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# Session 64PD
# Plan Qualification/Registration Issues for Multinational Sponsors

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*Summary: Plan qualification requirements in the U.S. and plan registration requirements in Canada pose different problems for multinational plan sponsors, as do comparable requirements in other countries. Multinational sponsors face a variety of issues in establishing one or more plans for their staffs in these countries. This session presents a summary of qualification/registration requirements for the U.S., Canada, and other countries and the means that some sponsors have used to comply with them.*

**Mr. Ethan E. Kra:** I am with William M. Mercer. The first speaker is Michael Sirkin, chairperson of the Tax Department at Proskauer, Rose, Goetz & Mendelsohn. Michael is a 1972 graduate of Columbia Law School, past chairperson of the Employee Benefits Committee of the Association of the Bar in the City of New York and co-chairperson of the Employee Benefits Committee of the New York County Lawyers Association, and is active in other bar associations. He's also a director and vice president of the New York Chapter of WEB. He is co-editor and co-lead author of *Executive Compensation* recently published by the Law School Seminar Press. Michael is also an adjunct assistant professor of law at New York University School of Law.

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**Mr. Michael S. Sirkin:** It is a privilege, as a lawyer, to be speaking to a group of actuaries. Fortunately, I don't have to mention too many numbers or too many calculations, so as not to be second-guessed. I am going to talk about why you should care about registration and qualification out of the U.S. and why it matters to a group of U.S. actuaries and companies.

I want to start by discussing why you should care and what rules or guidelines do you need to worry about as U.S. entities do business in the rest of the world.

The world, as you all know, is shrinking. Businesses are operating internationally. You'll find very few controlled groups of significant companies that do not have international aspects. Many U.S. companies are owned by foreign companies and the U.S. operation is the branch office or the assignment away from home, not the other way around. As executives go up the corporate ladder today, they will tend to serve both in the U.S. and other countries. The question is, how do you deal with these transfers and the premium arena? How do you have a career plan? It's easy if you have a person whose career is in one country and he retires there. You can deal with him in his own world with one set of taxation rules and one set of benefit plans and still have continuity. The problems arise when you start moving people around the world.

If an executive works in five or six countries in his career, how do you provide those executives with pension benefits on a total career basis without merely giving them a lot of segments from a lot of sources? If you take the typical final average compensation defined-benefit plan where employees keep changing from plan to plan, it will not work. You will not provide the person with one career benefit. The only alternative is to use supplemental plans; otherwise, you can't aggregate the service and compensation.

The other issue that becomes very important is how do you avoid hurting the executive on the taxes? Taxation around the world is very different. Not all countries say, "Oh, don't worry, it's somebody else's plan and we'll treat it the same way as a U.S. qualified plan." The U.S. taxes citizens and resident aliens on worldwide income. Most of the people we're going to be talking about are not nonresident aliens; if they were, they wouldn't be a problem since they're usually here for less than 90 days and do limited work in the U.S. What we're talking about are U.S. citizens going abroad, U.S. resident aliens going abroad, and people who will come from abroad and become U.S. citizens, resident aliens here, or otherwise subject to U.S. taxes as something other than nonresident aliens. All these people will be taxed on their worldwide income by the U.S. Many other countries also tax these U.S. citizens. Fortunately for the U.S., most other countries tax people not on

their worldwide income, but on their income earned in that country. There are exceptions to that rule.

There are some other countries that tax on worldwide income and we need to do an analysis on a country-by-country basis. We must look at where the person is coming from and know the rules of that country. Every country in the world has to deal with taxes. You'll find very different provisions in different countries. You can't start with any general tax rule that will apply in all situations.

Generally, the international treaties are more favorable to the international transfer than the Tax Code itself is. Unfortunately, most tax treaties do not deal with accrual of pension benefits. Most tax treaties only deal with treatment of distribution of benefits. I can think of only two exceptions off hand, and neither deals very well with accruals. The French treaty basically says that if your tax domicile is in France but you're a U.S. citizen and you continue in a U.S. qualified plan, France will then treat the U.S. qualified plan the same way as it treats the French equivalent of qualified plans. The rules also work in the other direction.

The Canadian treaty 1995 protocol basically deals with income accrual in tax qualified plans. Nothing else really mentions accruals. They focus on distributions. Now that is not a problem in most instances for foreign countries. The big problem is for persons subject to U.S. taxes.

If a qualified plan is involved, there is deferral until the money is paid out of both contributions and accruals. If you don't have a qualified plan, you have what's known as a nonqualified plan.

Most plans in other countries will be treated as nonqualified plans for U.S. purposes. If a nonqualified plan is unfunded, contributions and accruals are taxed only when money is paid out or earlier if the executive has constructive receipt, i.e., the right to receive the money. That's the U.S. rule and it applies to international plans. If the plan is unfunded, you're not taxed until you take the money out. Therefore, accruals generally have very little meaning. If, on the other hand, you have a funded plan, you are taxed when the benefit is earned or when it vests, whichever is later. If you're in a foreign-based funded plan, and you're accruing benefits every year, and there is five-year cliff vesting, at that point, all the money is taxed in the U.S. It is probably almost impossible to meet the requirements of both the U.S. qualification as well as registration, or whatever the term the foreign country is using. The only possible exception may be Canada and even that gets very difficult because in Canada you will have both federal and provincial rules. If you go anywhere else in the world and you go down the list of requirements, it's almost impossible to do it. I've known a lot of lawyers who have tried and they've

thrown up their hands in frustration. In the U.S./Canadian situation, there are a couple of companies that have done it.

