INTERNATIONAL BENEFITS POLICY:

A U.S. MULTINATIONALS PERSPECTIVE

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SUMMARY

This paper discusses the issues involved when a U.S multinational develops benefit guidelines from its corporate headquarters and then attempts to implement these guidelines overseas. We will focus on a multinational that, while having operated a business overseas, has never extended guidelines, or controls, to its subsidiaries benefit plans. Specifically, we will consider a company which draws on its domestic experience to construct a "benefits policy" and then exports this policy. Such a scenario is typical of the development of many multinationals in this area.

As background to the corporate perspective, it is helpful to review recent trends in the U.S. from both a legislative and benefit standpoint. This review forms the first part of the paper, and given this understanding of the U.S. environment, two major questions will be addressed:

- why U.S. multinationals are generally considered "hands-on" in their international subsidiaries benefits; and
- why many U.S. multinationals desire consistent benefit programs.

In the second part of this paper, we will review three distinct types of benefit: retirement, medical and employee stock plans. Typically, U.S. management tends not to see these plans as separate entities in themselves, but part of a bigger picture where the total cost of all benefits is more important than the individual components.

The final part of this paper uses this multinationals experience to highlight factors which will assist actuaries on both sides of the equation, namely:

- the U.S. corporate advisor who is acting as the headquarters "2nd opinion" for proposals coming from, or going to, the overseas subsidiary; and
- the local advisor who faces perceived interference from corporate when making recommendations to his client, i.e. local management.

In practice, many benefit decisions are made at corporate by management unfamiliar with the details of the specific overseas environment. Consequently, there is a duty on the local, or corporate, advisor to educate management and steer them away from ill-informed decisions that serve neither the corporation as a whole, or the local subsidiary in particular.

THE U.S. MULTINATIONALS DOMESTIC EXPERIENCE: LEGISLATION

First, why do U.S. multinationals have to "interfere" at all?

Consider the finance department at corporate. Someone there has to know, and understand, the impact of the following benefit accounting standards on its profitability:

FAS 87 & FAS 88

These relate to employers accounting for pensions. FAS 87 was effective for fiscal years beginning after December 15, 1986, while FAS 88 deals only with the specific situations found in "settlements and curtailments" of DB plans.

FAS 106

This relates to accounting for post retirement benefits other than pensions. This covers primarily medical benefits and was effective for fiscal years beginning after December 15, 1992. The impact of this standard is discussed under the heading **Medical** below.

FAS 112

This relates to post employment benefits. This covers all benefits received after employment ends but before retirement begins. Basically this ties up all forms of employee benefits not covered by FAS 87/88 or FAS 106. Examples are severance pay, workers compensation, disability, continuation of healthcare or life insurance. FAS 112 was effective for all fiscal years beginning after December 15, 1993.

Further, at the time of writing, the Internal Revenue Service is finalizing another piece of legislation:

Section 404A

This relates to the tax deductions U.S. corporations can claim for their subsidiaries contributions to foreign DB pension plans and other "deferred compensation" benefit plans.

No other country imposes such legislative burdens. Because of this, corporate has been forced to become **"hands-on"** and be able to accurately assess the financial impact of all its benefit plans, anywhere in the world. What is commonly perceived as interference locally is no more than corporate meeting its substantial financial reporting requirements.

THE MULTINATIONALS DOMESTIC EXPERIENCE: BENEFIT PLANS

Besides legislative issues, it is important to understand the typical benefits offered by a U.S. company to its own employees, since this influences its thinking when designing an international policy.

In broad terms:

Retirement

Normally, either a defined contribution plan (for example a 401(k)), or a modest defined benefit plan, or both. The DB market has been declining for several years with plans being terminated and replaced by DC designs. New, "start-up" plans would invariably be DC. Another important feature is that plans must be nondiscriminatory. In this context this means that accrual rates (DB) or contribution rates (DC) must be offered on the same terms for all employees. Therefore executives will not have a higher benefit formula, at least not from the qualified retirement plan, unlike many overseas countries where such practice is fairly standard.

