Headlines

Worldwide Pay and Benefits

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International

Companies adhere to HR strategies in Latin America

Major companies doing business in Latin America continue to pursue human resource policies that link employees closely to long-range corporate objectives, despite the economic turbulence that has afflicted much of the region in the last year.

This is one of the principal findings of a recent Towers Perrin survey, which asked human resource executives from US-based multinationals and other companies operating in Latin America to assess regional trends in salary and benefits and to comment on how they are seeking to implement policies that help their companies meet performance targets.

The survey results show how companies in the three biggest economies in Latin America — Mexico, Argentina and Brazil — are moving forward with HR policies that link employee performance to corporate measures of success. In doing so, they are helped by government policies that, although not always without direct costs that must be shouldered by employers, at least in overall tone and direction remain positive as far as the companies are concerned.

According to the survey (see Table 1 and Figure 1), growth remains the top priority of most major companies doing business in Latin America. More than four out of five (83 per cent) of the

respondents put maintaining growth at the top of the agenda, and nearly as many (79 per cent) said a top priority is increasing the pace of growth.

Despite the weak economic conditions in much of the region, most companies seemed to be avoiding pressures to slash operations and overhaul their business in dramatic fashion. Fewer than half of all respondents (48 per cent) listed cost cutting as a major priority, and only slightly more than a quarter (28 per cent) said they are focusing on restructuring business.

Intensifying competition — both for customers and for people with the skills and competencies needed to drive growth — is among the barriers cited most often by respondents in their drive to achieve key business goals in the region. There is a shortage of skilled talent, a situation that is increasing the use of stock options and other forms of variable pay to recruit and retain key executives. There is also growing interest in long-term incentives and global pay measures which can be applied to senior executives and, in some cases, mid-level managers with responsibilities considered crucial to company performance.

In general, the findings highlight the determination of major businesses operating in Latin America to continue pursuing human resource programmes that align employee rewards with strategic corporate objectives while recognising individual performance. For example, over two-thirds of 1999 survey respondents agree that their HR

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Table 1: Current economic and HR trends in key Latin American countries

	Mexico	Argentina	Brazil
Economic trends	Economy doing better than expected Peso recovering from 1998 devaluation Inflation around 15% Top personal tax rate raised to 40% Union power waning	Hit by recession as a result of Brazil crisis Currency lifted by rising dollar Ongoing trade deficit Large increase in budget deficit Employers paying lower payroll taxes	Little GDP growth Sharp devaluation of local currency Inflation receding after initial run-up Government budget under stress High unemployment
Human resource trends	Growing use of variable pay and changing performance measures Increasing interest in long-term incentive plans Social security system being practically privatised Ongoing shift from defined benefit to defined contribution plans Focus on cost-containment measures in health care system Asset management companies moving in	Deferred salary schemes becoming widespread Executives learning that they do not have lifetime jobs Employees adapting to new, private social security system Companies pegging union wages to productivity gains Multinationals extending stock option plans Medical plan costs rising	Globalisation creating intense pressures for companies Lack of people with needed skills Companies realigning benefit and compensation packages Higher inflation stirring employee wage demands Growing use of variable pay, long-term incentives Executive compensation levels being restored

Figure 1: Top business priorities in Latin America

programmes are effectively tied to business goals, and more than three-quarters (76 per cent) say that their Latin American employees understand how they can make a difference in helping achieve company goals.

At the same time, the survey also reveals that major companies operating in the region have more ground to cover with some issues. It is perhaps no surprise that nearly half of all respondents indicate problems recruiting professionals with the necessary skills. But the survey also finds only slightly more than half of those participating (52 per cent) believe that their company has sufficiently flexible human resource programmes to meet the changing needs of the region. Moreover, there is evidence that companies need to do more to explain how much they set aside in benefits and other resources for employees. Only slightly more than a third (37 per cent) say that employees in Latin America understand the financial value of their total rewards package, and slightly fewer (33 per cent) say their organisation effectively communicates pay and benefit programmes.

Still, it is clear that, overall, many major companies in Latin America continue to record progress in terms of adapting their human resource programmes and approaches to the rapidly evolving business climate in the region. Indeed, it can be argued that by taking such approaches — for example, by relying more on bonuses and other flexible rewards — companies have been able to insulate themselves somewhat from the economic shocks of the last year to the extent that these devices were adjusted to reflect setbacks in business. Moreover, it also seems that employees themselves are increasingly aware of market fluctuations beyond the control of their company — and willing to adjust their expectations accordingly.