The plans in foreign countries vary in concept. Some have minimum benefit requirements. Others treat it as mandatory severance. It often becomes very unclear if something is funded within the U.S.'s meaning. Germany, for instance, utilizes a "book reserve" requirement. I think it's unfunded, but I would not swear it's unfunded when we start going through all of the German rules. So if executives are moving around, you either put them in each country's plan or just put them in the U.S. plan and run the danger of the assigned-to country's taxing them on the U.S. accrual. If you put them in the assigned-country's plan, then you also must worry about how the home country will tax the executive. You usually do much better, incidentally, if you are working with an assigned-to country that has unfunded arrangements, although I worry then about the executive's security.

Just in passing, they've done a much better job in internationalizing Social Security. With regard to Social Security, there are basically treaties throughout the world that let employees stay in the home country's Social security system for five years basically with no problems. It helps very much with transfers.

Now what are the alternatives and what do you do about them? Let me just talk generally about some of these requirements, some of the issues, and some of the possible solutions to them. You have to think about it when you start transferring. In my mind, the easiest way is to keep somebody in the home-based plan. Generally, if you keep employees in a home-based plan, it's going to be simplest at career-end. But the question is, how long do you want to cover employees this way and will the accruals be taxed currently in the assigned-to country?

The other problem is how you do it. For a number of years there was only one way to do it and that was using Code Section 406, which is very complicated. It required a 3121(l) Social Security election effectively for all U.S. citizens or resident aliens in the company that elected. Fortunately, the controlled group regulations, which we have all found a nuisance because of other issues, have made this a lot easier. Now we have the foreign subsidiary adopt the U.S. plan to cover the employee; since they are within the same controlled group, it's the same employer and you continue to accrue in the plan. There are some issues as to deductibility of contributions, but that's an issue that is relatively small, and since defined-benefit plans are funded on an actuarial basis anyway, the issue doesn't usually come up. For short-term transfers, companies often use the "seconded" method and just keep them on the U.S. payroll.

The second method often utilized is a nonqualified plan. You create a nonqualified plan that basically covers a makeup of what is lost as a result of transfers. You may or may not put transfers in a foreign country plan and offset the benefits. Basically, the executive is told, "We'll make it up for you when you get back and we'll do it through a nonqualified unfunded arrangement." But if this is to cover more than a so-called "top-hat" group, i.e., a select group of management or highly compensated employees, you've got a problem if there are a lot of U.S. citizens involved. The plan is going to be subject to Employee Retirement Income Security Act of 1974 (ERISA) and you can't really do it. If a plan covers more than 10% U.S. citizens, I get very concerned very quickly; thus this arrangement only works with your top people.

Sometimes a plan is set up on a nonqualified basis for third-country nationals who are working for you in an assortment of countries other than their home country. This probably is not subject to ERISA. Some foreign countries generally tax, as I noted, on amounts earned in the country. You must realize, with regard to third-world nations, that you're rotating through the countries.

The third choice is to put the employees in the assigned-to country plan. It works fairly well if it's a long-term assignment. It doesn't work so well on short-term assignments. You potentially wind up with people receiving multiple pensions and ultimately you might have to do makeup to take care of people.

What do you have to worry about when you're thinking about which way to go? There's no easy answer on this, even with Canada and Mexico where everybody is going back and forth across the border on a full-time basis. Here, a permanent-type arrangement is necessary because there are going to be a lot of people involved. In the other countries, most companies will be transferring only a few people, but you need some type of arrangement to be sure that people are taken care of; otherwise, employees are going to resist the assignment. They're not going to go and you're going to have a lot of unhappy people who feel that you cheated them out of part of their pension. So most companies are trying to devise a methodology, depending on what country you're in. When we talk to people, they are suddenly shocked when we tell them that accruals in foreign plans are likely going to be taxed on a current basis in the U.S. Often people do not realize this, and it's not being dealt with until its picked up on audit. We look at the intended length of the transfer. If a relatively short transfer is involved, you're going to find a way to keep the employer in the home company plan.

The question is when do you revisit the issue? The answer is, at what point are they no longer a transfer, and should they be treated as a "native" of the other country. Some companies use five years, some use ten years, and some never do it. Which

country employees are coming from and which one they are going to may very well affect what's going to happen. What treaty is involved? What are the ultimate deemed benefit levels? What country is he or she going to retire in? I had a client that was an English company that had a nonqualified plan in the U.S. that recognized all service and final average compensation. All the executives wanted to come to the U.S. to do their last two or three years so they'd get the higher salary and benefit credit. They'd then retire in England where the pension in U.S. dollars was substantially higher than the English pension. They just wanted to come to the U.S., get the U.S. benefit, and go back there with it and retire and collect the U.S. benefits. It worked very well until we changed the practice.

