model, with the resulting cost recognised over the award's vesting period.

Unlike FAS 123, the IASB proposal would not allow companies to reverse the accrued compensation cost for awards that do not vest. Moreover, because it provides no exceptions to the expensing requirement, it would apply to all stock-based compensation, including stock purchase plans.

The final standard is expected to be effective for fiscal years beginning on or after 1st January, 2004. The US Financial Accounting Standards Board (FASB), as well as its Canadian and UK counterparts, accounting standards boards have invited comments on the IASB's proposal as they consider whether they should adopt a similar standard.

Pension plans

While no proposed standard has yet been issued, the IASB has agreed in principle on some of the key changes it intends to make to IAS 19, the basic international accounting standard. In particular, it has indicated that, like the new UK standard FRS 17, it intends to propose immediate recognition of pension fund gains and losses and all prior service cost (not just the vested portion, as is currently required). This is likely to lead to greater balance sheet and income statement volatility for companies with defined

benefit pension plans, and have a material effect on some companies' accounts.

An exposure draft of the revised standard will be published for consultation after a separate IASB project on financial reporting by companies has been completed. Indications are that the exposure draft will be issued no sooner than summer 2003, and possibly later.

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IASB and FASB moving on broad front to harmonise accounting standards

In an effort to improve the comparability of financial statements issued around the world, the IASB and the FASB in the USA have issued a joint memorandum of understanding that formalises their commitment to converge US and international accounting standards.

In connection with this effort, the IASB and FASB have added a joint short-term convergence project to their current agendas. Due to the significant differences between the IASB's current thinking on changes to IAS 19 (the international standard on accounting for employee benefits) and the comparable US accounting standards (FAS 87, FAS 88, FAS 106, FAS 112), these standards are not within the scope of the short-term convergence project. They will be addressed as part of a longer-term project, pending finalisation of the IASB's review of IAS 19.

IAS 19, FAS 87

The key issue for employers is how the two sides will work out differences between IAS 19 and the comparable US standards. Notably, FAS 87 allows delayed recognition of gains and losses and prior service cost, while a recent IASB decision would result in immediate recognition of all gains and losses and

prior service cost (see previous section). Arguably it is likely that the US rules on benefits accounting will move closer to the final outcome of the IASB's new and improved IAS 19.

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Australia

Employers assessing government pension proposals

Employers will again be considering the ongoing role of their pension funds and whether they should be further outsourcing the delivery of employee benefits in light of new measures proposed by the Australian Government.

In October 2002, the government announced its blueprint for the improved protection of pension fund assets. Although much of the announcement refers to the development of these arrangements in consultation with stakeholders, leaving many details unsettled, at this point a number of key requirements affecting employers are known. Key changes that have been announced include the following:

Australian Prudential Regulation Authority (APRA) licensing

All trustees of superannuation (pension) funds will need to obtain a Superannuation Trustee License (STL) from the APRA. To obtain and keep the licence, the trustees will need to meet certain conditions and will be allowed to 'buy in' expertise by hiring consultants or other third-party vendors.

ASIC licensing

Trustees of many private company-sponsored pension funds are exempt from

the requirement to obtain an Australian Financial Services License (AFSL) under legislation enacted earlier this year (see 'Headlines' (2002) *Pensions*, Vol. 7, No. 3, p. 290). However, the government says it will review this exemption.

Risk management plans

All trustees must prepare a risk management plan (RMP) that demonstrates arrangements to mitigate relevant risks relating to investment, outsourcing, governance and risk management.

APRA prudential standards power

APRA will have enhanced enforcement powers under the new regime, including a power to suspend or revoke STLs. However, it will not have the power to set prudential standards as it does for the insurance industry.

The government has proposed that legislation implementing the new standards take effect in October 2003, with a two-year transition period for existing funds to comply. In general employers have indicated that they accept the proposals and that they do not appear to be too onerous, provided there are no problems that crop up in the final details.

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Europe

EC moves against German tax policy

The European Commission has started infringement proceedings against Germany over what the EC regards as discrimination against foreign investment funds.

A rule on the taxation of dividends, which became effective in October 2000, flies in the face of the EU goal to create a single market in financial services by 2005. Under the rule, investors in

German domestic funds are taxed on only half the dividends, while investors in foreign funds are taxed on the entire amount.

The German authorities are also seeking to pass new legislation in February that would apply the same discriminatory treatment to the tax on capital gains from the sale of equities. Eleven top US and European fund managers have joined forces and sent an open letter urging the German government to remove the discrimination. The European Federation of Investment Funds and the BVI, Germany's mutual fund association, support the fund managers' position.

The infringement proceedings began when the EC sent an official request for information to Germany — the first tentative step in a long procedure that could end up in the European Court.

