Headlines

Worldwide Pay and Benefits

Compiled and written by Towers Perrin

Australia

New law grants employees choice of pension plans

Australian employees will soon have a right to choose to have their compulsory employer superannuation (pension) contributions paid to a pension plan other than the one sponsored by their employer.

Under the Superannuation Legislation Amendment (Choice of Superannuation Funds) Act 2004 that will take effect 1st July, 2005, employees will be able to select among a variety of pension plans and individual arrangements on offer from financial institutions and possibly industry-wide plans that open membership to employees of non-participating employers — in addition to their own company-sponsored plan.

The choice applies only to the employer's compulsory contributions of 9 per cent of an employee's earnings up to the current earnings ceiling of A\$32,180 per quarter (US\$23,291, €18,916). At present, most employers do not offer a choice of pension plans to their employees, although most employer-sponsored plans do offer a range of investment options.

Under the new law:

- Employers will be required to give all employees a 'standard choice

form' to indicate where the employee wishes the compulsory element of the employer's contributions to be paid.

- Employers may still be able to insist that any additional contributions be paid into the company-sponsored plan.
- Employees are not allowed to transfer any accrued benefit unless the plan rules permit it or unless they have not received any employer superannuation support in relation to that benefit in the previous six months.

Some employees will not have any choice of plans due to the structure of their employment arrangements (eg industrial arrangements such as awards and certified agreements) or the type of benefits they currently receive (eg some defined benefit [DB] plans).

Implications for employers

Employers will need to ensure that procedures are in place for the correct and timely payment of contributions to each employee's chosen plan. This may mean adapting payroll procedures or making arrangements with a third-party administrator. Given the magnitude of the reforms, all employers and fund trustees should undertake a strategic review of their current pension arrangements during the second half of 2004.

Pension plan trustees to be licensed

Trustees of company-sponsored superannuation (pension) funds will need to obtain a licence and meet onerous additional requirements under the new 'Safety of Super' reforms. The reforms, approved by Australian lawmakers and overseen by the Australian Prudential Regulatory Authority (APRA), became effective 1st July, 2004 and allow plan trustees a two-year transition period to comply.

Licensing of trustees

The new regulations require all pension plan trustees to obtain a new form of licence known as a Responsible Superannuation Entity Licence (RSEL) from APRA. All applications for licences from existing funds must be submitted before the end of 2005, and APRA will have the power to reject applications after that date. Conditions for the licence include trustee competence, risk management plans and outsourcing systems.

Trustees will still be exempt from the requirement to obtain an Australian Financial Services Licence (AFSL), provided they do not give financial advice.

Risk management

All trustees must prepare a risk management strategy (RMS) and a risk management plan (RMP) setting out their arrangements to mitigate risk. The RMS should deal with risks:

- associated with governance and the decision-making process;
- arising as a result of outsourcing;
- arising from changes to the RSEL;
- associated with potential fraud and theft.

The RMP should deal with operational risks (such as payment systems), investment and insurance risks.

Outsourcing

Outsourcing agreements will be required to contain specific provisions dealing with a number of issues, including the monitoring of the service provider and business continuity planning. It is likely that these new requirements will accelerate the trend in Australia to outsource trustee functions to 'professional' trustees.

Trustee competence

Trustees will be required to have a reasonable level of competence. The assessment will be made on the collective competence of the board of trustees as a whole, rather than on each individual trustee. APRA will not be setting educational or technical qualifications but will require the board to have a documented policy on how it will maintain its competence. If the trustees outsource their functions, little in the way of specific knowledge or training may be required by APRA. They will, however, still be required to have a basic knowledge to understand the advice they receive and make informed decisions based on that advice.

APRA prudential standards power

APRA will have enhanced enforcement powers, especially over DB plans. For example, they will have the power to direct the trustees to commission an actuarial valuation of the plan. The final extent of these powers is still being determined and will be clarified in subsequent regulations.

