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MULTINATIONAL EMPLOYER BENEFIT PLANNING

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- Corporate benefit function in a multinational corporation
- Design considerations in overseas programs
- Financing of non-North American benefit programs
- Special problems
- Recent significant legislative developments outside North America

MR. C. V. SCHALLER-KELLEY: The corporate benefit function is dependent on the organizational and power structure in the corporation for which that function works. It is also a relatively small part of a corporation whose principal object is to produce and sell goods.

The importance of the function may depend largely on the influence within the corporation of those senior executives who are interested in benefits. The senior executives with the closest interest will normally be those in finance, because benefits cost money, and those in personnel, because benefits may or may not motivate people. But sometimes the people interested will be lawyers or perhaps regional executives in charge of non-North American benefits, if the company is decentralized.

The importance of the corporate benefit function is also greatly affected by the competence, and the ability to communicate that competence, of the incumbents in the function. The credibility of the people in charge of the benefit function is essential if those people are to have the degree of independence necessary for personal satisfaction, creativity, and achievement.

I value creativity and its associated flexibility highly, especially in the offshore contexts, but I should also warn that the benefit function is bureaucratic; Parkinson's Law applies, "Work grows to fill the available time." Corporate executives can mistake visible change, preferably known to be initiated by themselves, as necessarily being a sign of

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progress when more cash pay or greater simplicity and efficiency might be better both for the corporation and its employees than yet another benefit program.

I am unable to generalize further without considering the questions facing the corporation. Many of the answers will have applications and effects much broader than the benefit function.

The answers can be combined in more than a thousand possible, reasonably logical ways and may vary from corporation to corporation depending on geography, size, shareholding, company history, available personnel, and even on the product; in other words, what has come to be called "corporate culture." Within a corporation, the answers may also vary geographically or by functional division. The answers may also have to vary within the corporation depending on people and times, respecting both business cycles and secular trends.

Alcan, for example, has had several greater or lesser reorganizations in my thirteen years with the company, sometimes greatly affecting the corporate benefit function and sometimes affecting it hardly at all. I have experienced that there are both advantages and disadvantages in each arrangement.

Some of the general questions are: Is the company centralized or decentralized? Is the centralization functional or geographic? Is international diversity genuinely an advantage or a disadvantage, and how is it perceived? Is the company structure inherently or artificially made, symmetrical or not symmetrical at all? Is the corporation a bold leader or a prudent follower? Are service departments, such as the corporate benefit function, attached to the corporate geographical or functional division with which they have the most contact? Answers to these will largely influence the structure of the corporate benefit function.

The corporate benefit function, whether local or international, must deal with three aspects: (1) design of benefits, (2) administration of benefits, and (3) investment. The latter aspect is, of course, irrelevant for most nonretirement benefits and where retirement benefits are provided almost exclusively by government (e.g. Singapore), or by multiemployer plans (e.g. France), or by unfunded book reserves (e.g. Germany), or where investment is under extreme government regulation (e.g. India). The legal aspects can come under design, administration, the corporate legal department, or can be handled by outside advisors. The accounting aspects of benefits can be grouped either with administration or investment, while the actuaries are usually independent consultants but may be in-house, like Alan Cooke and myself.

The company's attitude toward functional and geographical centralization will have its influence on benefit plans and this need not be the same for retirement benefits as it is for other employee benefits. For example, Alcan, in principle, requires head office finance and personnel department approval implementing or amending any retirement arrangement unless the action (1) is the minimum required by law, (2) is part of labor negotiations, or (3) is ruled by Alcan's chief actuary to be a minor amendment. The rules about when head office approval is needed are, at Alcan and many other companies, part of the company's system of financial control which applies to other capital commitments. The amount subject to approval should reflect more than one year's normal cost as well as the accrued actuarial liability. Nonretirement employee benefits require no head office approval at Alcan. Even when approval is not essential, prior consultation with the head office is common, especially for retirement benefits. It would clearly be embarrassing if a union somewhere obtains some pension feature, the inclusion of which, in another plan covering unionized or management employees, is being resisted tooth and nail by management.

Both finance and personnel departments, at the appropriate levels depending on the company's structure, have a serious concern particularly in retirement benefits. The relative influence of the two departments may determine the reporting arrangements of various aspects of the corporate employee benefit function at various levels and locations. For example, my contact at Alcan New Zealand is the chief financial officer. While I could not remember the name of the chief personnel officer in New Zealand, precisely the opposite applies at Alcan Australia. Administration of employee benefits may be considered by the company as mainly number-crunching, or, alternatively mainly dealing with the right people. In the latter case, reporting lines are likely to be to personnel, and employee annual statements are likely to be more prevalent and personalized even when not required by law.

Where do in-house actuaries fit into the picture? This again depends on the company structure and emphasis. Alcan emphasizes people and the plan design aspects of the actuary's work, and hence, actuaries report to the corporate vice-president of personnel. The in-house actuaries of most other companies report to finance.

In the context of a multinational company's operation outside of North America, the corporate headquarters benefits staff will probably perform some or all of the following, sometimes conflicting roles:

1. They must be a resource of benefits expertise available to both headquarters and local executives to oversee:

    a. benefit design,

    b. cost figures,

    c. choice of local consultants,

    d. compliance (particularly of the head office country),

    e. investment of pension plans, and

    f. choice of investment media.

2. They may help in writing or by advice, with establishing guidelines for the limits to acceptable plan design. However, the only time Alcan tried to write down guidelines, we found the numerous exceptions obscured the thrust of the guidelines, and ultimately,

the project was abandoned. Strangely, although the product was useless, the process for me was most educational.

3. They will consolidate information for use of head office management and accountants.

4. They may be a resource in establishing administration of plans abroad.

5. They may administer foreign plans in the headquarter's country if the foreign subsidiary is not able or willing to do so.

6. They will try to keep the insurance companies and other suppliers of services honest (e.g. by multinational pooling).

7. And finally, they will try to ensure that internationally mobile employees are fairly treated.

In my opinion, the best way of achieving the desired results is by personal contact, rather than by relying on written rules. This is a fluid field of endeavor where finding the best solution can be like trying to nail Jello to the wall.

