Headlines

Worldwide pay and benefits

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Australia

New regulations on flexible retirement arrangements

New government regulations to encourage phased retirement took effect on 1st July, 2005. The rules, which will allow Australian workers access to their pension benefits prior to retirement, are designed to encourage older employees to stay in the workforce and to assist workers wanting to make a gradual transition to retirement.

Workers who have reached their preservation age will be able to draw on their superannuation funds without having to leave their job or retire. (The preservation age of 55 for individuals born prior to 1st July, 1960 increases to age 60 for those born after 30th June, 1964.) Qualified participants can receive either regular income or an annuity over their expected lifetime but are not allowed to change the amount of the income stream once they make a selection. Lump sum payments won't be allowed unless the individual has satisfied certain conditions by retiring or reaching age 65.

Implications for employers

Superannuation funds are allowed to provide the new types of pension arrangements but are not obliged to do so. Employers and their funds will want to consider whether allowing these types

of benefits is appropriate, based on various factors such as:

- their workforce strategies;
- cost and other administration requirements;
- the reward practices of competitors.

Superannuation surcharge dropped

In a separate development, the 2005–06 federal budget announced in May by the Liberal government includes some substantial tax changes that will impact individuals and employers alike. One major change is the proposal to abolish the surcharge on superannuation contributions of high-income earners that has been in place since 1996. The surcharge of 12.5 per cent for the 2004–05 tax year applied to contributions of workers earning an adjusted taxable income above the minimum threshold of A\$99,710 (US\$74,992).

Implications for employers

Employers in Australia may wish to consider the impact of the new tax law change on their compensation programmes for high-income employees. The elimination of the surcharge will boost the savings of these employees and simplify the administration of superannuation funds, especially defined

benefit plans that typically have a complicated process for determining annual contributions of participants.

South Korea

Government offers pension alternative to severance benefit

Employers are reviewing the new pension legislation that will allow them to set up retirement plans instead of paying a lump sum severance benefit. The Employee Retirement Security Act (ERSA), approved by South Korean lawmakers last December, will take effect on 1st December, 2005 for employers with five or more employees. Employers with fewer than five employees will have to comply with ERSA by 2010.

At present, employers with five or more employees are legally required to pay a lump sum severance benefit to employees on retirement or earlier termination of employment, provided they have completed at least one year of service. The severance benefit must equal at least one month's final salary for each year of service. The severance benefits can be unfunded or partially funded using insurance products. It is not typical for employers to have any other type of retirement benefit plans for their employees.

Under ERSA, employers, by agreement between management and employees, can choose to keep the current lump sum severance benefit or adopt the new retirement system.

New framework

Key features of the new retirement system are:

- pension benefits must be comparable with those of the current lump sum severance system. Defined benefit

(DB), defined contribution (DC) or hybrid plans are permitted.

- DB plans: The benefit should be at least equal to one month's final salary for each year of service;
- DC plans: The annual employer contribution should be at least 1/12 of the employee's annual salary;
- the new retirement plans must be externally funded by a trust arrangement or an insurance policy, and employers' contributions are tax deductible;
- employers with fewer than ten employees may contribute to employees' individual retirement accounts (IRAs), instead of setting up a new company retirement plan;
- benefits accrued for an employee terminated before retirement may be transferred to an IRA;
- employees can choose to receive pension benefits instead of a lump sum benefit upon retirement after age 55, provided they have worked for more than ten years;
- detailed regulations on funding and investment are expected to be approved soon, although rules on tax treatment of plans are still awaited.

Implications for employers

The legislation does not compel existing employers to offer the new retirement system to their employees. Some employers currently do not set aside any financial reserves for the severance benefits and will need to consider the additional cost and cash flow implications of moving to a funded retirement system. Employers will also need to consider the tax implications carefully. Employers' contributions under the new retirement system are tax deductible, while tax incentives for funding the current severance benefits through an insurance

arrangement would be phased out over five years.

Employers should examine the advantages and disadvantages of the current and new systems, both for themselves and their employees, to determine the right retirement strategy for the firm.

