Corporate and individual retirement plans are being strengthened internationally to complement social security and provide benefits for the aging populations in foreign countries.

International Trends in Corporate and Individual Retirement Plans

Saying that U.S. pensions represent a significant labor cost and have an impact on the nation’s competitiveness in international trade, the Committee on Ways and Means Subcommittee on Oversight has recently recommended that the Department of Labor report to Congress on comparable foreign pension systems and practices. This Issue Brief—the second in a two-part analysis that began with international social security reform—explains various programs and proposals to expand corporate and individual retirement plans abroad. The particular issues were selected for discussion because they address concerns of U.S. policymakers.

Most foreign countries studied here have government-funded social security systems. But faced with the financial strain of providing for increasing numbers of retirees, they are now establishing and expanding private-sector retirement arrangements to complement their social security systems. Although some countries, such as France and Switzerland, currently mandate varying levels of employer-sponsored pensions, most countries use a voluntary approach to encourage the growth of private-sector retirement arrangements.

Following the U.S. example, individual retirement plans are among the new pension arrangements recently adopted and proposed in foreign countries. They are sometimes, however, more restrictive regarding preretirement access to monies in individual retirement accounts. In some cases, the money cannot be withdrawn before specified ages. Where preretirement withdrawals are permitted, penalties are sometimes imposed. Also, bonuses are sometimes offered to individuals who defer retirement.

Along with tax revisions to encourage the development of private-sector retirement arrangements, many countries are making reforms to their overall tax systems. Although European countries generally use a value-added tax (VAT), when Japan recently proposed adoption of a VAT, the proposal had to be withdrawn because of political opposition. A VAT has also recently been proposed in Canada, but it has not yet received much public discussion.
Introduction

The worldwide demographic trend toward an aging population is putting stress on the financing of the social security systems in many countries. The July 1987 Issue Brief noted the demographic trends in Canada, France, Italy, Japan, Switzerland, the United Kingdom, and the United States, and reviewed some specific steps taken by these countries to stabilize the financing of their social security systems.

Most governments are now placing limitations on the future liability of the public sector for the provision of retirement income to the population, or are considering such limitations. A major effect of such limitations is a shift in the responsibility for retirement income from the public sector to the private sector, either by specific intention of the government or simply by default. The private sector in this case includes both employers and individuals.

This Issue Brief compares recent U.S. developments in pension policy and practice regarding corporate and individual retirement plans with those of the same six countries discussed in the July 1987 Issue Brief—Canada, France, Italy, Japan, Switzerland, and the United Kingdom. The new pension initiatives in Belgium, Portugal, and Spain are also included briefly. In particular, the policies and practices of these countries are described where they have taken action on issues of current importance in U.S. pension practice (tax reform, vesting and portability of benefits, ownership of excess pension fund assets, etc.),

made significant changes in the structure of their pension system (introduction of mandatory corpo-

<table>
<thead>
<tr>
<th>Countries</th>
<th>Corporate Pension Plans</th>
<th>Individual Retirement Plans</th>
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<tbody>
<tr>
<td></td>
<td>Mandatory</td>
<td>Voluntary</td>
</tr>
<tr>
<td>Belgium</td>
<td>X</td>
<td></td>
</tr>
<tr>
<td>Canada</td>
<td>X</td>
<td></td>
</tr>
<tr>
<td>France</td>
<td>X (comprehensive)</td>
<td></td>
</tr>
<tr>
<td>Italy</td>
<td>X</td>
<td></td>
</tr>
<tr>
<td>Japan</td>
<td>X</td>
<td></td>
</tr>
<tr>
<td>Portugal</td>
<td>X</td>
<td></td>
</tr>
<tr>
<td>Spain</td>
<td>X</td>
<td></td>
</tr>
<tr>
<td>Switzerland</td>
<td>X (minimum)</td>
<td>X</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>X</td>
<td></td>
</tr>
<tr>
<td>United States</td>
<td>X</td>
<td></td>
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</tbody>
</table>
rate pension plans or new legislation for funded, employer-sponsored plans; or

placed new emphasis on individual savings for retirement.

Although some of these changes have strengthened employer-sponsored defined benefit plans, in other countries there has been a shift toward defined contribution plans.

As background, Table 1 shows the types of private-sector pension arrangements prevalent in each of these 10 countries, which all have basic social security systems. Belgium, Canada, Japan, Switzerland, the United Kingdom, and the U.S. all have well-established, voluntary, corporate pension plan systems. France has a complementary pension system that was originally established by means of union agreements, but that now covers virtually all employees in France, with few options for the employer. Switzerland has a well-established, voluntary, corporate pension plan system, but it has also required all employers to provide a minimum-level pension plan for employees since 1985. Spain and Portugal have recently passed new pension legislation to facilitate the establishment of funded, corporate pension plans. Some companies in Italy are now introducing corporate pension plans, even in the absence of any specific pension legislation.

In the area of individual retirement plans, Canada has had a well-established system of registered retirement savings plans (RRSPs) for some years, and these plans have been encouraged through the tax system. Tax changes are now underway to make the choice of pension arrangements tax neutral. For example, similar tax concessions will be available to employees who are members of an employer-sponsored pension plan or who make their own pension arrangements through a RRSP, or who have a combination of both types of plans. Belgium and Switzerland have both introduced new legislation for individual retirement plans within the last year. France has a similar proposal under discussion. The United Kingdom, however, has made the greatest attempt to shifting pension responsibility away from the government and to the individual. New "personal pension plans" will be available in the United Kingdom in January 1988.

Table 2 shows the approximate percentage of full-time, private-sector employees who are now covered by employer-sponsored retirement plans. This should be taken as a general guideline only, because the various surveys on which the percentages are based do not necessarily have the same basis.