MR. RICHARD A. C. LAWREY: As an actuary and consultant, who encounters many different corporations in North America and Europe, I have also observed that the way in which external consultants are used depends much on the corporate culture and the experience of the in-house benefits management function.

As background, the advice sought by corporations in the international benefits area falls mainly under five headings:

1. Advice on policy making--in developing and monitoring corporate guidelines for the design and financing of foreign benefits programs.

2. Advice on expatriate benefits and compensation--including advice on establishing and financing pension plans for expatriates and Third Country Nationals (TCN). A TCN is an employee who originates from one foreign operation and who is employed by another. A Frenchman working in the U.K. for a Canadian multinational would be an example.

3. Advice on international actuarial valuations--may be required by accounting or tax regulations such as Federal Accounting Standards Board (FASB) 36 or Section 404A in the United States, but may also be requested by an employer to identify hidden liabilities in foreign pension plans, and other postretirement benefit plans, in the normal course of business and often prior to an international merger or acquisition. They also are sometimes needed after the acquisition.

4. Advice on financing of international welfare benefit programs --typically entails reviewing the efficiency of the insurance

networks which are involved in multinational experience rating of these programs, and then negotiating with these networks on a client's behalf. However, at the same time, other risk management techniques, in addition to pooling, might be reviewed.

Mr. Schaller-Kelley mentioned the use of multinational pooling via an insurance network to keep the local domestic insurers honest. Consultants are used to keep the insurance networks themselves honest, since there can be a significant variance in the way that each network uses the clients' premium dollars.

5. Advice on foreign domestic consulting--general advice in relation to the employee benefit plans operated by the multinational's corporation foreign subsidiaries and affiliates.

In providing these five areas of international advice, consultants may take different roles for different clients; they may be:

1. initiators of advice to the corporation,

2. independent reviewers of advice provided by in-house or other external consultants, or

3. coordinators of information and advice obtained from different local countries.

When considering the roles of consultants, it is important to distinguish between: (1) consulting to foreign domestic corporate management and (2) consulting to international corporate management. Domestic management appoints local consultants to advise on purely local issues in the country in question. However, among larger multinationals, it is becoming increasingly more common for the international corporate benefits function to have the right of veto on local consultant appointments and, in some corporations, international corporate management would become heavily involved in the process of selecting a foreign domestic consultant.

Some international companies, particularly in Europe, may go no further; they may simply engage domestic consultants, without appointing a consultant (either in-house or external) to provide advice to international management.

The role of the consultant to international corporate management is altogether different from that of the domestic consultant. He will be involved in advising on truly international projects, such as, advice on benefits for expatriates, advice on preparing and coordinating exhibits for international actuarial valuations, and advice on the general design and financing of retirement and welfare benefit programs. However, he will also be involved in reviewing and monitoring the local pension levels and the adequacy of financing these programs. This is an attempt to keep the foreign subsidiaries and their consultants honest, so that they operate within such guidelines as may apply to them.

In addition to the level of expertise of the corporate benefit manager, the involvement of consultants to international management is also typically influenced by two further factors. The first of these is the money level of the corporate benefits function. Some companies will deliberately trim their corporate benefits staff to avoid the Parkinson's Law syndrome mentioned earlier. These companies use consultants more because of this. The second influencing factor is the extent to which consultants are asked to provide independent confirmation of the opinions of corporate benefits managers, often for political reasons.

MR. DENIS J. DEVOS: I work for a Canadian insurer that is not part of a network, but we're often asked to insure TCNs and foreign nationals themselves in the countries from which they originate, adding up to about a dozen people. What do you recommend for your client in these situations?

MR. LAWREY: Is the question related purely to insurance programs, or does it relate to retirement programs in addition?

MR. DEVOS: Normally, this is not for retirement programs. The benefits include life, long-term disability (LTD), health, dental, and short-term disability.

MR. LAWREY: There are a number of insurers that will establish and operate insurance programs based in certain offshore locations, such as Bermuda and the Channel Islands, and these are quite effective from an insurance viewpoint. There are however, potential problems in certain local countries if the insurer is not admitted locally for providing benefits. In practice, we would always make an employer aware of the fact that there were these potential local problems, but the employer generally would decide to establish a program on an offshore location rather than try to establish some local programs to cover expatriates.

MR. DEVOS: Let's say it was a Canadian employer, would he be covered under the Canadian Plan?

MR. LAWREY: I cannot speak for Canadian employers, but I can certainly say that for U.K. employers, Bermuda and all the Channel Islands would be a favorite location providing there was no problem with Canadian regulations.

MR. GREGORY T. GLASHAN: As for Canadian employers, there could be a problem in terms of the plan design of your domestic operation and a problem of whether you are legal.

As I understand it in Canada, whether you are legal is not going to be a problem, but it could be a problem in the U.S. for insurers who cover non-Americans overseas. They might be violating laws in the U.S., apart from violating the laws somewhere else. When you go to an offshore fund in Bermuda, you are eliminating the illegal aspect of violating the laws in your own country, but you haven't resolved the problems of being illegal somewhere else.

MR. DEVOS: Do you bother about those problems, or do you ignore them because there is only one or two people involved?

MR. LAWREY: We would certainly advise our clients of the potential problems. It would be up to them to decide whether they wanted to use a central fund which might be illegal or whether they wanted to go to the additional expense of establishing a local arrangement.

MR. GLASHAN: There is an old adage that TCNs are 1 percent of your employees and 99 percent of your headaches.

MR. DEVOS: How do these companies adjudicate disability claims in those situations? They don't have facilities in those countries, and it is pretty difficult if you are a thousand miles away to adjudicate a disability claim.

MR. LAWREY: Typically the plans that are operated would be corporate. Are you talking about medical or purely disability?

MR. DEVOS: Purely disability.

MR. LAWREY: You would need to use some local doctor or accept the fact that claims administration would tend to be less tight than out of your local clients. Generally, I think Mr. Glashan's comment is correct in terms of TCNs causing 99 percent of the problems and perhaps only being 1 percent of the work force.

MR. SCHALLER-KELLEY: Bear in mind TCNs aren't necessarily going to be the most unhealthy group. Your employer may be large enough that it will be largely experience rated, and so, on that basis, the insurer may not care greatly about whether everything works out exactly perfectly. Since these TCNs represent only 1 percent of the total population, and if the 1 percent has twice the bad experience of the others, it's not the end of the world.

