Headlines

Worldwide Pay and Benefits

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Canada

Court ruling tightens restrictions on transfers of pension plan assets

A recent decision by the Ontario Court of Appeal leaves Canadian employers increasingly cut off from opportunities to transfer their pension plan assets in mergers and acquisitions. More broadly, the decision marks a major setback in the ability of employers to exercise financial control over their defined benefit (DB) plans.

In its judgment on 8th December, 2003, in *Aegeon Canada Inc. and Transamerica Life Canada v ING Canada Inc.*, the court ruled that after a merger of two pension plans the employer could not use the surplus from one plan to fund benefits (in the form of contribution holidays) for members of the other. The decision turned on the terms of the trust agreement of the first plan, which provided that the plan assets must be used for the exclusive benefit of the members, and that employees were entitled to any surplus on the plan's termination.

Additional legal hurdles

Although the case concerns the law in Ontario, the legal issues around plan mergers and other asset transfers are common to all Canadian provinces, except perhaps Quebec. Notably, the ruling — which has been appealed to

the Supreme Court of Canada — raises important new legal hurdles for employers by applying classic trust law to pension plans.

In response to the ruling, the Financial Services Commission of Ontario (FSCO) has placed a moratorium on pension asset transfers until the Supreme Court makes a final decision. The FSCO will continue to review asset transfers in defined contribution (DC) plans and plans that are not subject to a trust (which is the usual arrangement for DB plans in Canada).

Implications for employers

Employers contemplating plan mergers, either on reorganisation of their pension arrangements or as a result of acquisitions, should seek legal advice. In addition, the ruling may throw into doubt previous mergers where surplus has been used in a similar way. Companies sponsoring such plans may wish to investigate their exposure. Companies should also be cautious in business acquisitions to identify any possible financial exposure in plans they are acquiring to make sure they are protected.

For employers with pension plans registered in Ontario, the FSCO moratorium means that applications to transfer pension plan assets in mergers and acquisitions will not be approved or, at the very minimum, will be delayed.

Canadian employers who sponsor DB pension plans are unfortunately getting used to an inhospitable legal climate. Recent judicial decisions have restricted the payment of expenses from a plan, and have sanctioned the right of plan members in a closed plan to force a wind-up of the plan. A major unresolved issue is whether there is a requirement to distribute surplus on a partial plan termination, which is the subject of a pending appeal to the Supreme Court of Canada in the *Monsanto* case.

Netherlands

Employers prohibited from discriminating against employees with disabilities

Dutch employers must ensure that they are in compliance with a new law that prohibits discrimination against employees with disabilities or chronic illness. The law became effective on 1st December, 2003, after Dutch lawmakers approved legislation to implement a 2000 European Directive aimed at providing equal treatment of employees in the workplace.

Under the law, employers are prohibited from discriminating directly or indirectly in their benefit programmes, recruiting, dismissal practices and terms of employment based on a person's disability or chronic illness. In addition, employers may be obliged in particular cases to implement special workplace measures to accommodate people with disabilities.

There are some exceptions. Indirect discrimination is permitted if the employer has an objective reason not directly based on an employee's disability in order to achieve a legitimate purpose related to the job requirements. Direct discrimination on behalf of disabled and

chronically ill employees is allowed in three specific situations:

- if it is necessary to protect their health and safety;
- if permanent measures are needed so that they can participate in the workplace on an equal basis;
- if the intent is to provide some special measures so that people can overcome disadvantages.

Singapore

Government seeks to make employee medical coverage more portable

Companies in Singapore are required to make their private medical coverage for employees more portable if they wish to continue to claim the maximum tax deduction of 2 per cent of payroll. Otherwise, the tax deduction for health plan contributions is limited to 1 per cent of payroll, effective 1st April, 2004.

The new government requirement is intended to encourage employers to address the increasing mobility of the Singapore workforce. Participating companies must cover hospitalisation costs through one of two types of arrangements:

- a portable medical benefits scheme (PMBS). These are arrangements in which the employer contributes up to 1 per cent of monthly pay into employee Medisave accounts, and employees take responsibility for hospitalisation expenses through self-insurance or the purchase of an approved insurance product. Companies may contribute on employee pay up to the Central Provident Fund (CPF) caps (currently up to S\$60,000 on annual base salary and S\$93,500 for total annual income);

- a transferable medical insurance scheme (TMIS). These are essentially group hospitalisation plans from an insurance company with provisions that extend coverage for 12 months after an employee leaves the employer and provide coverage for pre-existing conditions.
- a lifetime allowance of £1.5m on the total value of an individual's pension benefits at retirement;
- an annual allowance of £215,000 on contributions to an individual's account in a DC plan or, in the case of a DB plan, on the increase in the benefit value for any individual.

It is anticipated that most employers will choose a TMIS, because it would probably be less costly than the PMBS. Expectations are that employers will wait until policy renewal to move onto the TMIS. With most policies up for renewal at the end of the calendar year, it is likely the influx of companies adopting TMIS will occur on 1st January, 2005. This will provide many employers with the opportunity to review the new features of the insurance, the additional costs involved and their tax position before committing themselves.

UK

Government confirms pension tax reforms to go ahead

In its March 2004 budget statement, the UK government confirmed that its proposed tax reforms for pensions will go ahead, beginning in April 2006. As a result, employers are now able to start considering how these reforms will affect their pension plans and, in particular, their higher-paid employees.