Medical

Generally considered by employees and employer alike as the major employee benefit, and the most costly. In contrast to other Western economies, the employer benefit replaces the state system, rather than providing a supplemental benefit. Consequently U.S. medical plans are a significant cost strain to the employer. Further, because these plans are generally unfunded with employers previously recognizing costs on a cash basis, FAS 106 was introduced to quantify the accruing costs. How significant was its impact? A glance at the 1992 list of Fortune 500 Industrial Companies (the ranking of the largest U.S. companies) showed corporate profits go into the red as a direct result of firms taking a one-time hit for past liabilities on adoption of the standard. The actual figure for these 500 companies as a whole showed a loss of $196.2 million and was the first time that the 500 list lost money. FAS 106 was identified as the overriding component of this loss.

This huge impact on corporate profits has done more to focus both management and shareholders attention on the importance of quantifying the current benefit costs, and the projected costs, associated with benefit promises.

Stock Plan

Employers wishing all employees to have a financial stake in the company can offer stock plans on a tax favored basis. The main types are an ESOP (Employee Stock Ownership Plan) or a Section 423 Employee Stock Purchase Plan. Although the differences and objectives of these plans are complex, including whether they are a benefit or an incentive, the common thread is that they provide a vehicle for employees to own company stock.

In summary, the U.S. management will, based on U.S. experience;

- have a benefit committee consisting of senior multidisciplined management to review significant domestic and overseas benefit proposals, especially the potential financial implications. This multidisciplined composition is significant, and one of the major reasons behind U.S. firms desiring consistency of benefit programs. With their lack of specialist benefit knowledge, the closer overseas proposals mirror the U.S. experience, the easier it is for the committee to understand and consequently approve them.

- be extremely cost sensitive to any benefit plan largely as a result of FAS 106 and to a lesser extent FAS 87 and FAS 112.

- be adverse to DB plans, with Section 404A being another nail in the DB "coffin".

- have a lack of understanding of the role of medical plans and social security overseas, though this is changing as discussions on President Clinton's national health care system develops, and increases general awareness on how other countries provide healthcare.

- increasingly view employees as responsible for their own investment decisions through the stock plan, or through the investment choices open to them through the DC plan; and

- will not view favorably separate, and more generous, executive benefits because nondiscriminatory rules in the U.S. means their own plans do not have similar management advantages.

With this insight into the domestic benefit scene and the multinational management infrastructure, we can now look at the issues involved in exporting a benefits policy.

THE EXTENSION OF THE U.S. PERSPECTIVE OVERSEAS

As in the summary, we will consider the case of a U.S. multinational taking its first "hands-on" steps to control its international benefit programs. In particular, what are the problems it will face in seeking a consistent benefit framework modelled on its U.S. structure with regard to:

- retirement;
- medical; and
- stock plans.

Given the trend in its home retirement market, we will assume that this company is DC orientated, will consider a medical plan for all employees and have a desire to place company stock in employees hands.

The ability of corporate to impact overseas benefits varies by country. Indeed even within the same country, it can vary dependent on:

- the size of the subsidiary;
- the power or influence that subsidiary wields (almost invariably based on the profitability of that subsidiary within the organization as a whole); and
- whether the multinational is opening a completely new site (where no benefit programs exist) or inheriting an existing benefit program through acquisition.

Nevertheless, what general observations can we make as this company tries to export its benefits policy? Specifically, let us consider the company to have four substantial overseas locations: the U.K., Germany, France and Japan.

INTERNATIONAL BENEFITS POLICY: RETIREMENT OBSERVATIONS

Country	Main Type of Local Plan
U.K.	DB, Smaller plans DC
Germany	DB
France	Compulsory benefit arrangements integrated with the state system.
Japan	DB lump sums, DC plans unknown. Pension plans only in the larger companies.

From the table above, we can see that corporate policy immediately faces significant obstacles. The desire to have DC plans worldwide runs into the following problems:

U.K.: Primarily a DB market, especially for the larger employer. However, implementing a DC plan will be feasible if the subsidiary is relatively small, or if the firm is a start-up operation. Conversion of a large DB plan is possible, and several U.S. multinationals have successfully completed this exercise. However, the process is time consuming, expensive and involves substantial communication to employees.

Germany: Like the U.K., primarily a DB market. DC plans have limited tax concessions in comparison to DB plans. As a result, the U.S. company is unlikely to achieve its DC goal and provide a plan which provides a competitive level of benefits.

France: Little room for maneuver here because of the mandatory provisions. Private DC plans are found in the top executive bracket, which, because of the U.S. experience, is unlikely to appeal to the multinational.