MR. DEVOS: What we're finding with a lot of the Canadian consultants is that because they don't know much about TCN benefits, they are asking us to pool them. This then creates problems for us, because we don't know much about TCN benefits either. I agree with you that if everything is totally experience rated, it's not much of a concern.

MR. GLASHAN: In each country, the employer is faced with a decision of how to fund the benefits he is going to provide. In most of the English-speaking world, the concept of paying for a retirement plan via a trust with a managed fund and an actuarial valuation using various assumptions is well understood and practiced. Generally this is not true in the rest of the world. Frequently pension plans are book reserved. In Germany, an employer can receive a tax deduction using the book reserve method, so plans are frequently unfunded. In other countries, the employer could be able to fund his retirement plan but then might not be able to achieve a real rate of return on his pension assets and, therefore, may choose not to fund his pension plan anyway. Administrative Services Only (ASO) contracts, cash-flow arrangements, and so on are rarely practiced outside North America, for life, medical, and disability plans. In general, full insurance is practiced more widely in these countries than in North America.

I work for a network, and I will tell you a bit about how one works and why networks are so common. In 1983, the International Benefits Information Service (IBIS) did a survey of 55 American multinational companies; 51 of the companies (93 percent) had multinational pools. In 1984, IBIS did another survey of 44 sophisticated European multinational companies; 35 (80 percent) had multinational pools.

To my knowledge, no one has done a survey to determine exactly what countries are included in the multinational pools, but I suspect that few surveys have the U.S. or Canada included in the pool.

I would like to address the following topics:

1. What is multinational pooling and why did it come about?

2. What are the mechanics of pooling in certain special situations?

3. Why have the U.S. and Canada generally not been included in the multinational pools in the past, and why, in a limited way, will this be more so in the future?

Multinational Experience Rating

Experience rating in the U.S. is not new. In fact, experience rating of workmen's compensation benefits was well-established before World War II. Experience rating techniques were developed to provide benefits at equitable and competitive costs. Competition forced the development of experience rating. Experience rating across international boundaries is also not new and has been practiced by Canadian and American insurers for many years when they routinely combined the group insurance business of both countries to determine overall retention and experience rating balance.

Multinational experience rating was born in the 1960s initially to meet the demands of U.S. multinational companies. Whereas in the U.S., these companies could seek out competitive bids for their group insurance plans in the U.S., they found that in many overseas countries, the insurance markets were not and still are not competitive. These companies met tariff rate structures set up either by the local country's superintendent of insurance or by the insurance cartel. By American standards, these rates were excessive.

I did a survey of the companies in my own network and asked them for the rates they would charge for group life, yearly renewable term rates for males age 25, 35, 45, and 55. In the English-speaking countries which are competitive, for example, at age 25, Australia charged 80¢; our Canadian company charged 84¢; our U.K. company charged 90¢; our Italian company charged \$3.91; our Japanese company charged \$2.88; and our Mexican company charged \$3.52. There is a tremendous difference in the rate costs, but there are not tremendous differences in mortality in most of these countries.

Direct comparisons are not really possible, but I think you can assume that if a country speaks English, the competition is permitted and rates are low. Otherwise the competition is restricted, and the rates are excessive. Of course, mortality rates vary by country, and this could explain some differences, but the presence (or absence) of competition is the real explanation.

Most countries have some form of profit-sharing structure and pay dividends on their contracts. These dividends can be a credit against future premiums or an increase in sum insured. Germany pays out dividends by increasing the amount of death benefit on a claim. Our German company recently filed and received approval for a tariff which pays a dividend equal to 100 percent of the sum assured, so most employers will insure only half of the amount that they normally insure to pay the full benefit. Belgium has a similar structure; the dividend is 30 percent, so most employers need only to insure 1/1.30 of the amount required.

A demand arose for a type of contract which could introduce competition into a structure which was up until then not competitive. The result was to form insurance networks and develop multinational pooling. The networks usually had one of the following structures:

1. An association of independent companies. These networks typically have a "secretariat" to coordinate the efforts of the network and an executive committee formed by the larger members of the network to set network policy.

2. A network composed mainly of the subsidiaries of one or perhaps two major insurers. Network administration and setting of network policy were determined by the headquarters of the main insurer[s].

3. An association of independent insurers with one lead insurer who typically coordinates the efforts of the network and sets network policy. The lead insurer might automatically reinsure, say, 50 percent of all the network's experience-rated business.

Multinational experience rating is usually called "pooling" and to discuss "pooled benefits" means to discuss benefits which are experience rated. In American insurance terminology, "pooled benefit" refers to benefits which are not experience rated within the local contract but rather are "pooled" with the benefits of other corporations in the insurance-company-wide experience pool. In some instances, a corporation may have its insurance rates increased or decreased due to the pool's experience. In a multinational pool, the benefits of the corporation in one country which are not experience rated locally are "pooled" with the benefits of the <u>same corporation</u> in other countries. While the conditions of the local contracts have remained the same in each country, the experience of all the countries can be pooled and experience rated, so a corporation can receive an international dividend based on the corporation's own worldwide experience over and above any local dividends.

Because of the financial advantage, the headquarters of a corporation is more likely to direct that the benefits of its subsidiaries in foreign locations use the insurance member of the network with which it has a multinational pool.

This is especially true in tariff and cartel countries where all insurers charge the same rates. To be a member of a network has seemed essential to some insurers in order to protect themselves against networks and, in most countries of the world, the key insurance companies of that country are now part of an insurance network and participate in multinational pooling.

The networks began to offer other services besides multinational pooling. These include:

1. higher free cover limits,

2. superior cancellation provisions,

3. improved control of benefits,

4. greater information on local plans,

5. improved conditions for transferring pension reserves between countries upon the transfer of an employee from one country to another,

6. products for TCNs, and

7. increased use of captive insurers.

The terms "second-stage account" and "second-stage dividend" are sometimes used to refer to the international pooling account and the international dividend, respectively. The first stage refers to the local account. In many countries, a local dividend is paid; this is called the first-stage dividend. At the end of each year, a second-stage multinational account is prepared to show the combined results of the local plans for the year, provided that minimum qualifying conditions for pooling are met--normally a minimum of two countries with a minimum number of lives insured. There may be a minimum premium requirement.