Taiwan

New pension law ushers in new era for employer-sponsored plans

With the launch of the Labor Pension Act (LPA) on 1st July, 2005, Taiwan began a new era of retirement plan regulations. The centrepiece of the new law, which overhauls the retirement plan arrangements under the existing Labor Standards Law (LSL), is a requirement for employers to provide employees with some type of DC account that is fully portable.

Under the existing LSL, employer-sponsored retirement plans have to provide a DB scheme that does not vest until age 60 or early retirement (age 55 or above with at least 15 years of service, or at least 25 years of service). Because this benefit is not portable, many employees lose it when they change jobs.

Key LPA plan features

Under the new law, employers must provide employees with individual retirement accounts (IRAs) — a centralised collection of accounts managed by the government. Employers with 200 employees or above and with the union's consent (or with the consent of the majority of employees if there is no union) can, alternatively, choose to participate in government-approved annuity insurance products provided by insurance companies. The government

has not yet completed the approval process to make these products available, however.

Other important features of the new retirement system

- The employer contribution rate must be no less than 6 per cent of the employee's salary, subject to a monthly salary cap of 150,000 Taiwan dollars (US\$4,758, €4,018);
- Participating employees can voluntarily contribute up to 6 per cent of salary, subject to the same monthly salary cap that applies to employer contributions, on a pre-tax basis;
- All individual account balances are fully vested with the employees and can be transferred when an employee changes jobs;
- Accounts must earn a minimum investment return that is equivalent to the average two-year time deposit rate over the whole period of participation under the LPA;
- Age 60 is the minimum retirement age. Employees with at least 15 years of participation in an LPA plan must have the benefit paid as a quarterly annuity. Employees with fewer than 15 years of participation must receive the benefit as a lump sum.

Implications for employees

The LPA applies to all new employees hired on or after the law's effective date of 1st July, 2005.

Employees hired before 1st July, 2005 who are subject to the LSL will have the choice to either continue their existing arrangement or move to a new LPA plan for their future service. The choice can be exercised anytime within the five years after 1st July, 2005 (ie up to 30th

June, 2010), and the decision is irrevocable.

For those employees who choose to stay in the LSL plan, their benefits would remain unchanged. For those employees who opt for a new LPA plan, their accrued service under the LSL plan will be preserved as long as they stay with the same employer. In other words, if they retire with the same employer, they would have two benefits.

Implications for employers

Most employers have been contributing at the minimum level of 2 per cent of salary to the Central Trust of China to fund employees' LSL benefits. With the introduction of LPA plans, employers in Taiwan generally face additional cost because they will 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. It is expected that some large multinational employers will establish LPA plans that have employer contribution rate around 8 per cent to 10 per cent, higher than the mandatory minimum level.

Employers will need to appropriate communication programmes to ensure that employees understand their benefit choices and make an informed decision. Employers are also responsible for having in place a system to process payroll deductions and for providing monthly contribution statements to participating employees.

If a significant portion of employees opt for the LPA arrangement as of 1st July, 2005 it will be essential for employers to have an updated actuarial valuation performed on the LSL plan to determine whether adjustments to the current contribution and expense are necessary.

UK

Plan funding shifts from partnership to negotiation

Effective September 2005, the UK's minimum funding requirement (MFR) for pension plans is to be replaced with a less prescriptive plan-specific regime. The change in regulation from detailed funding rules to broad principles will require plan sponsors to engage much more closely with plan trustees.

These new requirements are known in the UK as the Statutory Funding Objective. It is being left to the plan trustees (subject, in most cases, to the agreement of the plan sponsor) to decide how to apply the broad principles to their plan.

It remains to be seen how practice will develop over time — whether funding objectives will be truly plan-specific or whether there will be convergence towards some perceived common principles.