Action plan for trustees

Trustees and plan sponsors will need to consider the impact that the new requirements will have on their pension plan and decide on appropriate actions in response. At a minimum, they should:

- assess the knowledge and skill levels

- of their trustee board members and decide how they will meet the new competence requirements;
- review their risk management systems and ensure they are robust enough and documented in the correct format;
- develop a timetable now so as to ensure that all the necessary systems and documentation are in place to submit the licence application by the end of 2005 at the latest.

Canada

Employers receive another unfavourable court ruling

A ruling in July by the Supreme Court of Canada may mean that employers will have to distribute a share of any pension plan surplus to workers affected by corporate restructuring.

More broadly, the ruling is yet another setback for employers in their endeavours to retain control over the financing of their DB plans. It follows hard on the heels of the Court's decision to deny leave to appeal the decision in the Transamerica case on 8th July, 2004.

In its decision (*Monsanto Canada Inc. v Ontario Superintendent of Financial Services*) on 29th July, the Court determined that under the Ontario Pension Benefits Act, a proportionate share of actuarial surplus must be distributed in the event of a partial plan wind up (where part of the pension plan is terminated and the assets distributed among the plan members of that part).

As required by the legislation, following a corporate reorganisation in 1997, Monsanto had applied to the Financial Services Commission of Ontario (FSCO) for approval of a partial wind up. The FSCO superintendent denied the application because it failed to include a distribution of surplus.

Effectively the decision applies to all DB plans.

Impact of ruling

The decision will directly and immediately affect similar cases dating back to 1994 that are awaiting final FSCO approval for a partial wind up. Any surplus in the plan at the time of the partial wind up will have to be determined and distributed to the affected members, regardless of whether the plan currently has a surplus. Moreover, there is the potential for re-opening partial wind ups going back as far as 1969, when the particular provision of the legislation that was the subject of the Court's decision was first introduced into the regulations.

Although the case concerns the law in Ontario, all other provinces, except Quebec, British Columbia and Alberta, and the federal jurisdiction, have similar legislation and therefore employers could expect a similar ruling from the courts in these jurisdictions. Even in those three provinces there is a possibility that partial wind ups before the current legislation came into effect could be challenged.

There are, however, many questions left unanswered by the ruling, including how to determine the amount of surplus to be attributed for a partial wind up. The FSCO is expected to issue guidance shortly which may answer some of these questions. However, the pension industry expects litigation as to a number of issues.

The Transamerica case

In *Aegeon Canada Inc. and Transamerica Life Canada v ING Canada Inc.* the Ontario Supreme 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 plan. Although this ruling

centred on Ontario law, it affects all provinces, with the possible exception of Quebec, in the wake of the decision by the Supreme Court of Canada to block an appeal.

Implications for employers

Employers involved in or contemplating mergers or acquisitions or corporate restructuring will need to carefully assess, in conjunction with their legal and actuarial advisers, the impact of these court rulings of their planned transactions. Those that already have a partial wind up or merger application awaiting approval by the FSCO may need to reassess their submission if the issue of surplus is relevant. Employers may also wish to review past transactions to assess the risk of legal challenges.

Pension plan funding affected by new actuarial standard

New guidelines issued by the Canadian Institute of Actuaries (CIA) may have significant cost and funding implications for sponsors of DB pension plans.

The CIA's new *Standard of Practice for Determining Pension Commuted Values* will come into effect on 1st February, 2005. It prescribes how to determine the lump sum value of a plan member's accrued benefits upon termination of employment and transfer to another plan. These values are also used to determine the solvency of a plan in the event of plan termination.

While the new standard is similar to current rules, there are two key differences in the assumptions used in the calculation of the commuted value.

— *Interest rate*: Like the current rules for calculating commuted values the new standard requires the use of one interest rate (the liability discount

rate) for an initial period followed by another rate for the rest of the period. Instead of a fixed rate for the second period, however, the new standard requires both rates to be based on yields of Government of Canada bonds and adjusted monthly.