The purpose of the accounting is to determine whether the combined income for the plans is greater or less than the combined outgo. If there is a multinational surplus, a dividend will be payable; if there is a loss, the treatment of this will depend on the pooling system, carry-forward, or stop loss, which is in operation.

What benefits are included in the multinational pool?

1. Lump-sum death benefits, survivors' pensions, accidental death benefits.

2. Disability benefits including lump-sum, pensions (which are common in much of the world), long- and short-term disability (may be

called permanent health insurance in some parts of the world, salary continuation in others).

3. Medical benefits.

4. In some parts of the world, the multinational pool can include retirement benefits where annuities are still fully insured. These could be endowment contracts or deferred annuities. Obviously things like managed funds, deposit-administration contracts or a vehicle called controlled funding, which I think is unique to the U.K., are not included.

Where annuity payments are experienced rated, they could either be partially or fully experience rated. Under partial experience rating, the full value of a liability is charged to the multinational pool in the year in which the pension comes into payment and then excluded in the following years. A country like the U.K. has normally done it that way. Under the full experience rating method, the pension itself will continue to be experience rated in payment. Special care must be given to this point when the stop-loss system is used.

The implications of pooling retirement benefits are frequently not well appreciated by persons who are used to experience rating only on life, medical, or disability.

In a typical tariff country in Europe, the client pays a premium to an insurer for benefits which are then guaranteed. Under a strictly local arrangement, when an annuity dies, the release of reserve flows through to the insurer, while under multinational pooling, this release of reserve goes through as a multinational dividend. This death causes a mortality profit. Of course, each year that the annuitant survives, a mortality loss is generated in the account, although generally the annual losses are smaller than the one time gain on death.

While in a smaller group life plan, we see routine small mortality profits and then one big loss when a claim occurs, the reverse is true when we experience rate annuities. The phenomenon of a death causing a mortality profit also occurs in the deferred period, under two circumstances: (1) when premiums are calculated on a nonreturnable before retirement basis, they are effectively returnable by death, and (2) where the present value of the death benefit is less than the present value of the deferred annuity. This latter situation is especially common for older employees insured under combined tariffs such as in the Netherlands.

I have read and heard arguments on both sides as to whether a company should pool retirement benefits, and as in any good argument, each position has its strengths and weaknesses. If requested by the client, I think every network would exclude retirement benefits from the pool. However, I have heard of many instances where insurers have done their best to exclude retirement benefits from the pool when asked to pool coverages. Assuming that the insurers will opt for the method most profitable to them rather than the client, you can conclude that retirement benefits normally should be pooled.

I also like to point out that the profit and loss in a multinational account extends beyond mortality gain and includes all the factors in the traditional dividend formula of mortality, interest, and expenses.

If there is a surplus, it will be made available to the parent company, if it is not required to cover the loss brought forward from the previous year. If the pool is large enough, the full dividend will be payable. If not, payment may be made over a period of years. The practices of the various networks are different on this point.

The emergence of a surplus depends on actual experience being better than expected. Potential is greatest in tariff countries, where expected claims vary from 30-70 percent of gross premiums. In the competitive markets, the expected claims will be a higher percentage. The long-term potential for a pool depends on the countries involved and the benefits pooled, but the dividends can be significant. The treatment of a loss depends on the pooling system in operation. The ones that you will find offered by networks are as follows:

1. Stop loss over one year or a period of years. Under this system any loss at the end of the stop-loss period is canceled by the insurer.

2. Loss carryforward with a number of bases: unlimited loss carryforward, with a maximum carryforward amount, with a limited period of carryforward of a loss arising in a particular year, and, with a contingency fund.

No matter which system is adopted, the client should pay exactly the same premiums, as determined under normal local bases.

In the long run, the results of any system should be the same given that the risk charges of each system are determined on a consistent basis. Many employee benefit managers make the assumption that their company's experience will undoubtedly be better than average and so choose a carryforward system. I believe that if a survey were done, it would show that the vast majority of international pools are on a loss carryforward basis.

The client always has the option to cancel a loss carryforward pool which is in a loss position, leaving the insurers to meet the deficit. Even if the insurance companies and the network involved provide the best possible service at a competitive cost, a substantial loss in the pool may lead to cancellation, and to the switching of business to try to benefit immediately from future experience. I personally find it very frustrating to do all of those things and then have a big loss. Because neither the client nor the insurers are particularly happy when the account develops a large loss, I believe more attention should be made to the risks included in the pool. We think that we should not try to be greedy and pool all coverages, all countries, and all benefits on the assumption that the rates are excessive in all countries, and that by pooling we are guaranteed a large profit. Even tariff countries are subject to adverse claims experience. Based on the assumption that a multinational pool is formed to extract surpluses normally available in some countries, the international pool can be protected by taking the following precautions:

1. limiting maximum individual claims,

2. providing against an individual catastrophe,

3. providing against catastrophic overall claims by placing a limit on the maximum amount of loss to be carried forward, and

4. limiting the period over which a loss can be carried forward.

It may well be better to have a reduced potential dividend in good years in order to have additional protection against bad years. If a client does decide to cancel a pool, surrender values under pension contracts may be the full amount of the reserves shown in the account, if the pool has been in operation for a certain number of years. This surrender value may or may not be reduced by the amount of any loss carried forward, up to the normal local surrender penalty. This depends on network policy. I'd advise anyone looking into multinational pools to look at that point very carefully.

The practical problem for actuaries is that calculating a risk charge is difficult since one is involved with more than one country, with varying mortality rates, and with the inclusion of the benefits other than lump-sum benefits--retirement, disability, and medical benefits.

Under the loss carryforward system, an additional complication is the subjective nature of the probability of the client canceling a pool in a loss position. Cancellation will depend on:

1. the size of the loss,

2. the estimated period which will be needed to return to surplus position, given certain claims assumptions,

3. the ease or difficulty of switching local plans (switching is far more difficult when retirement benefits are involved), and

4. corporate attitude towards cancellation.