Plan trustees will also be required to:

- prepare a statement of funding principles, setting out how the Statutory Funding Objective will be met;
- establish a recovery plan if a plan is underfunded. Typically this will require additional sponsor contributions over a fixed period, rather than the current general practice of revising the recovery period at each subsequent valuation;
- obtain annual funding updates in addition to the current requirement for a full actuarial valuation every three years;
- supply an annual funding statement to plan members that includes:
 - funding position against scheme-specific valuation;
 - funding position on insurance buy-out solvency basis;
 - the recovery plan (if one is needed).

Implications for employers

Unlike the MFR, the new funding regime increases the onus on plan trustees to agree on adequate funding programmes with plan sponsors. Trustees are encouraged to take a more robust position in their discussions with the employer, taking greater account of the sponsor's ability to fund the plan over the longer term.

Sponsors need to prepare to engage with the plan trustees in an environment that may well be closer to that of a commercial negotiation than to a partnership with the trustees, which is currently the prevalent approach. They will need to obtain their own actuarial advice to assist them with funding discussions in this environment, and it will be more important than ever that such advice is free from any conflicts of interest.

Plan trustees required to take on more responsibilities

Pension plan trustees in the UK are being required to play a much greater role in ensuring that employers meet their defined benefit promises. Employers will need to understand the new obligations placed on trustees, not only to assure ongoing compliance but also to anticipate how trustees can best respond to business decisions that have an impact on plan management.

Not only will plan trustees be required to take on more responsibility for plan funding, beginning in April 2006, they will also be required to be knowledgeable about the principles of plan funding and plan investments, as well as the law relating to pensions and trusts. They must also be familiar with key plan documents. New trustees will have six months, from their appointment, to reach the necessary standard.

If trustees are unable to demonstrate

that they have taken steps to obtain the necessary knowledge, the new Pensions Regulator may treat the plans as being at risk with a possibility, in the case of DB plans, of an increase in risk-related premiums payable to the Pension Protection Fund.

In addition, trustees of DB plans will be expected to play a more active role in protecting the security of members' benefits and, where appropriate, enforcing the sponsoring employer's pension promise. This is linked to new arrangements — including the Pension Protection Fund — designed to protect the benefits of members of DB plans. While the Pension Protection Fund will provide support to underfunded plans whose sponsoring employer becomes insolvent, trustees of such plans will be expected to take active steps to minimise claims.

Better knowledge of the business

In practice this means that trustees will need to interest themselves in the progress of the employer's business so that they can properly assess the employer's ability to fund the plan. Employers can expect trustees to ask periodically for information about the group's finances and, in a corporate reorganisation, trustees are likely to seek details of the proposal in order to have assurances that it is not likely to reduce the ability of the employer to meet its pension promise.

Employers who fail to understand the implications of the new trustee rules in the UK could find their commercial freedoms severely restricted.

Pensions Regulator issues clearance procedure for corporate transactions

Companies with DB schemes in the UK are now able to submit to a clearance

procedure to ensure that certain proposed corporate transactions will not fall foul of the UK Pensions Regulator.

New powers given to the Pensions Regulator in the Pensions Act 2004 caused concern because of the uncertainty they would bring to corporate transactions. The powers are designed to support the Pension Protection Fund by seeking to ensure employers do not default on their pension liabilities. Companies were concerned, however, that even when they engaged in an 'arms-length' transaction with the sponsoring employer of a DB plan, the Regulator could subsequently seek financial support from them for that plan.

The Regulator is able to require financial support in two ways: It can issue a financial support directive if it considers a pension plan sponsor has insufficient assets to meet its share of the plan's underfunding. This directive can be issued to any company within the same group as the sponsor. A more serious step would be for the Regulator to issue a contribution notice. The Regulator can issue this type of notice to any company it believes has taken action (or failed to act) to avoid pension obligations.

Clearance procedure

Under a special clearance procedure, a company may apply to the Regulator for confirmation that a proposed transaction will not give rise to a contribution notice or a financial support direction. The clearance statements are binding on the Regulator unless any information supporting the clearance application proves to be materially inaccurate.