— *Mortality*: New mortality tables should be used which reflect both current and future expected improvements in mortality.

Given current financial market conditions, the new standard is likely to result in higher commuted values for most plan members. Moreover, the values are likely to be more volatile due to the use of the variable interest rate in the second period.

Effect on plan funding

Canadian pension legislation generally requires plan contributions that are sufficient to fund benefits valued on both on an ongoing funding basis (on the premise that the plan will continue indefinitely) and on a solvency basis (on the premise that the plan will terminate and all accrued pension entitlements will be settled). The solvency basis typically assumes a portion of the plan's accrued pension entitlements will be settled by transfers of commuted values.

The use of the new standard is likely to result in higher solvency liabilities and raise funding requirements for many plans, which could mean higher plan contributions for plan sponsors. This comes at a time when plan sponsors are already facing significant funding issues. In addition, the volatility of the commuted values under the new standard will bring volatility in solvency liabilities and funding requirements in the future. Plan sponsors should review the impact that the new standard may have on required funding levels, cost and other aspects of plan financial management.

China

Government issues guidelines for new supplementary pension plans

New regulations recently issued by the Chinese Ministry of Labour and Social Security give employers an opportunity to set up fully funded defined contribution (DC) pension plans for their employees. The regulations, which became effective 1st May, 2004 and supersede the 1995 regulations, allow companies to create enterprise annuity plans (EAPs) that are intended to supplement the Chinese social security pension. The current national pension system was unified from a fragmented system in 1997 following a three-pillar model:

- *Pillar I:* A basic social security pension based on 20 per cent of average provincial wages.
- *Pillar II:* A social security pension based on mandatory contributions accumulated in individual accounts.
- *Pillar III:* Benefits under voluntary supplementary plans.

Some employers already operate supplementary plans, but these plans are often underfunded or even unfunded. In addition, these existing supplementary plans are not regulated in any meaningful form, and tax relief is a matter of negotiation between the employer and the provincial authorities.

Key features

The new EAPs are different from the existing supplementary plans in that they must be fully funded and must be set up under a trust, so that the assets are separate from those of the employer. Contributions will be eligible for tax relief, although employers are still awaiting clarification of the extent of the relief, along with other details.

Here are some other key features:

- The annual employer's contribution is capped at one-twelfth of the prior year's total payroll, and the combined contribution by the employer and employees may not exceed one-sixth of the prior year's annual payroll.
- The contributions are invested in individual accounts and are fully vested with the employees. The account balance is portable from one employer's EAP to another employer's EAP when employees change jobs. If the new employer does not have an EAP, the account balance may be kept in the old employer's EAP.
- Benefits are payable at the statutory retirement age in a lump sum or by instalments. If a participant dies or establishes permanent residence outside China, the benefit is payable in a single lump sum.
- The plan's trustee can either be a committee, with employee representatives making up to one third of the membership, or a qualified external corporate trustee. The trustee is responsible for appointing a plan administrator, a custodian and fund managers to manage the plan.

Setting up an EAP

For an employer to establish an EAP, it must:

- be up to date with its contributions to the mandatory social security pension system;
- be under stable and professional management, with sound financial performance;
- have an established process for staff consultation or collective negotiation and good internal management control.

The plan must be established in consultation with unions or employee representatives.

Implications for employers

The mandatory social security pension system in China does not provide adequate retirement income, especially for those employees who earn significantly higher than the average city wages. Employers are therefore looking to design supplementary plans as part of the overall benefit package needed to help attract and retain talent.

Some employers that already operate supplementary plans are working on changing their existing plans to comply with the new regulations.

Europe

EC making progress in ending cross-border tax discrimination

The European Commission is having success in its efforts to stamp out tax discrimination against European-based non-domestic pension funds. The EC considers the practice a violation of EU law guaranteeing freedom to provide services and free movement of workers and capital.