We find little evidence that companies in Latin America are turning away from the set of sophisticated HR policies and programmes that better serve not only corporate long-range needs but, in many cases, the employees themselves who seek recognition for their performance. This finding probably reflects the increasingly global scope of competition, but it should also encourage both business leaders and workers in the region.

Belgium

Funding levels for pensions changed

Higher minimum funding levels for defined benefit plans operated by pension funds and unallocated insurance contracts will require employers to reassess their benefit and funding strategy.

Minimum funding levels applicable to Belgian pension funds (effective 1st January, 1986) and unallocated insurance contracts (effective 1st January, 1993) have been raised as of 1st July, 1999.

The change will mean significant increases in the minimum reserves required to finance benefit promises — for example, for an employee aged 45 who is promised a single life annuity payable from age 65, the increase in pension fund reserves will be as high as 68 per cent for men or 80 per cent for women, and 30 per cent for men and 31 per cent for women in the case of unallocated insurance contracts.

There will be transition periods to eliminate underfunding — eight years for unallocated insurance contracts and 20 years for pension funds.

However, there is no transition period for individual terminations of employment prior to retirement. Therefore, defined benefit plans with vested benefits equal to, or only marginally higher than, the old minimum

reserves will be seriously affected by the new requirements. Indeed, the transfer value to which the terminating employee is entitled must be at least equal to the new minimum reserve.

Employers who are not prepared to accept the ongoing added cost of the new minimum funding levels will need to amend their defined benefit plans without delay. This implies that:

- the works council or, in its absence, the health and safety committee must be involved
- all employees must be kept informed in the absence of a council or committee.

These new requirements will inevitably quicken the recent trends in Belgian benefits toward:

- unisex lump sum promises in lieu of pension promises
- defined contributions in lieu of defined benefits or in combination with reduced defined benefits.

Netherlands

Revision of the Act on Pension and Savings Funds proposed

The proposed Bill will result in amendments to the Act on Pension and Savings Funds that will affect the financing and management of pension funds. The most important of these changes are:

- *Funding required for service-related benefits.* Service-related pension rights must always be financed. Existing past service must be financed within a period of ten years, although the Insurance Chamber will allow an extension of this in the event of severe financial difficulties.

- *Small pension funds will be under an obligation to reinsure their pension commitments with an insurance company.* This applies to pension funds with fewer than 100 members and also to large pension funds where the sponsoring company is no longer in existence.
- *Board members of pension funds will have to comply with certain quality requirements.* At least two people will have to be involved in the day-to-day running of a pension fund. The Insurance Chamber will check the competence and suitability of the nominated people, and the Insurance Chamber must be notified of any intended changes in the membership or management of the board. Pension funds should also have a code of conduct for board members and staff to prevent any conflicts of interest or abuse of information.
- *Supervision of the Insurance Chamber will be enhanced.* The Insurance Chamber will be able to instruct the board on pension fund management issues and notify the members, council and organisations of employers and employees about the contents of these instructions. Instructions can be enforced by means of a reprimand or fine. As well as having the power to appoint a trustee, the Insurance Chamber will also be able to appoint an independent financial supervisor to oversee and approve the implementation of these instructions. The Insurance Chamber will have enhanced powers over direct insured pension commitments.
- *Every pension fund will have to draw up an actuarial and operating memorandum.* In the case of a fully reinsured pension fund, the contents of the memorandum can be limited to: mandates, organisation charts in relation to implementation,

responsibilities and reinsurance policies. In the case of a self-administered pension fund, the memorandum should also contain investment policies (including derivatives) and an actuarial report. In addition, new pension funds should provide an opening balance sheet, as well as an estimation of income and expenses.

- *There will be a notification requirement for the accountant and actuary.* The accountant as well as the actuary will be obliged to provide the Insurance Chamber with the necessary information on any circumstance that is in conflict with the Act, or may endanger the payment of pension promises.

The Bill may be amended further during its progress through the second chamber of Parliament.

New Zealand

Compulsory superannuation scheme in near future?

With an election due shortly (in November 1999), press speculation is rife about how a new government might tackle retirement savings.

The two main political parties are: the National, currently in power, and Labour. The National Party is talking about continuing the current tax-neutral voluntary regime, but possibly reviewing the removal of some of the tax disincentives for lower-rate taxpayers, which essentially means continuing current policy with no major new initiative.