Blocked Currency Countries

For countries with blocked currencies, special procedures are required. A blocked currency insurer is prevented from sending money out of its own country to cover loss of another country and, thus, may not participate fully in the pool. Then the insurer in the blocked currency country may offer experience rating following network procedures, pay all surpluses locally, and in return, if the blocked currency country has a loss, the insurer will have a "first lien" on the surplus of the international dividend. The addition of a blocked currency country to a pool will not affect the risk charge to any hard currency countries.

Reinsurance to Domestic Insurer

In some instances, two networks will agree to combine their experience in order to lower their retention via a reduction in risk charge. Under this agreement, the client with two pools receives a lower risk charge from each network, and each network, in turn, has a first lien on the other network's dividend if the experience of the pool is negative. Insurope calls this a "Reciprocal First Lien" agreement, but others may have another name for it. This procedure differs from regular pooling agreements in that neither network shares in the loss of the other network.

In some instances, the networks will reinsure in whole or in part the risks of the pool to the client's domestic insurer. Effectively the risk charge for the benefits reinsured becomes that of the domestic contract which generally is significantly lower than the network risk charge.

Reinsurance to a Captive

In general, I have found a lot more talk than action in regard to reinsurance to a captive. Greatest interest comes from American and Swedish companies. Some of these arrangements involve a retrocession of excess risks back to the network so that, effectively, the captive receives the international dividends, but does not share in the risk. In either case, a time sharing of the risks occurs. There seems to be as many variations to this as there are captive insurance companies.

U.S. and Canada

A lot of insurers probably think they have never been or won't be involved in pooling. Initially, multinational pooling was most commonly used by American insurers for their overseas locations, and later, European and Japanese multinationals did the same thing. On the whole, the practice of including foreign subsidiaries in the multinational pool did not apply when the foreign country was the U.S. The reasons for this include:

1. A large portion of the group insurance program was health and dental insurance.

2. The U.S. market was complex.

3. American managers were independent.

4. The U.S. and Canadian marketplaces were competitive.

Nevertheless, some European benefit managers have insisted on treating Canada and the U.S. like any other country. In some instances, the American insurance companies have acted outraged and insulted that any further savings would be obtained by multinational pooling, over and above their own regular rate competition.

There are a few situations that I have encountered which have been pooled:

1. The case in North America is too small to qualify for local experience rating. Such cases can be pooled successfully some of the time. In general, I have tried to stay away from situations where the benefits pooled were mostly medical or dental coverage.

2. The client opts to pool the U.S. and Canada with overseas locations instead of having local experience rating because of the beneficial effects on the retentions on the overseas locations.

3. The case is experience rated in the U.S. on a competitive basis, but certain coverages such as group life are "pooled" above a certain amount. All the "pooled" benefits, or perhaps just life or a portion of the life, are experience rated in the multinational pool.

I have found, in recent months, increasing interest in this third situation, and while initially these cases were for European companies with American subsidiaries, American companies are now pooling their pool benefits in their international pool. I predict that European and Japanese benefit managers will become increasingly involved in the benefit programs with their North American subsidiaries, and that a growing market will exist for the insurers, consultants, and networks who adapt their North American operations to meet the needs of their overseas companies.

MR. BERNARD R. OUIMET: Regarding multinational pools and concerning the retention formulas or expenses charged by the insurance companies, does your client save overall in retention monies being paid to the insurers involved on this risk and are the expenses negotiated locally with each insurer or are they centralized? Concerning the honesty problem that has been referred to by all three panelists this morning, how can insurance companies hold dangerously low rates on the assurance that somebody somewhere is charging too much for and, therefore, draw from those surpluses in case the rates have been guessed too low?

MR. GLASHAN: Those are both good questions. Regarding the administrative expense question first, in many countries, there is no option to have multinational experience rating. Therefore the balance on a no-claim basis, in most countries, is that all the surplus is retained by the insurer. Any expense factor is better than a 100 percent confiscation, at least that is how the client sees it. Having said all that, various networks have different methods of determining their costs. Insurope has what is known as network scale costs based on the type of benefits involved and then a declining percentage of the premium. Under our method, there would be uniformity in the administrative expense between Japan and Mexico for identical benefits and premiums. As far as the second question, which is how do you stop someone from bidding too low, that ties back to one of the aspects of not being greedy.

Certainly, there are some countries where some insurers have quoted rates that were artificially low because they knew that they would be bailed out. Particularly, the French insurers, which have been, in some cases, dragged into pooling and in which medical insurance is significant, have charged rates which were too low and have caused a lot of grief to some companies who pooled out those benefits. Our position within our network is that a company decides to charge rates which are below proper rates, then it should not expect any company to pay for those benefits except itself. We have had one or two cases like that, but it is rare. Clients should be very careful on such matters. The U.K. market has people who will buy group life business. If that business is there and it is a big case, then if an insurer is prepared to charge rates that are below reasonable rates, you let that insurer have the business. You should not pool it. That is something that our secretariat won't allow in our pool; if the client insists, we will advise him that he is running a risk.

MR. LAWREY: In the U.K., there are insurers that are quoting rates which look very close to pure mortality rates. Consequently, many U.K. life coverages (disability coverages would be an exception) would not be pooled. Clearly any loss that would result from U.K. high claims is going to be transferred to profit from another country. There is therefore no real benefit. However, from time-to-time in order to make peace with the local U.K. subsidiary who may be used to paying very low rates, there may be pressures put on the multinational insurer, by the headquarter's operation, to reduce its rates in the U.K. in order for that coverage to be brought into the pool.

MR. SCHALLER-KELLEY: My experience with conditions overseas is mainly in connection with Jamaica, Trinidad, Brazil, Australia, New Zealand, Japan, Hong Kong, Thailand, Malaysia, Indonesia, India, and Ireland. The first thing to realize about benefits overseas is that many of the institutions and concepts which are considered absolutely basic to the subject may simply not exist in the foreign country or even in its language, or they may be quite disguised or distorted.

Who can feel comfortable in a country where the concept of "trust" is unknown, as in Thailand, or where, as until recently in Brazil, insurance companies do not sell annuities, or where the charging or granting of interest is illegal, as in some Moslem countries?

Sometimes you think that you recognize something, like the "qualified pension plan" in Japan; then you discover that irrespective of service, benefit is 50 percent of base pay, payable at age 55 for ten years certain and nothing thereafter. Should you then suggest delaying the retirement age to age 70? Do you want to bankrupt the company? Don't you realize that employees can continue working after retirement age?