The German Finance Ministry has said that it will review its rules on taxing investment funds in light of the EC objections.

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Japan

New cost-saving options available for employee pension funds

Many companies in Japan are looking to achieve cost savings by taking advantage of a change in the country's pension law to transfer a portion of their liability for employee social security benefits to the government.

This process of 'contracting back in' enables companies that sponsor their own Employee Pension Funds (EPFs) to recognise an immediate reduction in the ongoing cost of their retirement programmes. The switch is allowed under the Defined Benefit Corporation Pension

Law that was adopted in 2001 in Japan and became effective on 1st April, 2002.

EPFs provide for a portion of an employee's social security benefits, in addition to other retirement benefits. The social security or 'contracted out' portion of the plan can often amount to 40 per cent to 50 per cent of the total liability of the EPF. In exchange for providing the social security benefits through an EPF, companies pay a lower withholding tax for social security.

The new law allows companies, with approval from the Ministry of Health Labour and Welfare, to contract back in to social security. By doing so, a company must pay a higher contribution rate to social security, but the EPF will not be responsible for providing for future social security accruals.

With discount rates under international accounting standards (such as FAS 87) currently around 2.5 per cent, the cost of providing for the contracted out portion of the benefits is likely to exceed the reduction in social security tax a company would otherwise be paying. Therefore, by contracting back in to social security, companies may recognise an immediate reduction in their ongoing costs.

However, there are a number of other factors that companies need to consider before making a decision to contract back in. In particular, contracting back in means that past service liabilities must also be transferred back to the government, and the cost of this will not be determined until the autumn of 2003.

Transition rules in effect for deductibility of pension plan reserves

Employers in Japan are adjusting to transition rules aimed at phasing out tax deductions that companies have been claiming for traditional book-reserved pension plans, known as Retirement Allowance Plans (RAPs).

Under the old rules, companies could generally deduct 40 per cent of the accrued resignation benefits (voluntary termination benefits) reserved on their books for RAPs. Subsequent legislation reduced the limit to 20 per cent over a six-year period.

Under the new rules, advanced tax deductions for RAP reserves will be phased out and replaced with deductions that match the timing and amount of benefits actually paid out. Large companies with more than ¥100m of paid-in capital have a four-year period to add the value of their tax-deductible reserves as of 31st March, 2002, back to taxable income (assuming a 31st March fiscal year). For the fiscal year ending 31st March, 2003, large companies will need to add 30 per cent of the previously deducted reserve amount to taxable income. An additional 30 per cent must be added in the following year, followed by 20 per cent the following two years. Smaller companies have a ten-year phase-in period to eliminate the deduction for RAP book reserves.

After the phase-in period is completed, 100 per cent of the actual RAP benefit payouts will become tax deductible. There is no change to the deductibility of contributions to qualified plans, as those amounts remain deductible at the time of contribution.

Given the new, less than favourable, tax treatment for these plans, companies should review their employee retirement obligations to determine that both employee and employer needs and objectives are being met. Options such as converting to a funded qualified plan or a defined contribution plan could be explored. Although tax implications may be a driving force behind this review, it is also an ideal opportunity to develop the right long-term sustainable plan, both in design and in finance, that will better meet future needs in Japan.

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Netherlands

Pensioner representation on pension plans to be enhanced

Pensioners will have more opportunity to become involved in the running of their pension plans under an agreement in principle reached in December between the STAR (a government advisory body with members representing employers and employees) and the CSO (a body representing the rights of the elderly).

The key recommendation is to strengthen representation of pensioners on plan management boards and member councils. Under the previous 1998 agreement, there had to be at least one pensioner representative on the member council, or if no council was in place, on the management board.

The new agreement requires proportional representation for pensioners on the management board and on the council based on total membership of the plan. The change is likely to lead to reductions in the number of seats for active employee representatives on both management boards and councils, although active employee representation on boards is not allowed to fall below 50 per cent of the total employee representation. The agreement does not change the balance between employee and employer representatives on management boards.

The agreement also reinforces the position of member councils by:

- ensuring that they have adequate resources to improve their expertise
- strengthening the councils' right to advise on certain matters — and in

- particular requiring their advice to be followed in company liquidation, merger and takeover situations, unless there is good reason not to
- ensuring that any arrangements for representation of elderly organisations on the councils is consistent with the extent of pensioner membership of those elderly organisations.

Supporting legislation will be drafted to facilitate these recommendations and to require the establishment of a member council for direct insured pension plans with more than 250 members. The agreement itself does not apply to direct insured pension plans.