The Labour Party has raised two areas for possible policy changes:

- Establishing a fund that would finance individuals' future state-provided

superannuation. This has been prompted by the realisation that the effect of demographic change will be a fall in overall spending on state-provided superannuation in the short-to-medium term, but an increase in the longer term. One strategic response is to leave current income tax rates at around their current levels and channel the excess income into the fund that Labour is proposing.

- A major review of taxation, possibly leading to some form of limited tax incentives for retirement saving.

Curiously, the catalyst for change could be the deterioration in New Zealand's current account deficit with the rest of the world. Economists blame the deficit on New Zealand's low level of savings, and the Institute of Economic Research has said, in its latest quarterly report, that correcting the deficit will probably require some form of compulsory superannuation scheme. This is not a new idea, having been mentioned by the Minister of Finance back in 1998.

For employers who may be reviewing their superannuation arrangements, the possibility of some form of government encouragement or compulsion is obviously a factor in favour of continuing with superannuation.

Spain

Unit-linked products: Tax treatment clarified by officials

Companies considering channelling private pension plan commitments through an insurance policy (or companies that have not yet chosen a funding vehicle) now have a new funding alternative within group insurance arrangements: unit-linked contracts.

Although unit-linked products are well established in other countries, they were not previously particularly well developed in Spain, primarily because they were not specifically regulated and there was some uncertainty regarding their tax treatment. In July 1999, the Ministry of Economy clarified the situation by reporting that all unit links that met certain requirements would be considered as insurance contracts for all purposes.

All large banks and insurance companies in Spain have already started offering this new type of product and are expecting a huge demand. Unit link is basically a life insurance product where the money is deposited in investment funds. The policyholder may choose the investment strategy and modify it at any time without any tax repercussions. Benefits have the tax treatment of a life insurance product.

Investment strategy

Traditionally, companies that chose an insurance contract as the funding vehicle for their pension commitments used policies that had a guaranteed technical interest rate (increasingly lower) and, in addition, profit sharing. However, the net return obtained is usually low, since the insurance companies commonly establish a fairly conservative investment strategy with the aim to, at least, reach the guaranteed rate. This situation could change drastically with the introduction of unit links.

Policyholders can choose the investment strategy that best meets their needs and modify the asset mix at any time. Logically, a sensible choice of the asset mix will result in a higher return, which will be to the advantage of the company — lower costs in defined benefit (DB) plans — or the employee — higher benefits in defined contribution (DC) plans. However,

choice is limited. All unit links have set up one of the following options:

- *Choice among investment funds.* Each unit link establishes a number of investment funds from which the policyholder may choose.
- *Choice among preselected asset mixes.* Each unit link establishes a number of preselected mixes (which are designed to provide the highest expected return at a given level of risk, eg, conservative, moderate, aggressive) from which the policyholder may choose.

It is important to note that, if a company wishes to use a unit link to fund a private pension plan, the company would be the policyholder and choose the investment strategy. In this case, employees would not be able to choose their own asset mix. However, the company could voluntarily establish methods to allow employees to participate in the investment decisions.

Although the transfer of funds from one mix to another or from one investment fund to another has no tax effect for the policyholder or the beneficiaries, and funds may be transferred at any time, some banks and insurance companies do apply fees per transfer.

Tax treatment

If a company finances its pension commitments via group insurance, it can either take a tax deduction for the premiums and impute the premiums to employees as current taxable income, or defer the full tax deductibility until benefit payments are made and not impute the premiums to the employees. In the latter case, which is the most common, benefits from insurance policies (and, therefore, from unit links) are taxable to the employee at the marginal

rate but the taxable amount is reduced by 40 per cent.

Amounts are not taxed to the beneficiaries until withdrawn; hence the policyholder may switch from one investment fund to another or from one asset mix to another without the beneficiaries having to pay taxes. The company will be able to take a tax deduction on contributions when benefits are paid.

Fees and commissions

There are two sets of charges for unit-linked contracts, since both the insurance company and the fund manager charge commissions and fees. If these fees are high, the advantages may not compensate for the increase in fees and commissions. Nevertheless, as competition increases, fees should decrease, especially for group policies.

Legislation

It is still not clear from a legal viewpoint whether unit links will be an option for all types of pension plans (DB/DC). Companies will therefore have to wait until the Rules and Regulations to the 1995 Pension Law are published to determine whether unit links are a viable alternative for their type of pension commitments.

