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Understanding the What, Where, and When of International Retirement Plans

Employees who have worked outside their home country during their careers may discover that their retirement benefits are reduced compared to the benefits available if they had remained at home and never worked abroad. This can occur if employees working outside their home country can no longer contribute to their home country retirement plans or the host country retirement plan offers less benefits than what they would have received at home.

To ensure employees do not face this variance, many companies are establishing International Retirement Plans (IRPs) so employees do not lose out on retirement benefits because the company has asked them to work outside their home country.

Strategies for Providing Retirement Benefits to Assignees

There are a number of strategies that companies undertake in order to provide retirement benefits to employees who work outside their home country at some time in their career.

These may include:

- Maintaining home country coverage
- Joining the host country coverage
- Participating in an International Retirement Plan

Maintaining Home Country Coverage

Due to the ease of administration, the most common approach is to maintain employees in their home country retirement plan. The employee's familiarity with the retirement plan means no change is needed to the employee's retirement contributions.

However, some countries prohibit employees from remaining in the home country retirement plan if they are no longer a resident or employee in the home country. In some countries it may also not be legally permissible for the employee to remain in the home country retirement plan if they are working outside the country for an extended period of time. Other countries do not allow a person who is no longer an employee or resident of the country, to withdraw from the retirement plan without paying financial penalties.

Joining the Host Country Coverage

If the employee is unable to remain in the home county retirement plan, participating in the host country retirement plan may be an alternative. While this is a fairly simple solution for the company, participation in the host country plan may not provide retirement income consistent with what the employee would have received in their home country. This depends greatly upon the retirement plan of the host country and the period of time the employee remains in that country. If an employee is on assignment in a host country for a long period of time and the country has a generous retirement scheme, this may be an acceptable solution for both the employee and the company. However, for employees who have multiple countries of assignment throughout their career, or are on an assignment in a country with a less generous retirement plan than their home country, participation in the host country plan may not provide an adequate retirement benefit. It can create a fragmented and disjointed retirement situation for the employee who may receive retirement benefits from a number of different countries and may have difficulty collecting these benefits as a non-resident.

Double taxation may occur in some instances when the host country retirement benefit is claimed but the employee is a resident in another country. Exposure to currency fluctuation and administrative complexity may become factors as the employee attempts to navigate the retirement plans of multiple countries in order to collect their earned benefits upon retirement.

Participating in an International Retirement Plan

An International Retirement Plan (IRP) is a retirement plan designed to meet the needs of a mobile population. An IRPs may also be referred to as an inter-national pension plan, global pension

plan, or offshore plan. IRPs are increasingly becoming the retirement solution when the employee:

- is no longer able to contribute to the home country retirement plan
- cannot contribute to the host country retirement plan
- has retirement benefits in the host country that are not consistent with the home country
- is in a location where contributions to the host country retirement plan are highly taxed or can only be withdrawn if the employee is resident of that country.

IRPs are most often custom-designed by the company and provide a flexible vehicle for retirement savings. They are tax-efficient and allow for multiple currencies and languages. However, they can be expensive to establish and operate, so companies rarely set up an IRP for a small number of employees.

Types of International Retirement Plans (IRP)

IRPs can be designed as either a Defined Benefit or Defined Contribution Plan. Selecting the appropriate type of IRP retirement plan is a fundamental decision that must be made in the early stages of the strategy and design process.

DB plans pre-establish and guarantee an employee's retirement benefit based on the formula of calculating years of service, age and earnings history. DC plans provide an investment opportunity for the employee, but do not guarantee a specific amount of retirement benefits since retirement benefits are impacted by the performance of investments.

Defined Benefit Plan

A Defined Benefit (DB) plan is a type of retirement plan in which the employer promises a specified monthly benefit to the employee upon retirement. The amount is predetermined based upon a formula that calculates years of service, age, and earnings history. The benefit is defined in the sense that the benefit formula is known in advance. The investment risk is borne by the employer since they are to deliver the benefit as promised. DB plans are usually funded exclusively by employer contributions.

The most common type of DB plan is a Defined Benefit Umbrella. This type guarantees a retirement benefit based upon the DB plan formula of calculating years of service, age and earnings history and is typically funded exclusively by employer contributions. The difference is a Defined Benefit Umbrella plan usually "offsets" or subtracts any company-sponsored pension plans that the employee may have accrued a benefit while on assignment.

Defined Contribution Plan

A Defined Contribution (DC) plan is the prevailing type of IRP and has become popular all over the world in recent years. In many countries it is the dominant form of retirement plan in the private sector. In a DC plan, the employer makes contributions into an individual account for each plan member.