**Tax Reform**

**United States**

The Tax Reform Act of 1986 (TRA) included numerous provisions regarding employee benefit plans and individual retirement accounts (IRAs), in addition to the reduction in corporate and individual income tax rates. The changes in the pension and welfare area are in-

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**Table 2**

<table>
<thead>
<tr>
<th>Countries</th>
<th>Employees Covered</th>
</tr>
</thead>
<tbody>
<tr>
<td>Belgium</td>
<td>25.0%</td>
</tr>
<tr>
<td>Canada</td>
<td>47.0</td>
</tr>
<tr>
<td>France</td>
<td>98.0*</td>
</tr>
<tr>
<td>Italy</td>
<td>5.0</td>
</tr>
<tr>
<td>Japan</td>
<td>53.0*</td>
</tr>
<tr>
<td>Portugal</td>
<td>1.0</td>
</tr>
<tr>
<td>Spain</td>
<td>10.0*</td>
</tr>
<tr>
<td>Switzerland</td>
<td>100.0</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>53.0</td>
</tr>
<tr>
<td>United States</td>
<td>46.0*</td>
</tr>
</tbody>
</table>

* Includes the Complementary Pension Scheme.
* Employees covered by prefunded pension plans (i.e., tax-qualified and employees' pension plans); additional employees are covered by pay-as-you-go, lump-sum retirement plans. A total of 89 percent of all companies (not employees) with over 30 employees have some type of retirement plan.
* No estimate available of employees covered by insured or funded plans. A large number of employees are covered by unfunded pension plans under the labor law, but it is unclear whether many of these plans will be able to pay the promised benefits.
* Estimated.
* Participants.
tended to produce more comparable employee benefit coverage of rank-and-file employees and of highly compensated employees.

Some of the specific changes in U.S. pension and tax legislation are mentioned briefly in this Issue Brief to show the comparison with the practices and policies of other countries on these same issues. The provisions of TRA relating to employee benefits are discussed in more detail in the EBRI Issue Briefs of March 1987 and October 1986.

Canada

Canada has proposed extensive revisions to its tax treatment of pension contributions in an effort to provide similar tax arrangements for the various types of pension plans, so that the choice of pension arrangement will not be based on tax considerations. The revisions will equalize the tax advantages of employee contributions for retirement, regardless of whether the contributions are made to an employer-sponsored plan or to an individual retirement plan. The revisions will also equalize the tax advantages of defined contribution and defined benefit pension plans.

Under recent reforms proposed in Canada, the choice of pension arrangement would not be based on tax considerations, since various plans would receive similar tax treatment.

The effective date of the new retirement plan proposal is now expected to be deferred to January 1, 1989, although the implementing legislation is unlikely to be passed before the fall of 1987.

As background, there are the following types of private retirement plans in Canada.

Registered retirement savings plans (RRSP)—These are individual plans similar to IRAs in the U.S.

Registered retirement plans (RRP)—These are employer-sponsored pension plans. They are further divided into defined contribution RRPs and defined benefit RRPs.

Deferred profit sharing plans (DPSP)—These are employer-sponsored profit sharing plans.

The new tax system is based on the principle that a contribution of 18 percent of salary, per year of employment, would provide an annual retirement income of approximately 2 percent of final average salary times years of service.

To determine the maximum tax deduction permitted each year, the employer first has to calculate a "pension adjustment" amount for each employee. The following general methods are used for calculating the pension adjustment amount.

Defined contribution RRPs—It is the total of the employee and employer contributions made in a calendar year on behalf of the employee.

DPSPs—It is the total of all employer contributions made in a calendar year on behalf of the employee. There are no employee contributions to DPSPs.

Defined benefit RRPs—The general formula is (9 x benefit accrual rate x salary) minus about $450.1

However, the formula for the pension adjustment can be much more complicated depending on the features of the pension plan. The offset of Canadian $600 (U.S. $450) and the factor of 9 are arbitrary amounts set by the government. The offset of $450 is intended to represent the average cost of ancillary benefits such as

1 For example, in a plan with a benefit formula of 1.5% of salary times years of service, an employee with a salary of $40,000 would have a pension adjustment amount of $4,950 (9 x 1.5% x $40,000 minus $450). All amounts shown in U.S. dollars are rounded to the nearest $50. Exchange rate: U.S. $1.00 = C $1.34 (June 10, 1987).
survivors' pensions or indexation, regardless of whether a particular plan includes them. The factor of 9 is based on an assumed need for $9 of current funding to provide $1 per year of retirement income.

In general, the main tax provisions are aimed at RRSPs and require that the employee offset the value of his or her other pension arrangements, using the pension adjustment amount. That is, for 1989 and later years, an employee can take a deduction from taxable income for contributions to a RRSP up to 18 percent of the previous year's earnings (subject to certain maximums), minus his or her pension adjustment amount for the previous year. The 18 percent of previous year's earnings is limited to a maximum of approximately the following amounts (in U.S. dollars), for the year the tax deduction is taken.

<table>
<thead>
<tr>
<th>Tax Year</th>
<th>Maximum Contribution to a RRSP in U.S. $</th>
<th>in Canadian $</th>
</tr>
</thead>
<tbody>
<tr>
<td>1989</td>
<td>$ 6,350</td>
<td>$ 8,500</td>
</tr>
<tr>
<td>1990</td>
<td>$ 7,850</td>
<td>$10,500</td>
</tr>
<tr>
<td>1991</td>
<td>$ 8,600</td>
<td>$11,500</td>
</tr>
<tr>
<td>1992</td>
<td>$ 9,350</td>
<td>$12,500</td>
</tr>
<tr>
<td>1993</td>
<td>$10,050</td>
<td>$13,500</td>
</tr>
<tr>
<td>1994</td>
<td>$10,800</td>
<td>$14,500</td>
</tr>
<tr>
<td>1995</td>
<td>$11,550</td>
<td>$15,500</td>
</tr>
<tr>
<td>1996+</td>
<td>to be indexed</td>
<td></td>
</tr>
</tbody>
</table>

For example, an employee with a salary of $40,000 in 1988, and no employer-sponsored pension plan, could make a tax-deductible contribution to his or her RRSP of up to $6,350 for the 1989 tax year (18% of $40,000 = $7,200; limited by the maximum of $6,350).

An employee with the same $40,000 salary in 1988 who was a participant in a defined benefit RRP, with a 1.5 percent benefit accrual rate would be entitled to make an additional pension contribution of $1,400 to a RRSP for the 1989 tax year, as follows.

Pension Adjustment:
(9 x 1.5% x $40,000) - $450 = $4,950

Maximum (18% of salary): 18% of $40,000 = $7,200
Limited by maximum for 1989 of $6,350
RRSP maximum contribution: $6,350 - $4,950 = $1,400

For employees in defined contribution RRP, the maximum tax-deductible contribution by the employee and employer, combined, is as follows.