The reforms are widely welcomed as a major simplification of the current, highly complex, limits placed on contributions and benefits.

Tax thresholds

The current limits placed on contributions and benefits will be scrapped completely and replaced by two simple tax thresholds:

The lifetime and annual allowances will not be indexed in line with price inflation as originally proposed, but will be subject to review every five years. Over the initial five years, the lifetime allowance will increase steadily to £1.8m in 2010 and the annual allowance to £255,000.

Unlike the current rules, the value of benefits may exceed the lifetime allowance, but the excess will be subject to a recovery tax. The excess value will be taxed at 25 per cent, with the residual pension subject to income tax. Alternatively, the excess can be taken in cash, but with a 55 per cent tax. Likewise, plan contributions (or the value of the benefit) may exceed the annual allowance, but the employee must pay the required income tax on the excess.

Individuals with a benefit whose current value already exceeds the lifetime allowance may register that higher value as their limit with the Inland Revenue, but any future accrual will be liable to the excess tax charge.

Flexible retirement measures

Individuals will still be able to take a tax-free cash sum at retirement. The maximum will be 25 per cent of the value of their pension benefit, subject to the lifetime allowance. In addition, employees will be able to draw their pension while still working for their employer, although the earliest start date will be raised from age 50 to 55 as of 2010. Individuals also will have greater freedom in the way that they receive their pension income.

Implications for employers

It was originally proposed that the new rules should take effect in April 2005. The delay until April 2006 gives employers and plan administrators an extra year to plan and take appropriate steps.

- For their highly paid employees, employers will need to review their retirement benefit programmes. In particular, changes in the taxation of non-tax advantaged plans will make the use of these plans less attractive.
- Employers will need to decide how far to embrace the greater flexibility offered as to when and how employees can take their benefits. Some employers may wish to take the opportunity to undertake a total review of their retirement plans. At the very least, some minor changes to the benefit design are likely to be necessary to fit in with the new rules.
- A central feature of the new rules is greater individual responsibility in accounting to the tax authorities. This will create a need for more communication with employees to enable them to understand and meet their obligations.

Government proposals to protect pensions fall short of the mark

The reforms proposed in the government's recently published Pensions Bill are more likely to discourage employers from sponsoring pension plans than encourage them.

While the legislation promises a more secure pension system for employees, it is at the expense of employers. In contrast to the pension tax reforms which were generally welcomed, it introduces another layer of complexity and bureaucracy over what is already a burdensome system.

The key reforms are:

- a pension protection fund will be established. It will be funded by taxes on company-sponsored DB plans, and although the details are not yet known, it is likely that larger and less well-funded plans will pay more. Payouts subject to caps will generally be triggered when an employer becomes insolvent;
- a more proactive and risk-focused regulator will be established;
- a new funding standard will replace the current minimum funding requirements. Although the original aim was for plans to tailor the funding to their own profile, the draft bill gives considerable scope for determining the final requirements. Expectations are that the new standard could prove to be tougher in practice than the current requirements;
- the requirement to increase pensions in payment in line with price inflation will be relaxed but will apply only to future accruals. The increase will be capped at 2.5 per cent a year, rather than the current 5 per cent;
- companies acquiring businesses will have to continue to offer transferring employees pension arrangements of a similar nature and at a minimum level;
- at least one-third of the trustees of a company pension plan will be required to be selected by its members. There will no longer be a facility for employers to get member approval to opt out of this requirement;
- there will be requirements for trustees to have a minimum level of knowledge and understanding of their responsibilities;
- the Bill also contains enabling provisions aimed at improving

financial information about pensions and savings for retirement. In February, the government set out its proposals in a consultation document, 'Informed Choices for Working and Saving'.

The measures in the Bill are planned to come into effect in April 2005. They are unlikely to change and indeed may accelerate current trends. In particular, employers will continue to try and control pension plan risks and costs. For many, however, the new law will make it even more attractive to make future pension saving and investment the responsibility of the individual and not the employer.

USA

Treasury proposal backs cash balance plan designs

The Treasury Department has submitted a legislative proposal to Congress to clarify the status of cash balance plans by resolving age discrimination and conversion issues associated with the plans.

Treasury officials said the aim of the proposal is to assure cash balance plans remain a viable design option for plan sponsors in light of conflicting court rulings while making sure older and longer-service workers are treated fairly.

The proposal clarifies that the formula in a cash balance (or other hybrid) plan satisfies age discrimination rules if the

plan provides credits to the accounts of older participants that are not less than the credits for younger participants. Virtually every cash balance plan now works this way.

The proposal would also impose new requirements on conversions to hybrid plans. For each of the five years after a conversion, benefits for plan participants must be no less than those that would have been earned under the traditional plan. 'Wear away' of normal or early retirement benefits at any time would be prohibited. (Wear away occurs where less generous benefits are provided for service both before and after the conversion, which effectively means the participant stops accruing any benefits while the benefits under the cash balance formula catch up with the benefits earned before conversion under the more generous traditional formula.)

In addition, plans will be able to credit a 'market rate' of interest to their cash balance accounts and pay the true account balance, rather than the higher amount calculated under the controversial 'whipsaw' method prescribed by the Internal Revenue Service (under IRS Notice 96-8). (The whipsaw occurs because the lump sum balance is calculated by projecting the account balance forward to retirement using the plan's interest rate and discounting it back at a lower mandated rate.)

All of the proposed changes would become effective only for the period after they were enacted.