The contributions are invested, for example in the stock market, and the returns on the investment (which may be positive or negative) are added to the employee's account. Upon retirement, the employee's account is used to provide retirement benefits.

The amount of the employer contributions is typically determined as a percentage of the employee's base salary, but the actual amount of retirement income depends upon investment earnings. While the contribution to a DC plan is defined, the actual amount of the retirement benefit may fluctuate.

The two most common types of DC plans are:

Defined Contribution Target Plan

- Individual accounts are maintained based upon a pre-established contribution schedule and actual (or notional) investment returns
- Employees may be able to choose from a selection of investment options

Supplementary Defined Contribution Plan

- This plan is designed to make up any shortfall that the employee may experience as a result of working outside their home country for an extended period of time
- The plan facilitates a "top up" – this means that the company contributions are based upon the amount of projected pension shortfall either from the loss of home country social security benefits or the inability to participate in a home country pension plan

IRP Plan Design Components

When designing an IRP, several key decisions will need to be made including:

- Plan type
- Eligibility criteria
- Contribution schedule
- Vesting schedule
- Investment options

Plan Type

Determining whether to choose a DB or DC plan type is the first and most fundamental decision to be made. This decision dictates many of the IRP design features and funding options.

Eligibility Criteria

One of the most important elements of plan design is determining which employees are eligible for participation in the IRP. IRPs are typically highly desirable plans so eligibility should be strictly defined.

Contribution Schedule

A contribution schedule is the contribution amount and the timing of when the employee or company makes the contribution into the IRP. The contribution schedule can vary widely based upon the company's total compensation philosophy and the amount of compensation attributable to retirement benefits. Whether it is permissible for employees to contribute to the plan greatly influences the contribution schedule as many companies believe that retirement

savings should be a shared responsibility between the employee and the employer.

Generally, the combined employee and employer contributions rates range between 7% and 20%. Some plans vary the contribution rate based on the employee's home country or years of service. Others adopt a consistent contribution rate for all employees within a category of eligibility (such as job type or job level within the company).

Vesting Schedule

Vesting is the employee's ownership of their contributions and rights to the specified benefits of the plan in which they contribute. A vesting schedule dictates the point in time in which the plan assets are owned by the employee. For IRPs, the employee contributions are 100% vested at all times. However, the employer's contributions to the plan may be based on the employee achieving a service requirement, such as 1 year or 5 years. Another option is tying the vesting schedule to a particular age requirement such as age 55, or a "normal retirement age" as determined by the plan.

Investment Options

Whether employees can dictate the investment of their retirement plan assets depends greatly on the plan type. If a DC plan type is selected, employees generally have a choice amongst various investment options such as stocks, bonds, and income guaranteed contracts.

Selecting a Plan Administrator and Establishing the Plan

Once the IRP design decisions have been made, the next step is to choose which insurance carrier should provide the IRP to the company. Insurance carriers are the main providers of IRPs and are also the plan administrators. Carrier examples include: Aegon, Allianz, Fidelity International, Generali, Swiss Life, UBS, and Zurich.

When selecting an insurance carrier, the stability and strength of the insurance company should be a primary consideration. Use of an independent rating agency such as Standard & Poor's, Moody's or A.M. Best is advisable to help determine the financial stability and anticipated future solvency of a carrier.

Each carrier has different requirements on the minimum number of participants or the minimum amount of assets needed to establish an IRP. The larger the size of the IRP, the more flexibility the company has in designing the IRP and in offering design features such as investment options.

The IRP features or service capabilities that should be evaluated when selecting a carrier include:

- Wide range of investment funds
- Multiple currency options
- Multiple language options
- Variety of payment options
- On-line self-service administration for employers and employees
- Access to reports and valuations

Typically, most carriers offer a broad range of fund options including money market, managed, bond, regional equity, and global equity. Companies and employees can manage funds online and access reports and valuations in multiple languages and currencies. Online investment allocations and the re-allocation of investments are important plan features. Plans should also allow for a variety of benefit payment options including lump sum and multiple annuity options. The reporting capabilities of the carrier is important for employees who have income tax reporting requirements and may need to report in multiple currencies or annual reporting of investment details.

Funding the Plan

After selecting the IRP design and carrier, the next step is to determine how to establish the IRP. A company can implement an IRP in one of two ways:

- A trust arrangement
- An insurance arrangement

A **trust arrangement** is a relationship in which a person or entity (trustee) has legal control over certain property and has a fiduciary duty to exercise this control for the benefit of someone else.