After infringement proceedings for non-compliance were initiated against a number of countries in 2003, Belgium, Ireland, Portugal and France pledged to the EC to change their legislation.

However, the EC is taking further action against Spain and the UK. Although the Spanish government had agreed to change its legislation by September 2005 — the deadline for implementation of the European pensions directive — the EC considers this insufficient. It has therefore referred Spain to the European Court of Justice, as it did with Denmark in 2003. In the case of the UK, the EC

accepts that the pension tax system is currently being overhauled, but has still decided to formally request that the UK changes its legislation because it does not believe that the government has provided sufficient information about its plans to tackle the issues involved.

Progress has also been made in Scandinavia. Following the ECJ ruling in the Danner case, the Finnish government has plans to introduce legislation by the beginning of 2005 so that pension contributions to an institution in another EU state will receive the same favourable tax treatment as contributions to a Finnish institution. The tax authorities are already following this practice. In Sweden, the Supreme Administrative Court gave a final ruling in May in the Skandia case. The ruling stipulates that pension contributions to insurance companies and employer-sponsored pension plans based in other EU states must be given the same tax treatment as those based in Sweden.

Discriminatory tax treatment is slowing being chipped away in the EU, and this will go some way towards facilitating pension mobility for employees across Europe. Unless complete tax harmonisation is achieved within Europe, piecemeal solutions to the pensions issues for individual cases of employment mobility will remain necessary based on the types of assignment categories and the importance the company attaches to tax advantages in their transfer policy.

Germany

Changes in tax law seek to shift pension plan financing

Major changes are being made to the way that pension contributions and benefits are taxed under some types of

company-sponsored plans and under the German social security system.

The Retirement Income Tax Law (*Alterseinkünftegesetz*) passed by the Upper House of the German parliament in June will gradually remove the tax paid by employees on pension contributions and shift the burden to benefit payouts. (In Germany, employees participating in specific qualified plans are already subject to tax on their company's pension payments.) The new law also makes it easier for employees to transfer their pension rights when changing jobs.

Social security system

The reforms were prompted by a ruling by the Federal Constitutional Court requiring equal tax treatment of social security pensions and pensions of retired public service employees. Under the new law, both existing pensioners and new pensioners will be affected.

Starting in 2005, existing pensioners and new pensioners will pay tax on 50 per cent of their pension payments and the amount subject to tax will remain at 50 per cent throughout the payment period of the pension. Beginning in 2006, for new pensioners the portion of pension income subject to tax will gradually rise until it reaches 100 per cent in 2040. The tax rate that applies when a pension is newly drawn will remain unchanged for the whole payment period.

Conversely, 60 per cent of the social security contribution (by the employer and employee) will become tax-free starting in 2005, rising to 100 per cent by 2025. Currently, employers and employees in Germany each pay 9.75 per cent of payroll to social security.

Company-sponsored plans

The reforms affect company-sponsored plans that are financed by direct insurance (*Direktversicherung*) and to a lesser extent by captive insurers

(*Pensionskassen*). Plans with other methods of financing — book reserve, support funds (*Unterstützungskassen*) and pension funds (*Pensionsfonds*) — are not affected because their current taxation largely follows the new system.

Beginning 1st January, 2005, contributions of up to 4 per cent of the social security ceiling (SSC) to plans funded by direct insurance will become tax-free, but the benefits will be taxed, and these must be taken in the form of a life-long pension. Employees who have existing direct insurance contracts will be able to choose to remain in the old system.

The system of tax-free contributions by employers of up to 4 per cent of the SSC already applies to *Pensionskassen*. In addition, currently contributions above this limit and the resulting benefits may be treated the same way as direct insurance and taxed at a flat rate of 20 per cent. This will no longer be possible under the new system. Instead both for direct insurance and *Pensionskassen* another €1,800 per year in pension income will be tax-free on top of the 4 per cent contributions. While the 4 per cent contributions are linked to the annually increasing SSC, the tax-free allowance for the additional €1,800 will remain constant over time.