<table>
<thead>
<tr>
<th>Tax Year</th>
<th>Maximum Contribution to a Defined Contribution RRP in U.S. $</th>
<th>in Canadian $</th>
</tr>
</thead>
<tbody>
<tr>
<td>1989</td>
<td>$ 7,850</td>
<td>$10,500</td>
</tr>
<tr>
<td>1990</td>
<td>$ 8,600</td>
<td>$11,500</td>
</tr>
<tr>
<td>1991</td>
<td>$ 9,350</td>
<td>$12,500</td>
</tr>
<tr>
<td>1992</td>
<td>$10,050</td>
<td>$13,500</td>
</tr>
<tr>
<td>1993</td>
<td>$10,800</td>
<td>$14,500</td>
</tr>
<tr>
<td>1994</td>
<td>$11,550</td>
<td>$15,500</td>
</tr>
<tr>
<td>1995+</td>
<td>to be indexed</td>
<td></td>
</tr>
</tbody>
</table>

These amounts apply to the current year's salary. The RRSP maximums on salary refer to the previous year's salary. These limits are meant to have the same effect, except that an employer/employee makes a defined contribution RRP contribution in the same year as income is earned, and an employee makes his or her RRSP contribution in the year after earning the income.

The federal tax authority, Revenue Canada, currently plans to require that employers calculate the pension adjustment amount for each employee early in the following year (e.g., by February or March 1989 for the pension adjustment on 1988 salary). This information is to be submitted, by the employer, to Revenue Canada, not to the employee directly. Revenue Canada will then calculate the employee's remaining allowance for pension contributions and issue a statement to the employee, probably by the fall of 1989. Then the employee will have until the end of February 1990 (60 days after the end of the tax year) to make a contribution to any RRSP of his or her choice for the 1989 tax year. In Canada, if the employee makes no contribution to an individual retirement plan or contributes less than his or her full allowance for the year, the employee may carry forward his unused allowance for up to 7 years.

This new system of maximum allowable tax-deductible contributions to retirement plans does not distinguish between whether the employee or the employer makes the contribution, or whether it is to a defined contribution or a defined benefit pension plan.
A major reform of the individual and corporate income tax system in Canada has also been proposed. The finance minister announced proposals on June 18, 1987, to lower the top marginal tax rate for federal income taxes for individuals from 34 percent to 29 percent. There are also provincial income taxes for corporations and individuals. The combined federal and provincial corporate income tax rate will be cut from 50 percent to 42 percent, and numerous deductions will be eliminated for both individuals and corporations. A new “value-added tax” has been proposed to replace the existing limited sales tax after 1989. A value-added tax is collected by businesses (and paid to the government) from consumers as goods move from production to the final point of sale. The details and rate of the value-added tax are to be considered at a later date.

Canada’s reform of its tax rates was instigated by a desire to bring the tax rates more in line with those of the U.S. to prevent an exodus of companies and highly paid professionals across the border to the U.S. There was also a concern that U.S. companies operating in Canada might shift their taxable income to the U.S. wherever possible.

The proposed income tax revisions need to be passed by Parliament before becoming law. Even though Prime Minister Brian Mulroney’s Conservative Party, which proposed the revisions, has a majority in Parliament, these revisions cannot be assured of being passed without opposition.

Japan

The Japanese government proposed a plan for a major reform of its income tax system in December 1986. For the new tax year starting April 1, 1987, the main changes were to include

- a reduction in the maximum, federal, personal income tax rate from 70 percent to 50 percent;
- a reduction in the corporate tax rate, including local taxes, from 52.9 percent to just less than 50 percent;
- the introduction of a new 5 percent value-added tax; and
- the introduction of a new 20 percent tax on interest earned on savings accounts.

Strong opposition developed in Parliament, however, toward the new value-added tax from both the opposition parties and some members of the ruling Liberal Democratic Party. The annual budget for the year beginning April 1, 1987, was eventually passed in April without inclusion of the tax measures. A supplementary budget has been approved by the Cabinet and was discussed in Parliament in July; however, even this supplementary budget did not include any tax reform measures. A special committee of both ruling and opposition party members has been established in an attempt to work out a compromise on the tax proposals. The government still wants to introduce major tax cuts later in the year as part of its effort to stimulate economic growth in Japan.

The tax reform proposals under discussion do not include any changes in the tax treatment of employee benefit plans. Employer-sponsored pension plans in Japan may be established as tax-qualified pension plans or employees’ pension plans. A tax-qualified pension plan may be either an insured pension plan or a self-administered, funded plan established by means of a trust contract. Employees’ pension plans are contracted-out of the earnings-related portion of the social security system and can only be established for groups of 1,000 or more employees.

Employers’ contributions to both tax-qualified pension plans and employees’ pension plans are fully deductible as business expenses. Employees’ contributions are fully deductible from taxable income for employees’ pension plans, in the same manner as social security contributions. An employee’s contribution to a tax-qualified pension plan, however, is deductible from his or her taxable income only as part of the deduction for “life insurance premiums.” An employee’s cost for life insurance premiums and contributions to a tax-qualified pension plan, combined, is fully deductible up to about $1752 per year, 50 percent deductible between $175 and $350, and 25 percent deductible over $350 per year.

In addition, the maximum overall deduction for an employee for life insurance premiums and contribu-

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2 Exchange rate ¥142 = $1.00 (June 10, 1987).
tions to a tax-qualified pension plan is limited to about $350 per year.

Pension benefits received as an annuity are taxed at the regular income tax rates. Many employees choose, however, to take the lump-sum payment option. A lump-sum payment is taxed, at regular income tax rates, on only 50 percent of its value after the deduction of a special retirement deduction. The special retirement deduction is calculated at about $1,750 per year of service up to 20 years, plus about $3,500 per year of service in excess of 20 years. This means a retiree with 35 years of service would be entitled to a tax-free, lump-sum payment of up to $87,500 with only 50 percent of the remainder taxed at regular income tax rates.

Lump-sum payments upon retirement, instead of annuity payments, have been popular in Japan and other Asian countries for traditional reasons.