In summary, unit links are a welcome first step towards the evolution of more sophisticated long-term savings products where individuals will have freedom of investment choice.

United Kingdom

Government proposes integrated tax regime for pensions

In its final consultation paper on stakeholder pensions, the government has put forward radical suggestions for an integrated tax regime to cover

stakeholder pensions, personal pensions and some money purchase occupational pension schemes (DC schemes).

The shape of the regime is similar to the current personal pensions regime (contributions limited by reference to age and earnings, but emerging benefits unlimited) with the important difference that contributions up to £3,600 per year can be made without reference to earnings. Indeed, it will not be necessary for individuals to have earnings at all. Occupational money purchase schemes will be able to make an irrevocable election to fall into the integrated regime and so be treated as a DC scheme. It is not clear whether it is the trustees or the employer who will be able to exercise this option.

Individuals will be able to be in more than one type of DC scheme, but they will not generally be able to be in a stakeholder scheme or any other DC scheme at the same time as being in a defined benefit scheme.

The overall effect of these proposals is likely to be a boost for DC provision.

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Clarification emerging on part-timers' pension rights

Thousands of part-time workers may win the right to join their employer's occupational pension scheme and have their membership backdated to 1976.

The test case of *Preston v. Wolverhampton Healthcare NHS Trust and Others* was referred by the House of Lords to the European Court, and the Advocate General has now given his Opinion as to how the Court should rule. On the two key issues, his Opinion is that:

— the six-month limit for bringing cases by former part-time employees is

- ‘reasonable’ under the principle of legal certainty and in the light of European Court case law, but
- the two-year limit on retrospective membership in an occupational pension scheme is contrary to Community law.

The Court usually — but not always — follows the Advocate General’s recommendations. If it does so in this case, such a ruling could have huge cost implications for many non-contributory schemes. For contributory schemes, the requirement to contribute could act as a considerable deterrent to anyone claiming backdated membership. Any part-timer who has left the job and not brought a case against the former employer will be prevented from doing so outside the six-month period. However, backdating may apply to anyone who is currently in service.

United States

Survey confirms HR moving to the Web

For most employers, the day-to-day activities of benefit plan administration represent a major expense as well as a challenge to carry out in the most effective manner. Increasingly, human resource administrators are finding ways to manage costs by using Web-based applications to handle benefit enrolment, savings plan (typically 401(k)) administration and other types of transactions.

According to a recent Towers Perrin survey, Web-based systems are gaining greater acceptance as an effective tool that improves plan administration, helps control costs and delivers better-quality service to employees. The survey of 74 large employers found that although voice response remains the predominant method of handling information in a

number of key benefit transactions, the Web is fast becoming the medium of choice for delivering these services.

Not surprisingly, managers continue to rely on paper-based transactions to handle employment events (new hires and other status changes) and salary changes. In these two areas, Web applications are hardly used at all, reflecting the multitiered approval process, security considerations and other special requirements that often make these transactions far from routine.

Our survey confirms the growing role that Web-based transactions have in the delivery of some key HR services to employees. By taking advantage of the Web, employers and plan administrators strengthen their ability to deliver self-service benefit transactions more efficiently than they would using voice or traditional paper-based transactions. Employees end up with information that is delivered quickly and accurately, which in turn strengthens their personal link to the organisation and gives them more time to do their jobs.

Companies seek to align directors’ interests with shareholders’ via stock compensation

Providing company stock to outside directors (members of the board of directors who are not employees of the organisation) has become more prevalent in the last few years as companies seek to align directors’ financial interests with those of shareholders. According to a Towers Perrin CompScan survey of approximately 100 mostly large North American companies, the vast majority of companies provide some form of company stock as a core element of compensating outside directors.

More than half of the respondents in the survey (60 per cent) make stock option grants to their outside directors

and about one-third (31 per cent) grant restricted stock. Most of the companies make such grants annually (85 per cent and 77 per cent, respectively). A small percentage make only non-annual grants (15 per cent and 23 per cent, respectively).

Roughly half of the companies surveyed take some formal steps to promote stock ownership among outside directors. The majority of this group (56 per cent) use specific ownership guidelines, such as a multiple of the director's annual retainer. A few companies set guidelines in dollar amounts (eg, \$200,000) or number of shares (eg, 1,000).

More than two-thirds of the respondents permit directors to defer compensation into stock-based investments. In most cases, deferrals must be tied to the company's stock, rather than to other investments. Cash retainers are the most common form of compensation deferred, followed by cash meeting fees.

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