Portability of pension rights

The new law also gives employees the right to transfer the value of their accrued pension benefits to their new employer's pension plan. The employee must ask for the transfer within a year of termination. The right applies only to benefits under externally funded plans — *Direktversicherung*, *Pensionskassen* and *Pensionsfonds* — and if the new employer's plan is book reserved or financed through an *Unterstützungskasse*, both the previous and new employer must agree to the transfer.

Implications for employers

Employers are unlikely to consider revising their pension plans purely because of the change in tax law. Employees will see changes in their take-home pay, however, as social security contributions by their employer start to become tax-free in 2005. At a minimum, companies will need to communicate clearly to the employees what impact the new tax rules will have on them.

Netherlands

Pension plans subject to new solvency requirements

New solvency requirements for Dutch pension plans, set to take effect 1st January, 2006, are focusing employers' attention on funding and related financial management strategies.

The new financial assessment framework (FTK) was approved by the Dutch Parliament in March. It is the result of two years' discussions between the Dutch pension supervisory authority (PVK), employers and unions following the wave of criticism over the PVK's letter to pension funds in September 2002 setting out tougher funding rules.

New solvency requirements

The FTK requires plans to pass three interrelated tests:

- A minimum funding test whereby pension plans must have a funding level of at least 105 per cent. This is tougher than the 100 per cent requirement in force before the PVK's letter in 2002. If this test is not met, plans have one year to recover to the 105 per cent level.
- 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. The probability test will involve an assessment of market risks related to any mismatch between the plan's assets and liabilities. If the solvency margin is not sufficient, the fund has a 15-year period to reach the required level. This may mean adjusting the plan's asset mix or requiring the fund to achieve a higher funding level than the 105 per cent minimum.

- A new 'continuity' test (or continuity analysis), only to be used in specific situations. This is an analysis of future assets and liabilities and should show that the fund is capable of surviving adverse conditions. The exact details of this test are still to be determined.

In all three tests, benefit liabilities must be calculated using variable interest rates depending on the duration of the liabilities, rather than the fixed 4 per cent rate previously used. It is expected that these rates will be based on government bond yields.

Pension funds will be able to seek PVK approval for their own customised tests based on their own specific asset liability strategies. Alternatively, they can use a standardised model and methodology issued by the PVK; many smaller funds are likely to find it easier to choose this route.

Indexation

The government has chosen not to make indexation of pensions in payment compulsory. However, as part of the new requirements a pension plan must inform members about its policy on indexation, regardless of whether or not the plan is indexed.

Employers to develop customised tests

Although the new framework will not become law until the Pensions Act 2006 goes into effect on 1st January, 2006, the

PVK has the authority to start dealing with pension funds on the new basis immediately. Larger pension funds are likely to want to develop their own customised tests and submit them for the PVK's approval. In developing these tests, they will need to 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.

Government bans age discrimination at work

A new law in the Netherlands prohibits Dutch employers from including terms in contracts of employment and pension plans that are conditional on the age of the employee. The law, which became effective 1st May, 2004, prohibits employers from discriminating against employees on grounds of age, unless they can objectively justify the different treatment.

The new law implements a 2000 EU directive on equal treatment in employment. Employers will need to ensure that they are complying with the law, taking into account the following issues:

- Employees cannot be forced to retire when they reach normal pensionable age, if this is below 65, unless the employer is able to objectively justify the early termination of the contract. For existing employment contracts, employers have until 2nd December, 2006 to comply.
- For DB plans (that base benefits on final pay), the practice of disregarding increases in pensionable earnings after a certain age (eg age 55 or 60) is no longer allowed. However, at present under Dutch tax law, this practice

cannot be completely eliminated, and therefore any earnings-related restrictions for calculating pension benefits would have to apply to employees of all ages.