You do have to deal with the issue of currency fluctuation and decide how to protect pensions. Are you going to lock it in? Are you paying them in home country's dollars and when will a conversion take place? If employees spend a long time in one place, it's tough to move them out and say, OK, now they are not going to be in that plan anymore, and they'll have to start over someplace else. A defined-contribution plan, of course, is a lot easier to deal with than defined-benefit plans, because those are annual accruals. An interesting issue, by the way, is that under U.S. rules on 401(k) plans, you can't have a distribution until there is a separation from service. This is defined on a controlled group basis. Thus, somebody in a U.S. plan makes a 401(k) contribution for a number of years. They go back to Europe, or Japan, or somewhere else, but they have not had a separation from service. You cannot distribute to them when they leave. Often when they take the distribution in the other country, they will be taxed in that country. Each company has to figure out what to treat as the home country, where are people going to be taxed when you transfer them and do you care about taking care of people on a long-term defined-benefit pension plan basis so you can simply give them extra cash while they're on their transfer to make up for their lost pension. If you think through what you're trying to do for people, you're going to solve the problem. You have to look at it and analyze it on a country-by-country basis. The real concern is not to have people taxed on what they don't expect to be taxed on. A lot of people make the transfer and don't worry about the surprises until later.

**Mr. Kra:** I'll discuss a real-life situation that has been doctored enough to try to hide who the real client was and not put all their problems out in the public domain. We have changed it enough so that even though Mike's law firm works on it, Mike says he didn't know who the client was, and he wouldn't have been able to recognize it from the outline. Hopefully, it will remain as such. If anybody asks who it is, I will refuse to answer or comment, on what company, industry, or business this is.

Imagine you have six employers in a common industry—three in the U.S. and three in Canada. Each of these six employers have noncollectively bargained employees—some of whom are tax residents in the U.S. and some of whom are tax residents in Canada. In fact, they may actually be working in either the U.S. or Canada. The employer is wherever the employer is. Some employees may be telecommuting, where all the work is done by phone, fax, modem, etc.

The six employers also are collectively bargained with a union to jointly sponsor multiemployer pension plan for employees. Each of the employees has collectively bargained employees who were tax residents in Canada and who are tax residents in the U.S. However, the collectively bargained employees generally work on-site. Each employer is assumed to have fewer than 50 noncollectively bargained employees in this particular industry, yet each of these employers is part of a larger controlled group with many other independent business interests, unrelated to this particular industry.

Each of those controlled groups is assumed to be large. We'll assume that each has at least 1,000 employees, just to make it clear that there will be issues on separate lines of business that may create problems. The employers wish to provide a common plan design for the nonunion employees. Furthermore, the union employees tend, over time, to move from company to company. Some of the nonunion employees may have the same issue—there may be some pattern of moving from employer to employer.

What types of employees do we have? We have U.S. employees of the U.S. employers, Canadian employees of the Canadian employer and then the opposite—the U.S. employees of Canadian employers and the Canadian employees of U.S. employers. We have collectively and noncollectively bargained employees, so therefore, we effectively have a matrix of about eight different types of employees.

What were the objectives in the assignment? The first was administrative simplicity with a minimization of the number of plans. Of course, we wanted the three gold bars that you always want from a qualified or registered pension plan—the immediate tax deductibility of the contributions, the tax deferral for the employees so that they don't get taxed until they actually retire and collect benefits, and that investment income is not taxed in the investment structure, but is deferred until the payouts to the employee.

What were some of the legal issues we had to deal with? First, why not just qualify on both sides of the border? We had a few little difficulties. U.S. and Canadian law are incompatible in certain instances. For example, ERISA and the Internal Revenue

Code (IRC) generally prohibit in-service distributions from a qualified pension plan prior to the attainment of age 59.5 or termination of employment. Manitoba, however, mandates that the employee has a right to demand an in-service distribution to be transferred to the equivalent of an IRA or another type of pension vehicle, without the employer's blessing. It's an employee right.

The funding rules are different. In the U.S., the full funding limit is a cliff. For every additional dollar of surplus, you reduce the contribution by a dollar. In Canada, you're generally permitted to amortize that surplus over a period of years. Canada requires that there be a Canadian trustee and 80% of the assets are invested in Canadian property or Canadian investments. This could be potentially incompatible with U.S. fiduciary requirements.

In addition, some of the traditional benefit designs that we deal with in the U.S. may be illegal in Canada. For example, target benefit plans may violate the Canadian Human Rights legislation, because they're based on age. This is a gray area. There may be some prohibition in some parts of Canada to have a contribution made to certain types of plans after attainment of some upper age limit. Whereas, in the U.S., it's a violation of age discrimination to cease benefit accruals or contributions based on age.

Let's go through the issues by category of employees and employers. First, U.S. employers with U.S. employees. If you have a single plan covering the noncollectively bargained employees of the three U.S. companies, that would constitute a *multiple*-, as opposed to a *multi*-employer, pension plan. That would require a joint 5500 filing, with separate 5500 R and C filings, separate determination letters, and separate 410(b) and 401(a)(4) testing. For a defined-benefit plan, assuming it was created after January 1, 1989, under section 413 of the Code, you would have to allocate assets annually and determine separate funding standard accounts. Furthermore, a taint by one employer on any qualification issue could taint the qualification of the entire plan for all of the employees.