The Japanese typically go into incoherent agonies when a stupid foreigner asks a direct business question to which they have no immediate, accurate, and sensible answer. So it may take you some time to discover that the "qualified pension plan," whose benefits incidentally can be commuted to cash, is a way of funding a part of the traditional Japanese lump-sum retirement allowance payable at the age at which the employee ceases to work for that part of the company which gives automatic seniority bonus pay. That is why delaying retirement makes the benefit more expensive in Japan. The arrangement starts to look moderate and reasonable when you learn that the main company involved only hires straight from school or college and that base pay can mean less than 50 percent (in some cases 30 percent) of total cash remuneration.

Japan may be the extreme case of culture shock, but it serves to illustrate what can happen. Even in Germany a "Pension Kasse," which literally translates as a "pension fund," is actually a captive insurance company and is regulated accordingly. Suddenly, by contrast, you realize how long and strong a tradition of absorbing English business law there is even here in Quebec.

Even the most centralizing company must make some allowance not only for local law, but also for local practice. Sometimes local practice is fairly clear, but unacceptable. A mild example used to be in Brazil where companies either had no private pension plan and relied on government mandated programs or had pension plans similar to the large paragovernment corporations whose plans paid 100 percent of final average pay inclusive of social insurance. Neither of those choices were acceptable to us.

Sometimes there is no identifiable local practice in the private sector, yet there is the old gentleman, who was vital in setting up your business and whose positive influence in the community must be retained, who has reached the civil service retirement age. (You can always trust the civil service to have the first pension plan.) You may have to take a deep breath and rely on your instincts and those of your local colleagues. It may be cheaper to make a mistake than to travel to Indonesia a second time. You may not be able to find useful local consultants or consultants in neighboring countries who have a fair idea of what to do. Consultants in Hong Kong, for example, tend to be familiar with the whole of Southeast Asia. However, sometimes the only local actuaries available are university professors with insufficient business experience. That used to be the case in Brazil until Andre de Montigny and Towers, Perrin, Forster, and Crosby set up shop in Sao Paulo. Sometimes all potential local advisers are tied-in with insurance companies or trust companies, and the adviser is synonymous with the choice of funding medium or even the plan design.

You may also find that the advice on a factual matter is contradictory. For example, advice on the tax deductibility of book reserves of a pension in Hong Kong may be different, depending on whether you listen to your actuary (who probably has the most experience) or to your auditor (whose approval is necessary for your company accounts).

Some countries have surprising rules for retirement plans. In Brazil, when an employee leaves employment covered by a contributory pension plan, he is entitled to continue active membership in the plan for all future salaries from his new employers, provided only that he contributes both employee and employer contributions. In Brazil there is no vesting required, nor indeed usual, for participants terminating before retirement.

One must consider government social insurance benefits in designing retirement programs. But what do you do if parts of your plan's net benefits are subject to a surcharge of tax up to the amount of the social insurance benefits, as is the case now in New Zealand? Is an integrated plan then still a reasonable plan design? In many countries as diverse as Jamaica, Thailand, Italy, and Brazil, any person losing a job is entitled to severance pay in addition to notice (or payment in lieu of notice). How, if at all, should this be integrated with the retirement plan? It is always worth finding out whether severance pay has to be paid in addition to pension. Then how do you treat local government "Provident Funds," (they are like a savings plan), particularly if it is possible for employees to borrow against the fund or to draw from it for housing as well as unemployment and retirement?

Tax constraints imposed on retirement plans by various countries make a weird and wonderful, multiple and moving kaleidoscope. Hong Kong forbids full vesting in less than ten years; the U.S. sometimes requires it.

Foreign exchange controls may also have an effect on your plan design, particularly if they are combined with a local investment market in which the yield on investment, except on the most risky kind, is always outstripped by the salary increase rate.

The ability to fund your benefits on a profitable and tax-advantageous basis may influence your plan design. Don't assume all governments give tax favors to retirement plans. Many countries have investment restrictions such as minimum investment in government bonds. Some restrictions may be intolerable. An unfunded supplemental plan to bring benefits in line with final pay, may be desirable, but illegal. And how do you determine the real long-term cost of such a plan if salary increases are expected to outstrip interest? The usual methods can lead to absurd results; all actuarial formulas go upside down. This is a fruitful field for research.

What if there is a risk of expropriation either without compensation or with worthless compensation? For example, compensation may be in local currency, in low interest notes, based on an asset value less accumulated depreciation, or it may be in the form of goods which compete with your own product and for which you cannot find a buyer. Perhaps an unfunded plan is preferable so that liabilities as well as assets are expropriated, but they cannot have employee contributions.

The design of any plan will also be influenced strongly by the ability to administer a plan locally in the case of developing countries or small local companies. The concept of proper accounting for an unfunded pension plan is likely to present considerable practical problems. Alternatively, distance and compliance with local laws make head office administration impossible, even if the company's policy does not forbid it.

Once these local difficulties have been at least adequately studied, head office policies will have to be examined for compatibility with local circumstances. The head office may forbid automatic cost-of-living adjustments; Brazil requires them; the resulting choices are few. The head office may insist upon, or at least prefer, integrated plans, employee contributions (or none), and pensions rather than lump-sums. The head office may refuse, or at least resist (or perhaps insist upon) employee loans or investment in the employer's securities or employer-occupied real estate. A final-pay pension plan for unionized employees may be an anathema. It goes without saying that the objective is, as always, the best compromise between equity and simplicity (for employee satisfaction) and cost.

There are two general rules of thumb which I can recommend. If something is not compatible with head office requirements then the head office may be excessively centralizing. Those rules are:

1. For higher paid employees, who compare themselves with their peers in other countries or who may be transferred, design the local arrangement so it is as compatible as possible with the head office.

2. For lower paid employees, model yourself on local precedent if available. If precedent is not available, or unacceptable, wait. At least commit yourself to nothing you could regret later! If necessary, help local management to patch up a temporary solution which creates, as limited as possible, a precedent for the inevitable office grapevine. The advice to wait will be resisted by your local colleague because the proposed plan may cover him personally, and his next raise may depend on achieving the objective of having plan approved. Any local advisers will also have an interest in a positive result.