- DC plans must either have equal contributions at all ages or an age-related scale which is calculated actuarially to produce equal benefits. Employee contributions must always be equal at all ages.
- Where benefits under a pension plan, or any other employment-based programme, are changed, it may no longer be possible to include special transitional measures for older employees.

The new Dutch law does allow employers to continue to impose a minimum age requirement for membership in the pension plan, VUT (voluntary early withdrawal) plan or some type of early retirement program. This exception remains controversial, however, because it is viewed as age discriminatory and could be withdrawn at a later stage.

Spain

Government allows new flexibility for pension plans

The Spanish parliament has approved new regulations for tax-qualified pension plans sponsored by employers. The regulations, which became effective 26th February, 2004, include guidance for implementing the 2002 pension law as well as measures to comply with the European Union's pension directive.

These modifications affect both the pension plans and the investment managers of the pension funds in which the assets are invested. Some of the major changes are detailed below.

Structure of pension plans

There are several modifications aimed at strengthening pension plans so that they can better meet the needs of companies and employees, including those in labour unions. For instance, companies may now provide for automatic enrolment under a collective agreement with employees. There is also more flexibility to implement multiemployer pension plans.

The 2002 pension law requires a 50–50 split between company and employee representatives on the pension plan control committee. The new regulations allow a different split by collective agreement between the two sides.

Actuarial and financial reviews

There are more stringent requirements for actuarial and financial valuations of DB and DC plans. Under the old rules, DC plans did not require any actuarial reviews — only an economic report by the investment manager at least once every three years. Under the new rules, DC plans must perform an actuarial and financial review at least every three years. For DB plans, only an actuarial review was required each year. Now an actuarial and financial review is required each year.

Investment

There is now a clear differentiation between employer-backed pension plans and individual savings plans. Under the previous regulations, both types of plans could belong to the same pension fund, which required the investment policy of the fund to take into account risk levels and other requirements of the different groups of participants. The new rules no longer allow this because individual plans must be kept separate from company pension plans.

The plan control committee, which is

responsible for the investment of the plan assets, must have a statement of investment policy principles.

Pension plans will now be able to invest in a number of funds with different investment managers, rather than only one. An extensive list of permissible types of pension plan assets is now available, along with specific rules for investing in hedge funds, real estate and some other types of investment.

Pension fund managers must communicate additional information to plan participants and beneficiaries about fees, investments and changes in the law that may affect their benefits.

Many of the new regulations are still being analysed by the investment managers' association (Inverco), insurance companies and Spanish actuaries, as well as by companies themselves, in order to understand how to implement the rules. Employers and plan control committees have until 26th February, 2005 to comply. However, existing plan control committees that do not currently have a 50–50 split between employer and committee members should resolve the issue before 1st January, 2005.

Steps for employers

Companies in Spain should review the new regulations in detail and make sure they have a full understanding of their obligations so that they can take appropriate action. For many employers, there is still the issue of compliance with the changes in the pension control committee. It is also important to be prepared to meet the new actuarial and financial review requirements and to have an appropriate investment policy in place. Many DC plans started in December 2000, so they will need to carry out their actuarial and financial reviews for the first time this year.

Taiwan

New pension law includes mandatory cash contributions

Employers face major changes, including mandatory new cash contributions to their retirement programs, as a result of the Labour Pension Act (LPA). The LPA, which will become effective on 1st July, 2005, marks a sweeping overhaul of employer-sponsored retirement plan arrangements under the existing Labour Standards Law (LSL).

Key features of the LPA

Under the current law, the LSL plans provide a defined retirement benefit of two months' average salary for the first 15 years of service plus one month's average salary for service in excess of 15 years, subject to a maximum benefit of 45 months' salary. The benefit cannot be transferred from one employer to another.