Furthermore, under Code Section 401(a)(26), if a qualified plan covers highly compensated employee (HCEs), then it must cover at least 50 noncollectively bargained employees. Now there are certain exceptions for small companies that may have separate lines of business; however, all these companies are large. Thus, the best we could have hoped for is creating a separate line of business with 50 employees to get the number required to be covered down to 20. In general, there is the 401(a)(26) requirement and if any HCE were covered by a plan at any one of these employers, then it would have to cover 50 employees.

If pension simplification were to pass, then by setting the plan up as a money purchase plan, we would not have to deal with Section 401(a)(26). We would still have the issue of the 410(b)/401(a)(4) testing, which would have to go across the entire controlled group for the gateway test, as well as within any separate line of business for purposes of the regular 410(b) testing. That could be very difficult for any one of these controlled groups, because they are generally multiindustry and multibusiness, and dealing with a small group could be very problematic. Fundamentally, HCEs are a problem.

Now the next group: Canadian employers with Canadian employees. (We've taken the two easier situations first.) If you have a nonunion, noncollectively bargained multiemployer plan in Canada, you don't have the complexities of the U.S. multiple-employer plan rules. However, you are required to set up a joint board for administration of a plan involving both the employees and the employers—comparable to our Taft Hartley rules in the U.S.

Another difference that we can find in Canada is the availability of something called a Group Registered Retirement Savings Plan (RRSP). It's like a group IRA. Group RRSP contributions, however, are subject to payroll taxes which could be up to 10% of contributions. The dollar limit lags the regular defined-contribution limits in Canada by one year. However, there are advantages because you avoid the provincial legislation. One downside of Group RRSPs is that it may be more difficult to tie up the money and to prevent any preretirement withdrawals. With a regular registered plan, an employer can make sure that these monies are left for real retirement years.

Let's move on to the situation where a Canadian employer has U.S. employees—where you have a U.S. tax resident participating in a Canadian pension plan which is not U.S. tax qualified. In a typical situation, a Canadian company sets up its own pension plan and a U.S. employee becomes a participant in the pension plan. From the Canadian perspective, there's no problem. The real issue arises when the individual comes to file his or her U.S. income tax return. A U.S. tax resident is subject to immediate tax on the contributions made subsequent to the vesting date. There are certain Canadian requirements that are incompatible with the U.S. tax code that may make the Canadian plan difficult to qualify in the U.S. There is, however, one good saving grace. Canada is a little more rational and reasonable than the U.S. in dealing with international situations. There's no Canadian equivalent to IRC Section 404A. In other words, in Canada, contributions made to foreign pension plans for non-Canadian employees are tax deductible on the Canadian corporate tax return. You do not have to look at the foreign plan to check out how it complies or comports with Canadian rules. If the plan is qualified

or meets all the requirements of whatever country you're in, Canada says you can take your tax deduction.

Now let's look at those U.S. employers that have Canadian employees. What happens if they do the obvious and put their Canadian employees in a U.S. tax qualified plan? The employee participates there. The plan is not registered in Canada, so if the Canadian employee is participating in a retirement funded program that's not registered in Canada; it is the equivalent of a nonqualified plan as far as the Canadian taxing authorities are concerned. That makes it subject to what is called the Retirement Compensation Arrangement (RCA) rules. The contributions are subject to a 50% refundable tax payable by the employer. The refund would be paid when the benefits are paid. The employee is subject to tax at that time. In addition, the investment earnings in the trust are similarly subject to the 50% refundable tax. Canada is effectively saying, "Pay the tax now, and at retirement, we'll make the appropriate adjustments."

Prior to 1995, there were draft rules that permitted the employer an exemption from the RCA rules, allowing the employer to treat the employee, for tax reporting purposes, on the same basis as its employees in the domestic firm. There were certain requirements and restrictions. The employer, a U.S. company, would have to start submitting Canadian tax filings with respect to the individual employees, calculating and reporting what are called pension adjustments (PAs), which are calculations done to limit the amount of total pension contributions (almost like a Section 415(e)-type calculation) with respect to the Canadian employee.

The U.S. employer would have to file a report with Canada that would contain enough information for the Canadian authorities to monitor the equivalent of their version of Section 415(e) with respect to the employee. The exemption ended January 1995.

Another exemption—if a Canadian resident works in the U.S., then the employee could alternatively be responsible for reporting the PA. It's a complex calculation. It puts a burden on the employee. It then employs the RCA rules. Furthermore, IRC Section 404A precludes the U.S. employer from setting up a regular pension plan in Canada and obtaining the U.S. tax deduction for the contribution, unless a Section 404A election is made. One of the restrictions in Section 404A (which is the U.S. rule that limits the ability of a U.S. company to take advantage, for tax purposes, of contributions made to foreign countries), is that it does not envision participation in multiemployer plans; it envisions only single-employer plans.