How in practice does one reconcile divergent requirements? You know about the company and are a specialist in retirement plans but never think you really know the country (though you should try to, by subscribing to "IBIS" or "Benefits International" or both). Your local colleague knows the company and the country, but he will be struggling to understand retirement plans.

We always try to find someone locally who knows about retirement plans, and then we try to teach him something about the company. There are then at least two minds expert in each of the three aspects which must be covered. The three of you together should be able to find a solution which is suitable for the country and company and which is technically sound.

MR. GLASHAN: Mr. Schaller-Kelley talked about the aspect of the local company, head office, and communication. He also talked about credibility and about trying to get an appropriate plan design. One of our clients sent out a notice telling all of its subsidiaries to install 401(k) plans in their countries. None of the German, Japanese, Mexican and Spanish benefits managers had any idea of what a 401(k) plan was. That is how you destroy your own credibility. Those are some of the problems that I face trying to explain to unsophisticated people how benefit arrangements work. I often deal with start-up companies, and they often need to be reminded that good communication and understanding what other people want are very important. The head office has to be reminded that social security laws and tax laws are different. Any company that ignores those situations does so at its own peril. I feel that right at the very beginning in start-up companies, the manager should take charge, put in a benefit program, and exert his authority. If he does not, inevitably the local subsidiaries will do whatever they want. I have seen it happen time and time again.

There are a few special problems that multinational employers may encounter. One of them is that the accounting profession in the U.S. and more recently in Canada, has sought to standardize how pension plan costs and liabilities are reported on financial statements.

The requirements apply to overseas plans as well. The result, of course, is that the company may be required to do a valuation on a basis quite different from the basis applied in the local country. A country (as in Germany) with book reserves calculated using a prescribed mortality and interest assumption and with no salary projections and no withdrawal assumptions, might cause significant problems. In my view, the value of any termination indemnities, which are common in Latin America, should also be calculated. A great deal of work will have to be done for some companies to meet these requirements.

If I understand the situation correctly, a Canadian company filing Securities and Exchange Commission (SEC) forms will be required to disclose three sets of figures on its pension plan expense:

1. on the basis of the actual contributions which the company made (for tax purposes),

2. following FASB guidelines for the SEC, and

3. the Canadian Institute of Chartered Accounts (CICA) costs for the Canadian report.

I believe from discussions that I have had with some companies that they are viewing foreign plans perhaps not as being material for overall costs and aren't doing anything. Sooner or later, at least for some of the larger companies, this will be affected.

Another aspect that does not apply to Canadian companies but does apply to American companies is IRS section 404A. This section of the IRS code governs the tax deductibility, in some instances, of foreign pension plan expenses. In my view, the impact for Canadian subsidiaries of American firms will be negligible, but for other countries such as Germany, where book reserves are common, the regulations are important. Perhaps the most upsetting is that the time for meeting the regulations is rather short.

My last problem deals with the aspect of the worldwide valuation. Some companies have begun to do worldwide actuarial valuations. The greatest benefit of this to most companies is the discovery of exactly what is being provided in each country. In view of the complications that are being raised, by the accounting profession and the tax authorities in the U.S., I think that worldwide valuations will become more common.

MR. LAWREY: Primarily, I will discuss recent legislative developments in Switzerland and the U.K. Before I consider those countries specifically in the parallels we can draw between what is happening there and what may happen in the U.S. and Canada, I would like to identify a general trend in the provision of retirement benefits which is affecting a large number of the world's developed countries.

There are three pillars on which retirement income is based:

1. The first pillar is the provision made by governments under social security programs, usually financed on a pay-as-you-go basis out of contributions from employers and employees, or out of general taxation.

2. The second pillar is the provision made by employers and employees under corporate retirement programs. These programs may be financed by an external pension fund or by an internal balance sheet reserve or a combination of the two. The method of financing is usually influenced by tax-deductibility issues and whether the plan requires employee contributions.

3. The third pillar is the private savings made by employees for their own retirement--the accumulation of capital during the working lifetime to provide a supplemental retirement income.

The prevailing trends affecting many countries today are as follows:

First Pillar

Many countries were over-ambitious with their social programs in the past when demography was favorable and low unemployment and higher fertility rates seemed here to stay. Now, however, there are generally fewer people employed, and the ratio of those employed to those supported by taxes that they pay themselves is gradually deteriorating. Accordingly, many countries are trying to cut back on their social security benefits, and coming to terms with the need for increased social security taxes.

Second Pillar

Company pension plans in countries with generous social security benefits are generally directly integrated with social security. Consequently, any reduction in social security benefits leads to a direct increase in employer costs.

In search of cost-containment, employers are showing a great tendency towards implicit rather than explicit integration. Also, to reduce vulnerability to future inflation, discretionary cost-of-living adjustments generally are preferred to contractual increases and revalued career-average pay plans may become preferred to final pay plans (although they are still relatively uncommon outside the U.S.).

Employers that seek to insulate themselves from both the investment and inflation risks and rewards, are moving to establish defined contribution or profit sharing plans.

Third Pillar

What is the role of the individual in preparing for retirement? Cost containment by employers and reduced social security benefits will clearly increase the need for private provision. Governments recognize this and provide tax incentives for long-term savings via life insurance products or other savings media, such as:

1. Individual retirement accounts (IRAs) in the U.S., registered retirement savings plans (RRSPs) in Canada

2. Soon to come personal portable pensions in the U.K.

3. Possible introduction of full deductibility of life insurance premiums in Switzerland in 1987

Employers recognize this and provide incentives for employees to make additional retirement provision to their corporate pension plans. The 401(k) feature of many U.S. retirement programs and the additional voluntary contributions commonly found in the U.K. programs evidence this trend.

Switzerland

First Pillar

Switzerland has a flat rate pension of around 20-25 percent of national average earnings per single person. There is a 50 percent addition if a married male has a wife who is not entitled to a pension in her own right. The pension is fully vested after one year's contributions, and the full pension accrues after 45 years' employment.

The pension is indexed in line with inflation each year, but it is not increased unless the consumer price index (CPI) is increased by more than 5 percent. The Swiss social security taxes are 10 percent of the employee's salary without limit, split equally between employer and employee.