Many companies in Japan have not established either tax-qualified pension plans or employees' pension plans, but they nevertheless pay retirement, death, disability, and severance benefits according to a schedule set out in the company's "work rules." These benefits are not prefunded, but are simply made on a pay-as-you-go basis. The company receives a tax deduction for the lump-sum amount when it is paid to the employee. Such lump sums paid upon retirement are taxed to the employee in the same manner as the lump-sum payments described previously.

Lump-sum payments upon retirement, instead of annuity payments, have been popular in Japan and other Asian countries, for traditional reasons. Employees in Japan do not usually expect to stop all work at the normal retirement age of 55 or 60; they merely accept their retirement benefit and lose permanent employee status with their long-time employer. The lump-sum payment is sometimes invested in a small shop or business at which the retiree continues to be employed. The head of a family might use his lump-sum payment to purchase, or pay off an existing mortgage on, a family home in which the retiree, spouse, and married children live. The married children then assume responsibility for the ongoing living expenses of the family. The retiree may continue to be employed with the former employer, or one of its related companies, on a "consultant" basis at a lower salary and without regular salary increases and other benefits of permanent employee status.

Although the tax reform proposals do not include any changes in the tax treatment of pension plans, they do include a new tax of 20 percent on the interest earned on savings accounts. The Japanese have traditionally had a very high savings rate (15.7 percent household savings as a percent of disposable income in 1985) compared to Americans (5.1 percent). This is partly because interest on savings accounts, including the very popular Post Office Savings Bank, has been tax-free on savings up to about $21,100 per person, per year.3 Many Japanese have been able to ignore the maximum on tax-free savings accounts by opening more than one account under different names.

The tax reform proposals would impose a tax rate of 20 percent on the interest earned on savings deposits, beginning October 1, 1987. A full exemption from this taxation would be given to single-parent households headed by women, and to elderly and disabled persons. The tax is to be withheld by the institution paying the interest.

To date, most of the opposition to the tax reform proposals has centered on the value-added tax. Other aspects of the tax reform are likely to receive more attention as the special committee attempts to work out a compromise on tax reform.

3 As a benchmark, the average wage for production workers in Japan was about $13,000 in 1985 (converted at the end-1985 exchange rate of ¥239 = $1.00) compared to $19,980 in the U.S. However, if this same 1985 salary were converted at the current exchange rate of ¥142 = $1.00 (June 10, 1987), it would mean an average wage in Japan of approximately $21,800.
Switzerland

As of January 1, 1987, Switzerland adopted new provisions for the tax treatment of employer-sponsored and individual pension plans for employees. These changes were envisioned in the mandatory pension plan law, known as BVG/LPP, when it was passed in 1982, but were not scheduled to become effective until 1987.

All employer contributions to both the mandatory and voluntary portions of an employer-sponsored pension plan are tax deductible and are not considered taxable income to the employee; this is unchanged from previous regulations.

Pension benefits, paid as an annuity, are taxed upon receipt as ordinary income by the Swiss canton (similar to a state). The BVG/LPP law, however, makes a provision for a 15-year transitional period starting January 1, 1985, during which only 80 percent of the mandatory portion of a pension benefit is considered taxable income for the cantons.

Many employer-sponsored pension plans allow an employee the option of receiving a lump-sum benefit for both the mandatory and voluntary portions of a pension. The cantons have implemented a variety of methods for taxation of a lump-sum payment. However, many of them convert the lump sum to an annual "pension allowance" using conversion tables published by the tax authorities, and tax the annual allowance at regular income tax rates (similar to how an annuity would be treated). Many cantons give additional tax deductions to parts of the pension resulting from employee contributions.

Vesting and Portability of Benefits

Vesting is the nonforfeitable right to a pension benefit that has accrued during employment. Portability means an employee has the option and/or right to transfer his or her vested benefit from one pension plan to another, often upon the change of employment.

United States

Minimum vesting standards for U.S. pension plans were first specified in the Employee Retirement Income Security Act of 1974 (ERISA). TRA, however, has now set faster minimum vesting standards for private-sector, single-employer plans, effective, for most plans, in plan years beginning after December 31, 1988.

The new minimum standards for vesting in private-sector, single-employer plans are either of the following.

5-year rule—The accrued benefit from the employer's contribution must be 100 percent vested after 5 years of service (not 5 years of plan participation).

3- to 7-year graduated vesting—The accrued benefit from the employer's contribution must be at least 20 percent vested after 3 years of service, increasing by 20 percent per year of service, so that 100 percent vesting is reached after 7 years of service.

A plan requiring more than one year of service as a condition of plan participation must permit plan participation after a maximum of 2 years of service and must offer 100 percent immediate vesting upon participation (formerly a 3-year waiting period was permitted).

Portability—In the U.S., Social Security benefits are fully portable. For employer-sponsored plans, the best

4 Further information on the mandatory pension law in Switzerland is available in Employee Benefit Research Institute, Government Mandating of Employee Benefits (Washington, DC: Employee Benefit Research Institute, forthcoming).


6 Further details on vesting provisions in the U.S. are available in "Pension Vesting Standards: ERISA and Beyond," EBRI Issue Brief 51 (February 1986).

7 See also "Tax Reform and Employee Benefits," EBRI Issue Brief 59 (October 1986): 25.
Portability arrangements are within multiemployer pension plans (i.e., pension plans in which many employers participate), which are often established through collective bargaining under Taft-Hartley agreements. Most of these plans allow an employee to accrue credited service for vesting purposes by means of service with any employer participating in the plan. Full benefits are then paid out by the plan according to total service, regardless of the employee's change of jobs within the group.

For single-employer pension plans, the employee may have one of two choices for handling a vested benefit upon termination of employment. The employee may be able to take a cash distribution of the vested benefit, or leave the vested benefit in the former employer's pension plan and receive a deferred pension at retirement age.

The 1984 Retirement Equity Act gives employers the right to make a cash distribution of any accrued benefit of less than $3,500 to avoid their having to maintain records for small amounts for years. Larger vested benefits may be taken as a cash distribution at the employee's option if the plan allows lump-sum availability to all plan participants. Most defined contribution plans (almost 81 percent), but far fewer defined benefit plans (10 percent) allow large lump sums.8 There is no legal requirement for the employee to transfer the benefit to another retirement plan or to "preserve" it for retirement in any way. In an attempt to encourage retirement saving, TRA did, however, impose a 10 percent penalty on lump sums taken before age 59 1/2. The main options for employees are

- to leave the vested benefit in the former employer's pension plan and receive a deferred pension at retirement age (any income tax is deferred until payout of the pension);
- to buy an annuity with the cash distribution (any income tax is deferred until receipt of the pension);
- to "roll over" the cash distribution into an IRA (any income tax is again deferred until funds are withdrawn from the account); or
- to accept the cash distribution and pay income tax and the 10 percent penalty tax on the value in the year it is received.