Group RRSP contributions would be deductible, because they would be viewed from the IRS perspective as contributions to the individual. It's just a direct payment

to a fully vested account, transferred out of the control of the employer, so there's no Section 404A issue.

How did we deal with this and find a solution? For the collectively bargained employees, the recommendation was for two plans. The first was U.S. multi-employer plans covering all collectively bargained employees of the U.S. employers. The Canadian employees of the U.S. employer, because they did work in the U.S. (as we said, the union workers actually had to work on-site for a significant portion of their work), could file their individual PAs, and there were no legal impediments to putting all of these union employees of the U.S. companies in one multiemployer plan. On the Canadian side, we set up another multiemployer plan with all the employees of the Canadian employer, registered in Canada, with an attempt to qualify it in the U.S.

Now as far as the age discrimination, this particular industry doesn't have any collectively bargained employees over the age of 60 because of the nature of the industry.

For the noncollectively bargained employee, you would want to have identical plan provisions to the extent they are not inconsistent with U.S. versus Canadian pension law. However, to the extent that those are incompatible, we would have to deal with them. For the noncollectively bargained U.S. employees, we've recommended establishing a prototype plan as opposed to multiple-employer plans. There would be no difference between companies. We also advised excluding all HCEs. They will be dealt with separately.

Both U.S. and Canadian employers would adopt the prototype plan, thereby creating separate plans for tax filing purposes. These would be U.S. qualified plans. From the Canadian tax perspective, the employer would get a deduction, because this is a U.S. plan. Each of the companies would have their own U.S. plan with respect to their U.S. employees. For the Canadian employees of Canadian employers, you would establish a single multiemployer plan with one trusteeship. For the Canadian employees of the U.S. employers, we recommended a group RRSP so they avoid all income tax issues. For the U.S. HCEs, we recommended compensating them outside their qualified plan arena.

The significant trust issue when you go international, is that ERISA requires U.S. trusteeship for assets of a plan that are subject to ERISA. The problem with that is a lot of the people who were covered in the Canadian plan are U.S. employees. One way of getting around this was using a U.S. grant for a Canadian bank which should, hopefully, solve most problems on it to some degree. We also have a concern with fiduciary responsibility on the investment; that is 80% of the

investments is to be in Canadian companies; make sure that it is a prudent decision and adequately diversified.

The alternative approach that we were considering (but wouldn't it be warranted by the amount of the funds involved) would be to invest the monies primarily in Canada, but then invest adequate amounts in futures and derivatives that would then effectively capture the movement of the U.S. market and insulate against the movement in the Canadian market. Technically, the bulk of the money would be invested in Canada, but you would have effectively managed the investment results as if they had been invested in the U.S. That would be a function of the size of the investment pool. Our feeling is that this particular investment pool may not be large enough to warrant that level of complexity.

You could utilize a type of derivative transaction: either arrange some type of swap, or a derivative, or some type of financial instrument whereby the money was invested in Canada, but there was a piece that was tied up in some type of swap where they were swapping investment returns, that would possibly get around the Canadian limitations and yet provide the prudent diversification for the U.S.

If an individual becomes an HCE, he or she is kicked out of the plan. As far as top-hat plans, we do not make it a nonfunded deferred compensation for some of these people. Rather, we actually give them additional compensation and tell them, "You are responsible for setting up your IRA or we will buy you an annuity, but we'll tax you on it. We're just giving it to you. We do not have the legal ability to structure a benefit program for you." The other alternative we pose to these employers was to find other companies in the controlled group where these individuals could be included in the plan without destroying the nondiscrimination testing.

For example, if there were another company in the controlled group which had a ratio percentage of more than 100%, throwing in two or three highly compensated employees and excluding all the non-HCEs of this group, and just ignoring the fact that we give the non-HCEs any benefits but taking these HCEs and throwing them in, we could still possibly easily pass.

Our next speaker is Greg Glashan. Greg is a consulting actuary, a Fellow of the Society of Actuaries and a Fellow of the Canadian Institute of Actuaries (CIA). He is with Buck Consultants in New Jersey. He spent ten years in Canada with an insurance company and 16 years in the U.S. in international benefits.

**Mr. Gregory T. Glashan**: My clients are primarily U.S. domestic actuaries who ask me questions all the time. The other nature or type of client I have are from my non-U.S. offices and they call me all the time as well. What I'm going to try and do

is tell you a little but about the framework overseas in terms in terms of retirement programs.

The first thing is that when we think about benefits in the U.S. model we always think of whether we want to provide benefits. There's no legislation saying you have to provide a benefit. On the worker's compensation side we could say there is some sort of mandatory benefit in some of the states and some of the provinces. In terms of retirement benefits, everything's voluntary.