Japan: In terms of pension design, this is a relatively immature market. More likely the company will face pressures to convert the lump sum termination indemnities found in Japan to a formalized defined benefit pension plan. DC plans are rare, if any exist at all.

From a retirement standpoint, the multinational is unlikely to be successful in consistent DC coverage.

INTERNATIONAL BENEFITS POLICY: MEDICAL OBSERVATIONS

Country	Private Plan
U.K.	Yes, often senior management only
Germany	Yes, often senior management only
France	Yes
Japan	No

The above table shows the developing trend of employers offering private medical plans. The multinational can therefore implement its corporate philosophy in three countries. In the U.S. this benefit is the most sought after by employees and the costliest to the employer, but does not carry the same features overseas. Several points are of relevance to the company and consultant alike:

- The cost of these plans is far less than the comparable U.S. cost, generally because of the more comprehensive nature of each countries social security. In Japan for instance, the system is so comprehensive that the incidence of private plans is rare.

- Many companies will only offer plans to management employees rather than the workforce as a whole, as in the U.K. and Germany. This is contrary to the multinational's domestic practice and desired international policy. However recruitment of senior management may prove difficult if the multinational is not willing to follow local competitive practice.

- Generally plans are restricted to active employees only, so multinationals will have no FAS 106 exposure.

INTERNATIONAL BENEFITS POLICY: STOCK PLAN OBSERVATIONS

Country	Incidence
U.K.	Legal and widespread due to tax incentives
Germany	Legal, but not widespread due to lack of tax incentives
France	Legal and widespread due to tax incentives
Japan	Legal and widespread due to tax incentives

This is the least mature benefit in comparison to retirement and medical plans, but is the one where the largest multinationals have gone furthest as they view stock as the key to being viewed by their employees as truly international, truly "one company". However, while the principle is simple, the practicalities involved in extending a U.S. stock plan overseas are not. The U.K., Japan, and to a lesser extent France, offer tax advantages for granting company stock. However, even with taxation incentives employers have been reluctant to go to the expense of setting up these plans. Such costs can be substantial in designing a plan that meets all the local securities laws. Further currency exposure, dealing facilities and local administration costs can add together to result in low employee participation. With low participation, the cost per employee of setting up the plan can deter even the keenest multinationals.

However, in recent times the European Union has issued a Recommendation (which does not confer any legal power) aimed at encouraging employees to take a financial stake in their employer. In Japan, a striking feature is the "lifetime employment" expectations of the workforce and the loyalty that exists between employee and employer. Employee stock ownership is a natural extension of this loyalty. Despite this, the U.S. employer may well find their Japanese employees less willing to buy U.S. stock than if they worked for an indigenous firm.

Viewed short-term the multinationals objective may not be achievable and corporate may well selectively extend their plans into U.K. and France, with Germany and Japan lower on the priority list.

CONCLUSION

In any paper of this broad nature, the experiences of any one consultant will not accord with the generalities discussed above. However, a few pertinent factors should be reinforced, especially for those consultants dealing with the multinational which has developed, or is in the process of developing an international benefits policy. These are:

- the actuary, either at corporate or locally, increasingly must develop a broader consultancy background beyond the traditional DB skills, and to fully understand the client must be aware of the role of the benefits committee. Further, he must be patient and allow for the experience of its constituent members, and their inherent leaning towards their U.S. background, their "comfort zone".

- that corporate policies, however well intentioned, will need adaption to the local environment as witnessed by the examples in the four countries above.

- that financial concerns, more than ever before, drive U.S. management's decisions on benefit plans, with increasing pressure for employees to take more control of their own benefit decisions. This can be seen through employers pushing investment decisions onto employees via DC plans, more cost sharing of medical costs, or through encouraging employees to take a direct financial stake in the company via stock plans.

- that internationalization (or globalization in the current management parlance) is here to stay, and companies will increasingly strive for consistency of programs, even if this is not achievable at the current time.

As can be seen from the issues raised in this paper, an international benefits policy requires considerable planning both at corporate level, and in relation to the local environment. Indeed the creation of such a policy requires careful research into the company's benefits philosophy in the first place, including a thorough analysis of its overall objectives. Added to that, a company needs to have the proper management infrastructure and communication channels in place to effectively support the subsequent implementation of any policy. However the design issues and implementation procedures would justify separate papers in themselves!