A new employer may accept a transfer of a cash value into its pension plan, but is not required to do so.

There has been considerable concern in the U.S. that many employees simply spend their cash distributions of vested benefits, perhaps more than once during their careers, and do not save them for retirement. Among recent proposals to improve the portability of pensions and to encourage saving the vested benefits for retirement is a proposal to establish a national clearinghouse to centralize vested benefits received by employees upon leaving a former employer's pension plan. Another proposal would require or encourage employees to transfer any cash distribution to an IRA or to another employer-sponsored retirement plan (see EBRI Issue Brief, April 1987; and EBRI Issue Brief, July 1986 for further discussions of the portability issues in the U.S.).

There has been considerable concern in the U.S. that many employees simply spend their cash distributions of vested benefits, perhaps more than once during their careers, and do not save them for retirement.

Canada

Many pension plans in Canada have followed the minimum vesting requirements of 100 percent vesting after 10 years of service and age 45. During 1987-1988, however, shorter vesting periods will be required under federal and most provincial pension legislation. The...
federal Pension Benefits Standards Act applies only to the pension plans of certain federally regulated industries (e.g., airlines, banking, and communications), the public service, and pension plans located in the Yukon and the North West Territories, but it is used as a model for the various provincial Pension Benefits Acts, which regulate the pension plans in most provinces. Two provinces (British Columbia and Prince Edward Island) do not have provincial pension legislation. In addition, federal tax regulations apply to the pension plans in all provinces.

A revised federal Pension Benefits Standards Act became effective from January 1, 1987. It requires 100 percent vesting of accrued benefits after two years of plan participation; only benefits accrued after the effective date are affected by the new provisions.

Another bill revising the Pension Benefits Act of Ontario has been under discussion for some time. The Ontario Pension Benefits Act is quite important because many of the firms with the largest numbers of employees are located in the province of Ontario. Draft regulations to the Act were issued in February 1987 for public comment; public hearings have been held by the legislative committee reviewing the bill; and the bill is expected to be debated in the Ontario legislature before the end of 1987. The revised Ontario Pension Benefits Act would provide for the same vesting provisions as the federal Pension Benefits Standards Act—100 percent vesting of accrued benefits after two years of plan participation. The effective date for the vesting provisions could be retroactive to January 1, 1987, even if the revised act itself is not effective until January 1, 1988.

Many noncontributory plans have allowed for immediate plan participation upon employment and delayed vesting. However, under the Ontario Pension Benefits Act, companies could change their rules to allow plan participation after a maximum of two years of service. In such a case, full vesting could be delayed until after four years of employment.

The province of Alberta’s revised Pension Benefits Act became effective as of January 1, 1987. It requires, however, 100 percent vesting after five years of continuous service.

Two other provinces (Saskatchewan and Manitoba) have already introduced revisions to their pension legislation in the last few years. Nova Scotia and Quebec have revisions currently under discussion. Newfoundland implemented pension legislation for the first time in 1985, and New Brunswick has new pension legislation under discussion with an effective date targeted for 1989. New Brunswick previously had a pension plan registration law only. Only two provinces in Canada (British Columbia and Prince Edward Island) do not have provincial pension legislation.

In the past, employees with vested benefits could take up to 25 percent of the value of their vested benefit in cash, upon termination of employment. This is no longer possible for benefits accrued since January 1, 1987, under the federal act, and will not be possible under the Ontario act. Twenty-five percent of vested benefits accrued prior to the effective date of the revised acts will still be allowed to be taken as a lump sum, if the plan rules specify it.

Upon termination of employment before eligibility for retirement, the employee will have the right to leave the vested deferred benefit in the former employer’s pension fund, to transfer the vested benefit to a RRSP, or to buy an annuity that does not pay out benefits prior to 10 years before normal retirement age. Transfers to a new employer’s pension plan are permitted if the new employer’s pension plan voluntarily agrees to accept the transfer; a plan is not required to accept transfers. An issue of current importance is how such transfer values will be calculated in the future. This is expected to be the subject of much future discussion and perhaps legislation.

United Kingdom

Full vesting of the employer’s contribution after two years of service is now required for pension plans in the United Kingdom as a result of the 1986 Social Security Act. Previously, full vesting was not required until after the employee was age 26 and had at least five years of service. The age-26 requirement was eliminated in the 1985 Social Security Act. In addition, the vested benefit must be “preserved,” i.e., not taken as a cash refund. Employees’ contributions to a pension plan are always fully vested.
In the United Kingdom, vested benefits are treated in one of the following ways: (1) left in the old employer’s pension fund; (2) transferred to the new employer’s plan if it agrees to accept the transfer; or (3) are used to buy a deferred annuity from a life insurance company. The calculation of the vested benefit is governed by the Occupational Pension Schemes (Transfer Value) Regulations 1985. Under the previous rules, employees with less than five years of service usually received a cash refund of their own contributions, with or without interest, according to plan rules.

Under the 1986 Social Security Act, cash refunds of the employee’s contributions will only be allowed upon termination of employment for employees with less than two years of service. For employees with 2-5 years of service, the employer can require the employee to transfer the vested benefit to an insurance company (referred to as a “compulsory buy out”) if the employee does not make transfer arrangements voluntarily. This provision is designed to prevent the employer from having to keep records of small amounts of deferred benefits for many years.

Full vesting of the employer’s contribution after two years of service is now required for pension plans in the United Kingdom.

A major issue under the new pension provisions is the employee’s right to transfer his or her vested benefit to a personal pension plan (a type of individual retirement arrangement described in a later section). Draft regulations (United Kingdom, DHSS, Fourth Set, February 1987) to the 1986 Social Security Act would allow an employee the option of transferring the vested benefit from the employer’s plan, upon terminating employment, to a personal pension plan. If the employee does not terminate employment, he or she will be able to choose not to join, or to stop participating in, the employer’s pension plan. The employee will not, however, have the option of transferring the vested benefit, accrued before the regulations take effect, to a personal pension plan, if he or she remains employed. This was a government concession to plan sponsors who feared that the funding of their company plans would be disrupted if current employees could transfer their vested benefits to a personal pension plan while remaining employed.