Second Pillar

After considerable procrastination over three years or more, the Swiss introduced mandatory corporate pensions on January 1, 1985. The coverage applies to all employed people and also relates to the self-employed. It is a defined contribution plan which must provide benefits which are immediately fully vested and fully portable. Every employer must establish a fund. The income covered by the plan is between the first pillar level, which is about 20 percent of national average earnings, and three times this amount.

I said it was a defined contribution plan; the defined contribution levels are as follows:

Age	Contribution Rate
25-34	7%
35-44	10
45-54	14
55-64	18

Persons under the age of 25 are covered for risk benefits only.

Additionally, there are contributions for death and disability benefits, a guarantee fund, and a special measures fund, which probably add about 4 percent or 5 percent to the overall costs. At least 50 percent of the total contributions for the second pillar in Switzerland must be employer paid. Each year these contributions must be credited to an account with interest. The current rate in Switzerland is 4 percent a year (which is not necessarily low by Swiss standards).

At retirement, the employee's accumulated defined contribution account must be used to provide him with a pension at a minimum conversion rate of 7.2 percent or about 14:1. At least 60 percent of the annuity must continue to a male employee's widow after his death.

Employers which operate defined benefit plans may continue to do so but must maintain parallel records to defined contribution accounts to ensure that the annuity provided is at least as high as under the mandatory defined contribution plan.

Third Pillar

It is intended by the government that the first and second pillar together should provide around 60 percent of covered earnings after a full career. The main third pillar incentives which exist are via life insurance where annual premiums, up to a given amount depending on which particular canton, are deductible for income tax purposes. It's likely that federal laws are going to be introduced in 1987 to provide that life insurance premiums in Switzerland are fully deductible.

United Kingdom

First Pillar

In the U.K. we are seeing similar trends happening as in Switzerland. The first pillar, the social security system, is comprised partly of a flat rate pension of around 20-25 percent of national average earnings and partly of an earnings related pension which provides 25 percent of covered earnings at age 65 for males and 60 for females. This benefit accrues for a maximum of 20 years and commenced in 1978. Covered earnings in the U.K. are from the level of basic state pension, (20-25 percent of national average earnings) to about seven times that amount.

Contributions currently total 19.45 percent of covered earnings, split 9 percent employee and 10.45 percent employer.

Companies which operate pension plans that satisfy minimum benefit and funding standards can opt out of the earnings-related component and pay lower social security taxes. The reduction is 6.25 percent of covered earnings, split 4.1 percent employer and 2.15 percent employee.

This has proved to be a popular option, since a lot of companies have maintained generous pension plans, even before this earnings related component was introduced in 1978, and around 90 percent of employees in the U.K. are members of contracted-out pension plans.

Now, the earnings-related pension component is under imminent threat of removal.

Second Pillar

The second pillar is not probably too different from the U.S. and Canada. Company pension plans are not mandatory but an overwhelming proportion of employers with 20 or more employees operate a pension plan, generally on a defined benefits basis.

Typically plans would provide a retirement pension of around 60-70 percent of final average pay after 40 years of service and would be directly integrated with between 65-100 percent of social security.

Commonly companies in the U.K. provide discretionary pension increases to make up to between 60 and 80 percent of the inflation. Employee contributions to corporate pension plans are tax-deductible.

As far as vesting is concerned in the U.K., there is a minimum five-year period at the moment, but there are indications that this may be reduced in the future.

Proposals have been announced by the government to revalue benefits between the date of termination and retirement at 5 percent per year or the CPI increase if lower. That is, in the future defined benefit plans vested benefits for terminations that were frozen will have to be indexed between the termination and retirement date. It's going to add a significant cost to retirement programs in which there has been traditionally a higher turnover of staff. Clearly, this increase in benefits for the terminated vested members is going to effect pension increases for members who have actually retired from the company.

In the budget this year, there have been threats of taxation on pension funds. Presently investment income is not taxable, it is possible for employees to take a tax-free lump-sum when they retire, and all contributions to corporate pension plans are tax-deductible. It is rumored that one of these three can be attacked, possibly more than one.

Finally, personal portable pensions are under discussion at the moment mainly because of bad publicity arising from frozen pensions provided by defined benefit plans.

The U.K. government has prepared a green paper which represents proposals for change in the future. There will be comments submitted; following there will be a white paper; then there will be a bill; and finally, there will be a law. It is probably going to take about three years to change, but the U.K. government is in a fairly strong position, and some of these changes are likely to be implemented.

The earnings related components of social security are going to be phased out. For those people of age 50 or over at the date of change, future expectations are going to remain unaffected, but for people who are under the age of 40 at the date of change, future expectations are going to be nil. Their accrued rights up to the date of change will probably be revalued thereafter, but no further accrual under the earnings related component will take place. People between the age of 40 and 50 will receive added service credits; 1 year to people age 40 to 7.5 years to people age 50 with a scale in between to make up for the fact that the mandatory defined contribution plan will not provide sufficient benefits to make up for the loss of the earnings related component for those people.

The next proposal is that a mandatory defined contribution plan is introduced with a minimum contribution of 4 percent of which 2 percent, at least, must be paid by the employer. There would be a minimum 50 percent survivors pension. This mandatory employer plan would have to provide immediate vesting and full portability; it would need to cover all employees.

An employee will be able to elect whether he will participate in the mandatory company plan or whether the contribution will instead be paid to his own personal pension plan (RRSP or IRA).

The government has indicated that the investment of these personal pension plans, which are currently only available to the self-employed and which are currently only managed by insurance companies, are likely to be extended to cover banks, building societies, unit trusts, and other savings media. The insurance companies had a monopoly on saving for self-employed retirement, but this is likely to go.

The social security contributions, as a result of the change, are likely to fall because clearly quite a substantial part of social security is being removed, but they won't fall substantially. They will fall from 19.45 percent in total to about 16.5 percent. In addition, of course, there is going to be this 4 percent payable to a mandatory defined contribution plan. Certainly some of the changes that are being announced or proposed in the U.K. seem to be quite consistent with what has already happened in Switzerland, and it's probably pertinent to discussion currently taking place in Canada and the U.S., as to what provision is made in the future under all three pillars.