The other thing is that we have this idea that there is a plan that has some tax advantages. In the U.S. we use the word qualified. Canada uses the word registered. You're basically talking about something that has tax advantages to it. What are the components of this tax-advantage plan? Well, the first concept is that you set up a trust. The average trust is set up and you put in the employer contributions into this trust. Contributions are tax deductible and contributions are not taxable to the employee and all the time it's in the trust, the investment income accrues. There's no taxation on the investment income. When the benefits end up being paid out, they are taxed to the recipients. Of course, for tax-advantaged programs, there's some limitations, so you end up with a nontax-advantage program. In the U.S. model typically that's because we have a benefit limit. Some of the salaries are too high. Because we want to provide benefits that you cannot provide, there are nondiscrimination rules. You actually put it in a trust, and then the contributions are taxable income. The investment income is not tax deferred and the benefits are not taxable when you finally pay them out, because you've paid the tax all along the way or you've put them in an unfunded arrangement with no security. The employer pays the benefit only when the benefit falls due and the benefits are taxable to the beneficiary on receipt. That's the basic model we have.

Now when you go overseas, you must determine whether benefits are voluntary but that's generally not the case. In many countries it's not. What I'm going to do is give you some examples of the programs that you're going to find overseas. If you have operations in Latin America, and in some places in Africa, you'll find that there are severance benefits. If you ask somebody do you have any retirement programs they'll say, no, they don't have anything. That doesn't mean to say they haven't got liabilities. It doesn't mean they don't have a *Financial Accounting Standard (FAS) 87* issue. There is a liability and it's on the books or it should be on the books at least for Financial Accounting Standards Board (FASB) purposes. Just because this is the mandatory benefit doesn't mean to say the union hasn't negotiated the benefit back there. It will only let you know there's a benefit and you'll find that through most of Latin America. In fact, you'll generally find that in countries where the economies aren't very strong and where there's a lot of fluctuation in terms of

currency. Often the benefit is simply paid and is just the function of the salary when you actually leave the company.

There are a few other types. In Italy they have an unfunded termination benefit. Compare that with cash-balance plans. They're both severance-type benefits. At least in the U.S. we start talking about pension equity plans, but really we're talking about this type of thing. Italy has had cash-balance plans for a long time. They don't have to put the money aside. There are a few other places where there are severance benefits where you actually have to fund them. Taiwan has laws on that, but their actuarial standards are terrible. You have to put in funding.

**From the Floor:** There are only four or five countries in the whole world that mandate private pension plans.

**Mr. Glashan:** I'm not sure if it's four or five, but Switzerland certainly is one. Australia also fits the bill.

**From the Floor:** Yes, actually one of them is the Ivory Coast. The Ivory Coast has mandated five pensions. I have a specific question in mind with regards to the South American situation. In fact, I'm employed by one of your clients, which is an inter-American development bank that wanted to put in a pension plan, and in so doing eliminated the termination of benefits.

I don't know how that was legally resolved, but apparently that ran afoul of the laws which mandated the termination of them. I just wondered whether you knew of any resolutions to that kind of thing. Could they say we're not going to give a termination indemnity, but we'll give you a pension instead?

**Mr. Glashan:** No, what often happens is that you can have a pension plan setup that is funded. In Mexico, where you can't get a tax deduction on a severance pay, you can set-up the retirement program and then have this retirement benefit. One of the first things that this retirement benefit does is it covers severance liabilities and you can structure the plan. That gives you a chance to fund somebody, but I don't think you ever end up waiving the benefit. I also recognize that the international organizations are tax exempt. They have all sorts of rules that private employers never have.

**From the Floor:** The issue there would be to ignore the national laws because we don't care about them anyway.

**Mr. Glashan:** I've never seen a situation in which anyone could waive a benefit.

**From the Floor:** Part of their pension plan would be the equivalent in this termination situation.

**Mr. Glashan:** Yes, you could do it that way.

**From the Floor:** Could there be an optional form of payment in lieu of taking a lump?

**Mr. Glashan:** They probably could, but no one in these countries would. The problem is you have it in a country with 50% inflation. You wouldn't really trust your pension plan, so in a lot of countries employees just want the money. There are others in terms of mandated retirement plans. Switzerland's a good example of a country with mandated retirement benefits. The structure's rather interesting. The employer's obligation is actually to make contributions that are based on age, which I think would cause trouble in the U.S., but they are age-limited contributions. They've had that for a number of years, but many employers already provided pension plans. What you end up with would be called a basic plan that they would call a shadow calculation to make sure that you have the minimum.

Australia technically doesn't require a superannuation retirement plan. However, if you don't make the contribution, you end up paying the equivalent to this defined contribution to the government, but you don't get a tax deduction. It's the same contribution, but not tax deductible, which effectively means that it's a mandated benefit. The contribution rate is scheduled to rise every year or so. Ultimately, early in the next millennium, it will be 9% and if that's going I can't imagine that we'll have too many employers with defined-benefit plans. I think there's a future for consulting actuaries in Australia.

**From the Floor:** It's a good future for those who are into recordkeeping and investment management.

**Mr. Glashan:** I'll give you an example in terms of one of my clients. A couple years ago he wanted to put in a defined-contribution plan. They were small. It was an American company that wanted an investment choice. Australians don't believe in investment choices. It's a stupid thing to do and why would you give members choice?

Earlier this year we went back and found they now have 14 choices. It's very easy to do with, clearly, an explosion in terms of the benefit or I'm sure there's an explosion in terms of the needs of U.S.-style recordkeeping and communications and stuff like that, but give them daily evaluations from stuff those options.