Ownership of Excess Pension Fund Assets

Several years ago, many employers and the population in general were concerned about the underfunding of pension plans. Attention to this issue coupled with the excellent investment returns of recent years has resulted in some pension plans now having assets well in excess of their liabilities. This is the first time that this situation has occurred in many countries. Legislation and plan documents are not always clear on who owns these excess pension plan assets—the plan sponsor or the plan beneficiaries.

United States

A U.S. employer is obligated to provide employees with the promised benefits under a defined benefit plan. Section 4044(d) of ERISA, permits surplus assets of a single-employer pension plan to be returned to the employer if the plan is terminated, the distribution is in accordance with all laws, and the plan rules specifically allow for the return of assets to the employer. Under ERISA, assets of an ongoing pension plan can only be returned to the employer under extremely limited conditions, such as when contributions are made in error or contributions are made to a plan that later failed to become a qualified plan. (See Albert, May 1987 for a historical description of asset reversion issues in the U.S.)

In the U.S. from 1980 through May 4, 1987, 1,406 pension plans were terminated that had asset reversions of $1 million or more, making a total reversion of assets to employers in excess of $11 billion over the 7 1/2-year period (EBRI Issue Brief, July 1987). Considerable concern has been expressed about the appropriateness of the current U.S. policy toward asset reversions. TRA imposed a 10 percent, nondeductible excise tax on any

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asset reversion from a pension plan, effective retroactively from January 1, 1986. A current proposal before the House Ways & Means Committee would double the excise tax to 20 percent and would not allow employers to withdraw a portion of the surplus without terminating the plan, as the Reagan administration proposed in February 1987 (EBRI Issue Brief, July 1987).

Canada

In Canada, determination of the ownership of surplus assets of a pension fund is based on a combination of the language of the plan document, trust law, specific pension regulations in some provinces, and court decisions. Many plan documents do not mention, or are vague on, the issue of ownership of pension plan surpluses. Therefore, they are not helpful in determining ownership.

In cases where the plan document is specific on ownership, the plan document is the determining factor. The federal or provincial pension regulatory authority, e.g., the Pension Commission of Ontario, then oversees withdrawals from the fund and ensures that conditions specified in the plan documents are met.

In Canada, determination of the ownership of surplus pension assets is based on a combination of the language of the plan document, trust law, specific pension regulations in some provinces, and court decisions.

Trust law is based on common law and tends to be similar in most provinces. Trust law was originally formulated to cover personal trusts created by wills or deeds. Therefore, it is sometimes difficult to apply the provisions on ownership of assets to a pension plan when there is a trustee, a company, and beneficiaries involved. However, trust law has been interpreted as intending that the surplus assets revert to the plan members, in the absence of other legislation or language in the plan document.

In the province of Ontario, where many of the larger companies and pension plans are located, the Pension Commission of Ontario must give consent to any withdrawal of surplus assets from either an ongoing (allowed under circumstances described below) or a terminated pension plan. The Pension Commission of Ontario issued a release, effective October 27, 1986, which set out new procedures to be followed and conditions to be met for an application for withdrawal of surplus pension assets to be considered. The Pension Commission of Ontario does not, however, determine the ownership of the surplus assets. This must be done through a combination of plan documents, trust law, or court decisions.

To apply for a withdrawal of surplus assets, the Pension Commission of Ontario requires that plan sponsors

- submit a recent actuarial valuation or insurance company cost report;
- submit all plan documents, relevant union contracts, court decisions and written information given to employees (to ensure that the plan sponsor actually has title to the surplus assets); and
- notify plan members and the relevant unions (who may appeal to the Pension Commission of Ontario).

Before the Pension Commission of Ontario will allow a withdrawal of surplus assets, it requires that assets sufficient to meet plan liabilities, plus a specified minimum reserve, be retained in the plan. The minimum reserve to be retained in the plan is as follows.

- Insured plans—two years of employer's current service cost.
- Noninsured, noncontributory plans—two years of employer current service cost, or if greater, 25 percent of the total accrued liability.
- Noninsured, contributory plans—all surplus assets attributable to the employees' contributions, plus the same reserve as for noncontributory plans.
These regulatory procedures for the withdrawal of surplus assets will be included as part of the revised Pension Benefits Act of Ontario, which is expected to be passed by the Ontario legislature this year, giving legislative support to current procedures.

In addition, the finance minister of Ontario has recently imposed a moratorium on withdrawal of surplus assets from ongoing pension plans until the Friedland Task Force—a committee drawing up recommendations on inflation protection of pension benefits—finishes its report. Applications for the withdrawal of surplus assets from terminated plans can still be made during this period, however. The final version of the revised Ontario Pension Benefits Act is expected to include some provisions on the indexation of benefits.

A few court cases on the ownership of pension plan assets have been decided, and more cases are pending. In general, courts have favored the employees in their decisions. In light of the possible negative employee reactions to a proposal to withdraw assets, some pension plan trustees have been reluctant to allow a refund of the surplus to the employer, regardless of whether the Pension Commission of Ontario has approved it or not.

**United Kingdom**

Many pension funds in the United Kingdom have appeared to be overfunded recently, due to excellent investment returns, low inflation, and substantial reductions in the work force. Prior to 1987, a company that wished to recapture its surplus pension assets could apply to the supervisory agency for company pension plans, the Occupational Pensions Board (OPB), for permission to reduce the surplus. OPB would usually require that several measures be taken, prior to a cash refund to the company. These measures were drawn up by plan trustees and had to be approved by OPB. Acceptable measures generally included improvement of benefits for retirees and/or plan members; a “contribution holiday” for the employer, for up to 5 years; a contribution holiday for the employees (most plans are contributory); and then possibly a refund of the surplus to the company.

Under these rules, any refund of surplus pension fund assets was counted as income to the company in the year taken.

Several companies received unfavorable publicity when attempting to recapture a surplus. Employees often believed that their benefits were being reduced if money was taken out of the fund, even though most companies in the United Kingdom have defined benefit plans, which promise a benefit based on a specific formula and put the investment risk on the employer. In addition, the government was concerned that it was losing tax revenue from companies who were still making tax-deductible contributions to an overfunded pension plan.