For a company to apply for a clearance, its pension plan must be in deficit (deficit in this context would normally be determined in accordance

with whichever of the standards — the UK's FRS17 or the International IAS19 — that the company uses for its corporate accounting). In addition, the transaction must be one that would be financially detrimental to the plan's ability to meet its pension liabilities. The Regulator is likely to give clearance if it considers it would be unreasonable to issue a financial support directive or contribution notice, taking into account a number of factors, including whether the transaction would preserve employees' jobs.

Implications for employers

Clearance is not compulsory, but companies will need to analyse some of their business dealings more closely to decide whether it would be advisable to obtain a clearance statement. It may be desirable to seek clearance for a merger or acquisition, depending on the financial effect on the plan, but other events, such as giving a charge over company assets for a bank loan (thereby reducing the assets available to the pension plan as an unsecured creditor on company insolvency) may also need clearance.

Employers can expect pension plan trustees to seek to be more involved in their financial affairs. The Regulator's clearance guidance emphasises the changing role of the trustees, expecting them to take positive steps to mitigate any adverse effects of transactions on the plan's funding and negotiate with the employer in the same way as any other large unsecured creditor. Evidence of such negotiation is likely to be a key factor in determining whether or not to grant clearance.

New notification rules for employers

New rules impose a legal duty on employers to report some of their

business affairs to the Pensions Regulator. The purpose of the new rules, which apply to both employers and plan trustees, is to provide officials with an early warning of possible insolvency of the company or worsening of a plan deficit so that the Pensions Regulator can assist or, if necessary, directly intervene, in the operation of the plan.

The notifiable events regulations provide detailed guidance on the types of events that require action by trustees and employers. Events that must be reported by employers include:

- a decision to take action that will result in debt to the pension plan not being repaid in full;
- a decision to cease carrying on business in the UK;
- receipt of advice that the employer is trading wrongfully or in a situation in which the directors know there is no reasonable prospect of avoiding insolvency;
- conviction of an individual director for an offence involving dishonest behaviour.

In addition, if the pension plan is not 100 per cent funded, the following events must be reported if they occur:

- a breach of banking covenants by the employer;
- a change in the employer's credit rating;
- a decision by a controlling company to relinquish control.

In most cases, plan trustees need to make reports only when the plan is not 100 per cent funded and a decision is taken to significantly increase the plan benefits or to make or accept a significant transfer of assets to or from another plan.

Implications for employers

Companies doing business in the UK should become knowledgeable about the new pension plan notification rules and make sure they have administrative procedures in place to ensure full compliance.

The final rules also require each plan to submit an annual return. The purpose is to enable the Pensions Regulator to collect a wide range of information about UK pension plans, including details of membership, sponsoring employers, administration, funding and investment results.

Employers to consult on pension plan changes

Starting April 2006, employers will be required to consult with their employees before making any material changes to their future pension arrangements.

Under draft regulations recently issued by the government as part of the reforms under the Pensions Act 2004, employers must undertake consultations with employees before making any changes listed in the regulations. In broad terms, these are changes that would increase the cost of the plan to employees or reduce the value of benefits provided for future service. The draft rules specifically require consultations in the following situations:

- an increase in the age at which benefits become payable;
- closure of the plan to all or certain categories of prospective members;
- cessation or reduction of future accrual of benefits, or conversion from DB arrangements to DC arrangements;
- a requirement for members to contribute or a material increase in their current contributions.

Some flexibility

The draft regulations give employers some flexibility in selecting a partner in the consultation process, provided they talk with representatives of the plan members who will be affected. They can choose trade union officials (if any), representatives specified in negotiated agreements, representatives specifically elected for the purpose of the particular consultation exercise or, if none of these exist, they can consult directly with affected members.

The consultation period must last for at least two months.

Implications for employers

Until recently there was no statutory obligation for employers to consult on any matter other than in circumstances such as collective layoffs and business transfers. This has changed as a result of a European employment directive. Starting April 2005, employers must put in place information and consultation procedures about developments in the workplace if requested to do so by more than 10 per cent of employees. The matters to be covered, the method and timing for exchanging the information and other aspects of the consultation process are left to the employer and employees to negotiate.