Another example is the U.K., which goes back to some of Margaret Thatcher's ideas. There was a recognition in the U.K. that their basic social security was inadequate, so they mandated a second tier of social security, but it really only applies to companies that don't provide a private pension plan that meets certain standards. Most companies contract out at social security, pay a lower net insurance contribution, and there are all sorts of published rules most of which change next April. So if you have any plans with operations in the U.K., as of April 1997, all those rules change. Switzerland basically instituted that reform at the beginning of 1995. They are all redone. Australia's still going through reform. U.K. new reform rules start in June 1997.

Holland is one of those countries that has a lot of industry-wide funds. Most of the time you don't really get a chance to control your benefits. If you're in an industry that has anything to do with metal, you end up with the metal funds. There are also funds if you're in a fast food chain; there's a bunch for health care, or whatever. On the other hand, there are certain industries that don't have one, like the chemical industry, which doesn't have funds. In this case you can have very sizable pension plans.

I come to what I think is perhaps the most important thing. It's not really going to superannuation in Australia, but understand some of the concepts of tough law. We operate under English common law. Maybe we don't think we operate under English common law, but basically the countries that speak English use a certain type of law and even if the rules are different, we understand one another. We can go to the U.K. about what a trust looks like and figure there are other countries that operate this way. Basically, you have this sort of trust that works along the model that we have. If you go to other places that's not the case. Most countries don't operate under English common law.

The whole concept of the trust is vague in Germany. We had the idea that there are trusts and there are funded arrangements in Germany, but most often the circumstance in Germany is the book reserve. If you talk to the Germans and you say, "Aren't you worried about this system? You've got an aging population." They answer no. Again, we talked before about how severance plans aren't funded. When you go to a place like Holland, you will have trust type of plans. They aren't quite like ours, but you do have that sense of a trust with assets and fund managers.

If I was going to leave you with one issue, it's how the role of trustees is often misunderstood. We actuaries who work in this country primarily for employers, are paid by employers, hired by employers, and fired by employers. In many countries that's not the case. They're hired by the trustees and you may think as an U.S. employer you can hire or fire those consultants or tell them what to do. The answer

is generally you can't and that's a very tough one for a lot of people to understand. Let's also recognize that the rules are different in every country. You can't generalize, but that's probably the most important rule.

The other issue is taxation. We went through that model of how you put your contribution in and they're not taxed or you get a tax deduction. In Australia and New Zealand the trust pays the tax. The tax is very high in New Zealand. In Australia the tax is low. Investment income is also taxed. In a few other countries investment income is taxed.

There have been all these changes going on in the last two weeks in one of the states of Australia. It announced that it is going to impose a payroll tax on contributions to superannuation plans, which is a very negative thing. It will be a 6.5% cost. That is in one state. My colleagues said that if one state can get away with it, they'll all do it, because they all want money. When the benefits come out, the Australians kept very favorable tax rules. New Zealand basically has no tax at all. Australia has all the tax rules. It's their effective way of handling benefit rules. There really is no maximum benefit limit. There is a maximum benefit that you can get with tax-favored rules, so that's really how they handle it. In the U.K. there is a provision that allows employers to commute some of their pension and take it in cash. They don't pay any tax on it.

In Belgium, I remember asking one of the insurance companies if they ever had a client who had taken an annuity and the answer was they had one. I think the laws in Belgium are illogical and they actually favor taking lump sums to taxation. Levels are rather low. It doesn't matter that the structure may look like it's an annuity; in practice everyone thinks of it as a lump sum.

I have to say something about France and taxation. That goes back perhaps to culture and laws. It's very difficult to explain to somebody what the laws are in France and what people really do. The reality is that the French are masters of working at systems to get their benefits paid without paying any tax. One of their favorite ways is, no matter how a retirement plan is structured, to try and get themselves fired, even if they haven't done anything to be fired. They basically asked to be fired. Have the benefits out as part of a penalty and then, therefore, it's not taxed and it's a nice thing. One other thing is they also work on the idea that if you have a book reserve plan, you don't get a tax deduction; that doesn't faze them.

These are just examples. There are more, but Germany probably is the most important one. It was a very sophisticated book reserve system. It's well established and there is an insolvency insurance premium that you pay. One of the problems which we run across with the Germans, is that a book reserve is basically

calculated only for people who are vested. It does not recognize future salary increases, even though it may be a final average pay plan. I think one of the reasons why the Germans don't mind having book reserves is because they do have insolvency protection. At least up until now their pension benefit guaranty corporation type premiums have been fairly low, so I think at some point that may change. Right now they are happy with it.

**From the Floor:** Greg, that, of course, goes back to the issue that I raised earlier. The Germans are in a funded or an unfunded plan for U.S. purposes. Nobody managed to figure that out for a while.

**Mr. Glashan:** Well, that goes back to what does funded mean? There are some plans that look like trusts. The company puts the money in the trust and the next thing that happens is it borrowed back out, so the only asset is an IOU with the company.