The LPA will require employers to provide DC arrangements that will be completely portable between employers. Here are the key features of the LPA:

- The employer contribution rate will be no less than 6 per cent of the employee's salary.
- Employees can make tax-deductible voluntary contributions of up to 6 per cent of salary.
- The contributions are invested in individual accounts and are fully vested with the employees. The account balance is portable when an employee changes jobs.
- The benefit will depend on the value of the account at age 60, and employees with at least 15 years of participation under the LPA can choose to have it paid as a lump sum or have it converted into a monthly annuity. The conversion method has not yet been announced.

— The two permissible types of DC arrangements are:

- *Individual Retirement Account:* A centralised DC arrangement managed by the government.
- *Annuity Insurance Products:* Government-approved products sold by insurance companies.

Which employees will the LPA affect?

The LPA will apply to all new employees hired on or after the law's effective date of 1st July, 2005. Existing employees currently covered by the LSL will have a one-time irrevocable choice to either continue their existing arrangement or move to the new LPA arrangement for their future service. The choice can be exercised anytime within five years.

What does LPA mean to employers?

Most employers are contributing at the minimum level of 2 per cent of salary to the assets with the Central Trust of China to fund employees' LSL benefits. Under the LPA, some employers' cost may increase as they have to contribute at least 6 per cent of salary for their new employees and those existing employees who have opted for the new LPA arrangement.

Under the LPA, employers will need to communicate the one-time irrevocable choice to their existing employees to ensure they understand their choices and make an informed decision. Employers are also responsible for making voluntary employee contributions on behalf of the employees through payroll deductions and providing monthly statements to employees showing the contribution details. There will be additional administration work as employers may, potentially, be required to administer all three types of retirement plans the old LSL plan and the two new arrangements under LPA. Heavy penalties will be

imposed on employers for non-compliance.

United Kingdom

Companies concerned by draft pensions bill

Provisions introduced in the draft pension reform legislation during its progress through the UK parliament have alarmed companies and particularly venture capitalists. If enacted in its present form, the pensions bill is likely to have a major impact on corporate restructurings as well as mergers and acquisitions.

The government has said it is sympathetic to these concerns and has said it will look at the provisions and how they will be operated in practice.

The proposals are designed to support the Pension Protection Fund (PPF), which the government is planning to establish to pay benefits to employees in underfunded DB plans in the event that the sponsoring company goes into liquidation. The bill would enable the UK pensions regulator to seek financial support for an underfunded DB plan from any company within the same corporate group, regardless of whether or not the company participates in the plan. The agency would also be authorised to seek support from the assets of controlling shareholders and company directors.

Perhaps most alarming, the bill does not require anything specific before allowing the pensions regulator to issue a direction for financial support. This is intended to be one of the proactive powers the agency would have in its armoury and is deliberately far-reaching in scope to deal with circumstances which lawmakers may not have contemplated.

Currently the bill authorises the regulator to issue two types of orders:

— *A financial support direction*: This could be issued if the sponsoring employer has insufficient net assets to meet a specified percentage of the plan's underfunding. The company receiving the direction would be able to decide how to put the required support in place, subject to the regulator's approval. The support could, for example, be provided by bank guarantees or by an agreement that makes the holding company (provided it is located within the EU) responsible for the sponsoring employer's pension liabilities. Alternatively, there could be an agreement among all companies within the group. Failure to make arrangements in response to a financial support direction could lead the regulator to issue a contribution notice.

— *A contribution notice*: This could be issued to any companies or persons that, either through action or inaction, seek to block the sponsoring employer from meeting pension plan obligations — for example, by stripping company assets. In this case, the recipient of the notice would be required to make a payment to the pension plan.

The new provisions would apply retroactively to 11th June, 2003, leaving companies virtually no scope to take appropriate action before the bill becomes law.

Implications for employers

Ideally, any measures taken now (regardless of whether they are connected with a pension plan) that might affect the ability of a company to meet its DB pension liabilities should be scrutinised carefully. Employers should assess whether they might subsequently become the subject of a notice requiring an

immediate contribution or a direction seeking financial support. Both types of orders could also be issued to non-UK companies, provided they have assets within the jurisdiction of the UK courts against which the orders can be enforced, if necessary.