In an **insurance arrangement**, a contract is held between an insurance company and a person or organization. The insurance company assumes the liability for the pension plan and any guaranteed investment returns.

The choice between a trust or insurance arrangement is mainly driven by the size of the IRP, the anticipated growth of IRP assets, the IRP membership and how much IRP design flexibility the company wants to have. Generally, for IRPs with less than 100 members, an insurance arrangement is the most feasible. While an insurance arrangement is often much quicker to implement and easier to administer, it does have limitations on IRP design and funding alternatives. The IRP design flexibility is often limited to a few choices of simple, off-the-shelf designs with limited customization.

Some carriers allow the IRP to be initially established within an insurance structure with the flexibility to convert into a trust once the size of the IRP is large enough to warrant the extra cost for customizing the IRP design. This funding flexibility can be an important feature for companies that anticipate significant growth in their mobile workforce in future years.

A trust arrangement offers companies the flexibility to fully customize the IRP design and control the IRP assets. However, the start-up costs can be much higher and the implementation timeline more lengthy than with an insurance arrangement. Companies

rarely establish a trust without a minimum of 100 participants because of the administrative expense in designing and operating this type of IRP. In addition, companies must assume more fiduciary responsibility and ensure internal controls and increased governance with a trust as compared to an insurance arrangement.

Segregated Assets vs. Aggregated

If a trust arrangement is implemented, the manner in which IRP assets are established must be determined. IRP assets can be segregated by individual IRP participants or aggregated (also called earmarked and non-earmarked options).

Segregated assets are allocated to specific employees enabling both the employer and employee contributions to be recorded separately. **Aggregated** contributions are not allocated to any specific member and are simply "pooled" to enable the employer or trustee to determine each member's benefit at the time of retirement.

Tax Considerations

IRPs are typically established in well-regulated, financially secure offshore jurisdictions such as the British Channel Islands or Bermuda. For this reason, these plans are sometimes referred to as "offshore retirement plans." While the taxation of IRPs is a relatively gray area, generally the benefits are free of tax at the source, meaning that there is no benefit-in-kind tax levied on employees for retirement plan contributions made by the employer. One negative aspect of an IRP is that they are non-qualified, meaning IRPs do not meet any country-specific rules or regulations. There is no way for employees to take advantage of tax deferrals or pre-tax contribution opportunities. In addition, because the IRP is non-qualified, the company typically loses the ability to take a corporate tax deduction for contributions made to the IRP.

For most IRPs, there is no tax liability for the employee until benefits are paid out, so the tax position depends on the employee's place of residence at the time the retirement benefits are distributed from the IRP. In addition, there are generally no taxes assessed on capital gains resulting from favorable tax treatment of investment returns.

For these reasons, funding the IRP offshore is considered a favorable tax strategy. However, as the prevalence of IRPs grow, so does the scrutiny around the taxation and the offshoring of retirement plan assets. Companies should establish internal controls and must be diligent in their governance of IRPs. Consultation with Procurement, Legal, and Tax Departments before making any final decisions regarding IRPs is advised. These Departments should be involved in every step of the decision-making process.

Conclusion

Generally, companies attempt to keep employees in their home country retirement plans for as long as legally and administratively possible. This is the best approach since there is no additional administration or costs to the company to manage the employee's retirement benefits and the employee is already familiar with the home country retirement plan provisions.

When it is not possible to keep the employee in their home country retirement plan due to tax or legal restrictions, participating in the host country retirement plan may be an appropriate alternative. However, this can lead to a fragmented retirement situation with potential exposure to double taxation, decreased retirement benefits, exposure to currency fluctuations, and administrative complexity.

IRPs are increasingly becoming the solution used by many companies to provide a vehicle for retirement income for employees who work outside their home country on a long term or permanent basis. The need for this type of plan is expected to increase as many companies are growing their mobile workforce.

Lisa Burkard
Managing Director

Spectrum Group Consulting Services, LLC is an independent consulting firm specializing in international benefits and global mobility. We provide services to assist global companies with the design, implementation, and management of global mobility and international benefit strategies and solutions. By servicing a niche area within global HR, we are able to offer pragmatic and cost-effective solutions.

Our consultants have extensive global experience and have worked as Global Mobility and Global Benefits managers. We know what you do, and therefore we can help you do it more effectively. By successfully navigating the corporate environment, we are positioned to work in partnership as an extension of your Total Rewards department.

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SpectrumGroupConsulting.com.
LisaBurkard@SpectrumGroupConsulting.com