The agreement still must be ratified by the rank and file members of the STAR as well as by the general board of the CSO. If agreement is not forthcoming, there is a possibility that more extreme measures will be taken, such as legislation along the lines of the proposed bill introduced by the Democrats '66 (a political party in the Netherlands).

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Switzerland

Government reduces guaranteed investment rate

After months of debate, the Swiss government announced that the guaranteed interest rate on assets in company-sponsored pension plans was lowered from 4 per cent to 3.25 per cent, effective from 1st January, 2003. The new guaranteed interest rate is likely to be reviewed periodically in order to reflect market conditions.

The rate is particularly important for companies that sponsor defined contribution (DC) plans, whether the assets are invested in insurance policies or

managed by the plan itself:

- if the plan assets are held in insurance policies, the insurer is responsible for meeting the guarantee and therefore bears the investment risk. If the return achieved by the insurance company is higher than the minimum rate, the pension plan is usually credited with a dividend, but that is not likely over the next couple of years unless the market turns around.
- plans that do not invest in insurance policies, however, bear the liability of the guaranteed minimum return themselves. Although sizeable pension funds had reserves, they have been used up — in the majority of cases to guarantee the 4 per cent in 2001 and 2002. Fund sponsors may therefore need to review their investment strategy to ensure that they can meet their commitments in the future.

There is also some evidence that insurance companies are currently not willing to guarantee the minimum return on the total level of plan assets, even at the lowered rate of 3.25 per cent, for new contracts. This means that companies setting up new DC plans may therefore be unable to pass the liability of the guarantee on to an insurance company, and will have to take on potential liabilities without the backing of existing reserves. They will therefore need to consider the plan's investment strategy very carefully to manage this liability.

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Thailand

Government accelerates implementation of new savings programme

Employers in Thailand will need to

review their current employee benefit packages in light of government measures requiring compulsory contributions to a new long-term retirement savings programme.

The Thai government has approved a proposal by the National Economic and Social Development Board, a central planning agency, to accelerate the implementation of a mandatory provident (employee savings) fund. The government wants the fund to be in place starting in 2004, one year earlier than originally targeted, and it is expected to cover all workers nationwide by 2013.

However, details of the new programme have yet to be finalised, and for employers, the crucial issue of the contribution level required from them is still to be considered. Some employers, mainly multi-national companies and large local corporations, already operate voluntary provident funds for their employees.

Coverage of employees under these voluntary provident funds is relatively low, and the state provides an old-age benefit of only around 15 per cent of salary. The government's aim is to improve the level of people's retirement income to around 50 per cent to 60 per cent of final salary.

Further details about how the new system will operate are not expected until next spring, and there is already some speculation that the new programme will not be implemented by 2004.

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UK

Government proposes radical tax reform of pensions

Executives will need to review their retirement planning in light of

government proposals for a radical simplification of the pension tax rules.

The tax proposals are part of the UK Government's promised green paper on pensions, which is a consultative set of proposals aimed at simplifying the current system while making it stronger and more flexible.

The simplified tax rules are a bid to make it easier for people to save and for employers to contribute. While the current system of tax relief will remain unchanged, the existing highly complex limits placed on contributions and benefits will be scrapped completely and replaced by three simple restrictions:

- A lifetime limit of £1.4m on the total value of an individual's pension benefits at retirement
- An annual limit of £200,000 on plan contributions (or for defined benefits, on the increase in value) for any individual. Any employer contributions (or value) above this limit will be taxed as income
- a limit of 25 per cent on the value of benefits that may be taken as tax-free cash at retirement.

The lifetime and annual limits will be indexed in line with price inflation.

Flexible retirement

The proposals also include a facility for employees to draw their pension while still working for their employer, although the earliest start date will be raised from age 50 to 55 beginning 2010, and there is greater freedom in the way that pension income can be delivered.

Excess value

The lifetime and annual limits will affect relatively few people because they are set at such a high level. For individuals who receive a benefit that

exceeds the lifetime limit, a penal tax charge of one-third of the excess will be applied at retirement. Individuals with a benefit whose current value already exceeds the limit may register that higher value as their limit with the Inland Revenue, but it appears that any future accrual will be liable to the excess tax charge.

Key areas unsettled

The non-tax proposals are much less radical and are essentially a regurgitation of many ideas floated previously by the government and two government-commissioned pension and savings reports, the Pickering and Sandler reports, published in 2002. In fact, in many areas the government is still seeking views rather than putting forth

its own recommendations.

Commentators have criticised the government for not tackling the more immediate pension issues in the UK. Many UK employers are closing their defined benefit plans due to cost considerations, and there is concern that there is no guarantee that employees will receive the pension that they have accrued, highlighted by several cases where plans have been wound up (terminated) with insufficient funds to cover liabilities.

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