In his March 1986 budget speech, the U.K. Chancellor of the Exchequer set out new rules to be effective April 1987 on the maximum level of tax-sheltered funding allowed to a pension fund and on the requirements for reducing any surplus.9

Pension plans in the United Kingdom are required to submit an actuarial valuation certificate to the Superannuation Funds Office of the Inland Revenue at least every three years. Under the new rules, for valuation certificates issued after April 1, 1987, the actuary must be able to certify that the pension fund is not in surplus when the valuation is performed using methods and assumptions prescribed by the government actuary.10 This valuation is for the Superannuation Fund Office and tax purposes only. Companies can still use whatever other actuarial valuation method and assumptions they wish for funding purposes.

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9 The legislation covering surplus pension assets is included in the Finance Act of 1986, Schedule 12; the regulations are in Pension Scheme Surpluses (Valuation Regulations) 1987; and interim rules for 1986-1987 in the Joint Office memorandum No. 82 of the Superannuation Funds Office of the Inland Revenue.

10 The government actuary is responsible for all actuarial matters for the government. This description of the new rules is partly based on an article by Edward Johnston, the present government actuary (Johnston, July 1987).
The prescribed valuation method is the "projected accrued benefit method." Some of the prescribed assumptions for the valuation include (1) the rate of interest, which is 8 1/2 percent per year (can be reduced by one percent for career pay plans); (2) salary increases of 7 percent per year; and (3) the net investment yield after retirement of 8 1/2 percent per year (can be reduced for guaranteed increases in pensions).

The liabilities of the pension plan are calculated according to the prescribed methods and assumptions. Then 5 percent of the liabilities are added, and the result is the acceptable level of total liabilities of the plan. If the assets of the pension plan exceed the acceptable level of total liabilities, there is a surplus under the new rules.

If the actuary cannot certify that the plan is not in surplus at the triennial review, a full actuarial valuation report must be submitted to the Superannuation Funds Office indicating the amount of the surplus. The trustees of the pension plan are then required to present a proposal to the Superannuation Funds Office within six months specifying how they propose to reduce the surplus to the required level within five years. The options for reducing the surplus are the same as those described previously.

For the assets to be refunded to the employer, the plan rules must already allow for it, or the trustees and the company must apply to the OPB for permission to amend the plan rules to permit such a refund.

Any assets refunded to the employer, however, will be subject to a special tax levy of 40 percent of the amount of the refund, regardless of whether the company has a profit or a loss for the year. The 40 percent rate was set by the government to generate tax revenue and/or to encourage the trustees to choose other methods of reducing the surplus.

The trustees of a pension fund in the United Kingdom have considerable power to decide issues which would be determined by plan regulations in the U.S. The trustees' duty is to administer the pension fund for the benefit of all the beneficiaries. Once they have decided that there is a surplus to be reduced, then the trustees can choose the method they prefer, customarily paying due regard for employee relations issues.

If the pension fund does not reduce its surplus according to the required rules, the only penalty is that the investment income on its surplus assets (not on all assets) will no longer be tax deferred. Contributions to the pension fund by both the employer and employee will continue to be tax deductible, however.

Mandatory Corporate Pension Plans

The choice of a mandatory or voluntary system for employer-sponsored pension plans usually occurs in a country in response to a variety of political, economic, and social factors, many of which are not necessarily related to the population's need for retirement income.

United States: Voluntary System

The U.S. has developed a private-sector retirement system with a considerable amount of regulation while the system itself remains voluntary for employers. In 1981, the President's Commission on Pension Policy made a proposal (Coming of Age: Toward A National Retirement Income Policy) to require that all employers offer at least a minimum universal pension plan to some of their employees. This proposal was never introduced as legislation or enacted. It is also not likely to be enacted in the near future. More recently, a proposal (H.R. 1992) was introduced by Reps. Edward Feighan (D-OH) and Robert Matsui (D-CA), which provides that any employee in a firm without a pension plan may request that the employer establish such a plan, and the employer would be obliged to make the arrangements for a plan.

Mandating of pension benefits was discussed at a policy forum on the subject of Government Mandating of

11 Defined in Institute and Faculty of Actuaries, Pension Fund Terminology, 1986, as: "The 'projected accrued benefit method' compares an accrued actuarial liability [calculated by summing the present value of all benefits accrued as at the valuation date based on service up to that date and projected final earnings from members than in service] with the value placed on the scheme assets for valuation purposes."

12 See ICF Incorporated, 1981, for an analysis of this proposal.
Health, Pension and Other Employee Benefits, sponsored by the Employee Benefit Research Institute—Education and Research Fund (EBRI, forthcoming).

Switzerland: Mandatory System

All companies in Switzerland have been required to provide retirement, death and disability benefits at minimum levels, since January 1, 1985. These requirements derive from the Federal Law on the Occupational Old Age, Survivors' and Disability Benefit Plan (usually referred to as the second pillar legislation or the BVG/LPP law).

All companies in Switzerland are now required to provide retirement, death, and disability benefits at minimum levels.

It has been estimated that about 80 percent of employees in Switzerland were already covered by some type of employer-sponsored pension plan by the late 1970s, although no good survey data exist. Many large companies and unions had defined benefit pension plans with benefit levels well in excess of the minimum requirements of the new law. The lengthy discussions and the prospect of mandatory requirements encouraged other firms to introduce plans, so that by January 1, 1985, it has been estimated that only about 10 percent of employees remained to be covered under a pension plan for the first time under the mandatory legislation. Those employees not covered by pension plans were usually employed by very small or newly established firms, or in industries with a high turnover rate and many part-time employees, such as restaurants.

The legislation was also intended to solve vesting and portability problems. A major issue, prior to the mandatory pension legislation, was the lack of stringent vesting regulations in existing plans. No vesting was required prior to 5 years of plan participation, and full vesting was not required until after 30 years of plan participation. Between 5 and 30 years, the vesting scale was not specific. A second pension issue concerned the lack of portability of any retirement benefits that were vested.

The retirement benefit in the mandating pension legislation is based on the concept of a defined contribution pension plan with a payroll tax, which varies by age and sex of the employee and accrues at a current interest rate of 4 percent. Companies are not prevented, however, from continuing an existing defined benefit plan, with minor modifications, or from introducing a new defined benefit plan. They merely need to show that their plan provides benefits equivalent to the minimum requirements.