I'd like to make a couple of comments on asset mix. Some countries actually have limits in terms of what sort of assets you can hold inside the country. The U.K. is an example of one that doesn't seem to have them. It's astonishing to look at an asset mix that has in general agreement on tariffs and trade (GATT) in these equities.

I've always been very frustrated with Continental Europe because the investment mix has traditionally been very conservative and very risk adverse. They love to have insurance policies and bonds. I've more than once tried to get some people in Holland who have pension plans to put 10% in equity. It would be a major achievement. They say, "No, that's too dangerous."

I think some Americans just are astonished when they look at the U.K. equities or U.K. equity mix. I'd say 10% maximum would not be in equity, so that's a typical blend that I have. One comment to make also is we had this whole idea of whose selection investment mix it is and that's real tough sometimes, because there are Americans who want to oppose an asset mix philosophy from up above which was mentioned earlier. There are local considerations, there are local laws and there are local people who have fiduciary responsibility, so it becomes a problem.

I wanted to talk about indexation. When I talk to American clients, the first thing that they do is say, "I hate indexation." It's their number one complaint. Germany requires that you have indexation. The U.K. has commonly provided indexation. As of April 1997 it won't be an option anymore. It will be mandated. There are other countries like that and the first reaction is, "I don't provide indexation for Americans and I won't do it." I just go around in circles on that. If it's mandated by law, it must be done. The U.K. is one of those countries that also indexes for

investment benefits. Even people who had short service when they're young will still have decent benefits because of the indexation.

People think of vesting in the U.S. When I first started out in vesting I found out that people would tell me what vesting was in various countries, but they really didn't mean what I thought they meant. It took me quite a while to understand. In Germany, disability benefits have to be vested. Now we don't do that here, but they do it in Germany, so if you have vested employees or terminated vested employees in Germany, you'll probably have vested benefits, even on the disability benefits.

We talked about plan qualification issues as being a condition for vesting. In the U.K., vesting is irrelevant in terms of plan qualification. You can have an informal plan like when John Smith retires, you give him a pension. You've done it all along.

If somebody leaves and says where's my pension, you say, well, it's not a funded plan, that's irrelevant. Vesting isn't part of plan qualification. It goes under the broad category of social security. Well, don't ask exactly where the law is. Really the standards apply to funded plans and a formal plan. Holland has been big in pushing for portability of a pension. Now that's a big issue throughout all of Europe. Belgium is also going in, and so is Switzerland. The basic idea is that you can move from one employer to another. You can take your assets with you, buy a tax service, and basically end up with a complete career.

I'd like to make one comment about the tax-accrued plan. There is no U.S. comparable program. The U.K., for example, has a profit-related pay program. That really deters companies, so you won't see too much about it. Mrs. Thatcher wanted to include everybody's productivity, so she basically allowed companies to set up programs whereby if the employees met certain targets you could give them a benefit on a tax-free basis. You're actually looking at tax accrued plans in the U.K. You'll come across it. You'll also come across various types of stock ownership programs. Each country has its own various rules and regulations.

Accounting standards are another one of my favorites. When *FAS 87* came out, the U.S. was doing the first one with a major accounting standard that we imposed. I used to have all sorts of battles with people. The British like to be overfunded and they objected. We felt that the plan really didn't have that surplus that *FAS 87* reported. Then you'd cross over to their melee and fight, because *FAS 87* says you have to recognize pay increases and you have to recognize indexation. Therefore, book reserves is the only reporting. If you're small, they had to report a bigger expense and they would fight it. You have those differences.

Now Canada has its own accounting standards, but it's not that different from *FAS 87* and B3, which is the Mexican accounting standard. Again, these three have one thing on common which is that they all use projected unit credit. They're expected to use salary increase. They're expected to use indexation if that is the case. The British will use something called Statements of Standard Accounting Practice (SSAP) 24. The whole concept under SSAP 24 is different from these. The British don't believe in pension shock. In the U.S. the idea is if there's a big change in interest rates, that should be recognized in the accounting. The British don't believe in that. They have a tendency to want to have a constant average pay, almost like an aggregate funding type of arrangement. There's a lot of controversy and there's some belief that SSAP 24 will get amended and it will be more like these other standards. I don't think that's really resolved.

Then there's the German accounting standard, BiRiLiG. You may see that in literature. It's important if you're a U.S. domestic actuary and your parent company is German, because you can't use these systems very well. One of the major differences between BiRiLiG and the other standards is that they don't really allow you to defer plan derivatives. So if you have an hourly pay plan and you have a benefit improvement, the *FAS 87* would say let's amortize that into the additional cost over the average expected future working lifetime. In Germany that wouldn't work. You'd have to have much more payment on the books and the Germans can get upset about it.

A German company, in fact, didn't take the tax deduction for book reserves because it just wasn't making any money and the books never showed a record of the liabilities. When they went bankrupt, they realized that they had this huge unfunded liability that was not on the books. If you read BiRiLiG, you would get the impression that you could use these. There is a very specific statement that says if you set up a book reserve that is less than the minimum under the tax deduction, you have to disclose it. In practice what the Germans have done, in most cases, is simply use the German book reserve system. You could use some of these. There's also an International Accounting Standard. I don't know anyone who uses it, but I know it does exist.