If the draft regulations are passed in their current form, however, the new requirement to consult on pension changes will be mandatory — whether or not employees request it and will become effective April 2006 for employers with 150 or more employees in England, Scotland and Wales. Those with fewer than 150 employees will have until April 2007 to comply; and those with fewer than 100 until April 2008. Employers with fewer than 50 employees will be exempt.

Consultation does not equate to negotiation, so this change does not mean that employers will be forced to negotiate on pensions if they do not wish to. Although employers will still be able to override employee objections, the process does imply having an open mind and a willingness to consider employees' views. The consultations can also be an opportunity for employers to demonstrate that they have acted reasonably on changes to employees' contractual terms and conditions.

The requirement to consult will need to be factored into employers' communications with employees. Many employers will already have procedures for employees to convey their views to employers and will be able to use these procedures to comply with the new consultation requirement. Others will need to conduct elections to appoint employee representatives before starting the consultation process.

Republic of Ireland

Pension reform law alters rules for employers

Employers in the Republic of Ireland will have to adapt to new minimum funding rules, along with new plan administration and trustee oversight rules, under the Social Welfare and Pensions Act 2005. The new law is designed to strengthen the security of the country's pension plans and incorporates changes to comply with the EU pensions directive.

Multinational employers may also welcome the new tax relief measures for members of overseas plans who are transferred to the Republic of Ireland.

The key changes, which are expected to be effective starting September 23, 2005, are:

Plan funding and administration

- In the Republic of Ireland, plan sponsors must adhere to a minimum funding standard that requires them to have sufficient assets to fully cover liabilities, based on prevailing values in the event of a plan termination. There must be a recovery plan to eliminate any deficit within three years, subject to approval by the Irish Pensions Board. Under the new rules, employers may file for an extension of the three-year period if they can show underfunding due to an increase in liabilities — previously applications could be made only on the basis of poor investment returns. However, an extension will be granted only in certain situations and only if it is determined to be in the interests of members.
- Plan trustees have been given the power to veto the award of early retirement pensions if they believe that this would be detrimental to the funding of the plan. This power overrides plan rules and any right of decision by the employer. Trustees already have the power to pay less than full value in the event of a departing plan member requesting the value of the accrued benefit to be transferred to another plan.
- To comply with EU law, actuarial valuations of defined benefit plans must be carried out every three years, rather than the previous requirement of every 3½ years.

Investments: Trustees must prepare and maintain a statement of investment policy principles. They must continue to invest in line with the prudent person principle and are banned from borrowing, except when the plan needs liquidity. Most assets must be invested in regulated markets.

Standards for trustees: Plan trustees and/or their advisers are required to have sufficient qualifications and experience. The specific regulations will be issued later.

Cross-border membership: In line with the EU pensions directive, Irish employees will be allowed to join a plan established in another EU country, and members of EU plans may join an Irish plan. However, the plan will have to comply with the social, labour and investment laws of the employees' home country.

In addition two tax changes give practical help to cross-border membership.

- Under the Finance Act 2005, an employee who is transferred from another EU country to Ireland may obtain 'migrant worker' tax relief on contributions to an overseas plan, subject to certain conditions. In particular, the employee must already have been a member of the overseas plan, and the contributions must have been eligible for tax relief in the EU country from which the employee was transferred. In addition the EU country must have fully complied with the EU pensions directive.
- The Irish tax authorities have relaxed their rules on the transfer of pension plan benefits to overseas plans. In broad terms, the transfer can take place if the overseas plan provides similar benefits and if it is a EU plan, subject to the provisions of the EU pensions directive.

Implications for employers

Employers with underfunded plans will need to discuss a funding strategy with the plan trustees to ensure that the trustees do not block early retirement pensions (which often cost more than

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the 'reserve' held for them in the plan and can make the underfunding worse). They may also wish to review and discuss investment policy principles, which may impact plan funding, with the trustees.

In view of tax changes, multinational employers may wish to take the opportunity to review their pension plan

policy on the transfer of employees within the EU, particularly employees transferring to the Republic of Ireland.

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