Clarification from the government on the intended use of these new powers is urgently needed if corporate transactions are not to grind to a halt. The government has suggested a procedure whereby companies that are restructuring or involved in an acquisition could undergo a review of their pension liabilities by the pensions regulator and obtain clearance before completing the deal.

USA

New pension law reduces contribution requirements

Employers sponsoring DB pension plans are reviewing their funding levels and contribution requirements in light of the Pension Funding Equity Act (PFEA) of 2004, the interest-rate relief legislation signed into law on 10th April by President Bush.

In many cases the new legislation will allow plan sponsors to reduce contributions over the next two years compared with what would have otherwise been required. Even under the new rules there will be many instances where contributions increase substantially from prior years. Enactment came as employers were facing a deadline of 15th April to make quarterly contributions to meet minimum funding requirements.

Interest rate changes

Under the Job Creation and Worker Assistance Act (JCWAA) of 2002, employers were temporarily allowed to use an interest rate as high as 120 per

cent (instead of 105 per cent) of the four-year weighted average yield on a 30-year Treasury bond. The higher cap reduced a typical pension plan's current liability, which is used in determining deficit reduction contributions. JCWAA was a temporary stop-gap, however, and there was general consensus among employers, lawmakers and others that the use of 30-year Treasury yields was no longer viable.

Under the new law, plan sponsors can set the current liability interest rate within a range of 90 per cent to 100 per cent of a four-year weighted average of yields on long term corporate bonds in the top three quality grades. The US Internal Revenue Service (IRS) quickly released the new interest rates in Notice 2004-34. The maximum rate is 6.55 per cent as of 1st January, 2004. This is more than a full percentage point above the 5.51 per cent that applied once JCWAA relief had expired and above the 6.30 per cent that would have applied if the prior JCWAA relief had simply been extended.

The relief provided by the new law may prove more useful to some companies than others, but it allows all companies a greater degree of flexibility in determining an appropriate funding strategy.

Resolution of cash balance issues left to Congress

The decision by the IRS and the Treasury Department to formally withdraw the age discrimination regulations for retirement plans places the responsibility for resolving the cash balance issue squarely on the shoulders of Congress.

The action, announced on 15th June, leaves it up to Congress to set both the structure and pace of basic guidance in what has become a highly technical and controversial set of issues that are also

under review in US federal courts. While Congressional committees have held hearings on this and other retirement plan issues, it seems likely that legislation will not be enacted until after the elections in November. As a result, plan sponsors will have to continue to operate their plans without the critical guidance that they have been seeking for some time.

Long-running controversy

The proposed rules were issued in 2002 to implement the requirement for qualified DB plans not to discriminate as to the rate of benefit accrual on the basis of age, with a particular focus on cash balance plans. The proposal was subject to broad criticism from a variety of sources, including cash balance opponents and sponsors of both cash balance and traditional DB plans. While the Treasury was working to address this criticism, cash balance opponents in Congress managed to secure legislation barring the Treasury from issuing final rules.

The Treasury indicated that it does not intend to issue guidance on compliance

with the age discrimination rules for cash balance plans, plan conversions, or other hybrid plans while the issues are under consideration by Congress. Accordingly, the freeze on determination letters for converting from traditional pension plans to cash balance plans — dating back to 15th September, 1999 — will not be lifted until Congress acts.

Implications for employers

Companies that planned to consider implementing a cash balance plan will need to decide whether to defer consideration until these issues are resolved. Companies that are in the process of designing a cash balance plan should review whether and how this development affects the timetable for the plan design project, the actual design of the plan and any eventual decision to implement a cash balance plan.

Companies that have a request for determination letter for a cash balance plan pending with the IRS will still not see any action taken on the request.

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