Some of the main features of the minimum mandatory pension plan are the following.

- All employees earning over about $11,700 per year must be covered from the date of employment for retirement benefits if they are over age 25, and for death and disability benefits if they are over age 17.

- The minimum mandatory contributions are paid on wages between approximately $11,700 and $35,000 per year. The employer must pay at least half of the minimum mandatory contribution rate, which varies by the age and sex of each employee, as follows.

<table>
<thead>
<tr>
<th>Age of Employee</th>
<th>Minimum Mandatory Contribution Rate (as percent of covered wages)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Men</td>
<td>Women</td>
</tr>
<tr>
<td>25-34</td>
<td>25-31</td>
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<tr>
<td>35-44</td>
<td>32-41</td>
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<tr>
<td>45-54</td>
<td>42-51</td>
</tr>
<tr>
<td>55+</td>
<td>52+</td>
</tr>
</tbody>
</table>

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13 A detailed description of the mandatory pension provisions in Switzerland will be included in Employee Benefit Research Institute, Government Mandating of Employee Benefits (Washington, DC: Employee Benefit Research Institute, forthcoming). The description here is extracted from that publication.

14 Exchange rate: SF 1.48 = $1.00 (June 10, 1987).
The rates were designed to allow employees nearing retirement to accrue a higher benefit. It was assumed that older employees would have a greater interest in making contributions for their retirement than would younger employees, and it also allows those employees with only a few years under the mandatory system to accrue a reasonable benefit.

- Any company whose average contribution rate for all employees is over 14 percent, because of a high proportion of older employees, may apply for reimbursement from a national security fund (funded by a special payroll tax on all employers), so that its actual rate of contribution does not exceed 14 percent of covered earnings.

- Employers must pay the full cost of the death and disability benefits (about 2 to 4 percent), plus about 0.3 percent of covered payroll for the security fund. They are also required to pay one percent of covered payroll to their own pension fund for "special measures," such as future indexing of benefits and supplements for older employees.

- The minimum mandatory retirement benefit per year is 7.2 percent of the contributions accumulated in an employee's name plus minimum interest of at least 4 percent (set by the government), paid to the retiree each month as an annuity for life. The 7.2 percent conversion rate was set by the government when the law was passed. If the plan rules allow for it, the employee may choose to take a pension in one lump-sum payment.

- All contributions by both the employee and employer under the mandatory pension system are fully and immediately vested.

- The value of an employee's mandatory pension benefit is fully portable (transferable) to the pension plan of a new employer.

- Employee representatives must make up half of the Board of a Foundation, which provides retirement benefits under the second pillar legislation.

The proposals for mandatory pension plans in Switzerland were discussed for many years, and approved in a national referendum by the whole population, before becoming effective January 1, 1985. Three circumstances, in particular, assisted in the smooth introduction of mandatory pension plans in Switzerland.

- The vast majority of employers already had pension plans with benefits in excess of the mandatory requirements. They needed to make some administrative adjustments to their plans to comply with the law, but increased costs were not a significant factor for most employers.

- Only about 10 percent of employees remained to be covered for pension benefits for the first time by the implementation date of the law.

- A strong network of employers' trade associations assisted with the education of their members on their responsibilities under the new law. Many trade associations established collective pension funds for their members. This provided information to employers through an already existing network and relieved employers of the necessity to make numerous decisions in the selection of an investment manager and other details of managing the pension fund.

When mandatory pension plans were introduced in Switzerland, it was not because of an initial concern over the small sector of the population that had no pension coverage. Today, many financial experts in Switzerland favor the combination of a pay-as-you-go social security system along with a funded private-sector pension system. When mandatory pension plans were first discussed in Switzerland in the early 1970s, they were proposed as a political alternative to an expanded social security system. There was some concern that, under certain political conditions, existing corporate pension funds might be nationalized to expand the comprehensive social security system. This prospect never materialized, but the interest in strengthening the private-sector pension system remained. The vesting, portability, and total coverage issues became
more important as the pension discussions progressed over nearly 15 years.

Spain and Portugal have recently introduced pension legislation to encourage the establishment of funded, self-administered, corporate pension plans.

*New Corporate Pension Plans*

Three countries—Italy, Spain, and Portugal—are significant in a discussion of the partial shift of responsibility for the provision of retirement income from the public sector to the private sector. Each of these countries has a social security system that promised retirement benefits sufficient to provide the entire retirement income needs for an average employee. None of the countries had significant private-sector pension activity, except for supplemental plans for executives and collectively bargained pension plans for some employees. All pension plans that did exist were insured, unfunded or book reserved, because none of the countries had formal pension legislation regulating funded, self-administered pension plans. In addition, very limited investment opportunities were available for funded plans.

Italy, Spain, and Portugal, however, along with other countries, have become aware that their social security systems may not be able to finance the future level of promised benefits (see EBRI Issue Brief, July 1987). Spain and Portugal have just recently introduced pension legislation to encourage the establishment of funded, self-administered, corporate pension plans. In Italy, pension legislation has not developed, but new corporate pension plans are being established even in its absence.

**Italy**

Until recently, social security and termination indemnities were expected to provide sufficient retirement income for all but the highest-paid executives in Italy. Insured individual or group pension plans have been available, but have generally been used only to provide additional benefits for executives. In 1986, less than 5 percent of the total population in Italy was estimated to be covered by a pension plan, in addition to social security.

There has been a growing interest, however, in corporate pension plans from corporations and insurance companies. In April 1986, a conference was organized in Rome by the economic planning unit for the Montedison Group (a major Italian firm) in conjunction with ABI (Italian Bank Association) on the Development of Capital Markets and the Role of Pension Funds. In early 1987, an insurance company, Azzicurazioni Generali, sponsored conferences in Milan and Rome for its own staff and for corporate representatives. Both conferences were intended to educate attendees as to the role of pension plans in other countries and to discuss pension solutions that might be appropriate for Italy.

By early 1987, about 200 corporate pension plans were known to have been established, even though no formal pension legislation exists. The tax regulations are not very detailed regarding tax treatment for pension plans. Premiums for an insured pension contract, however, are regarded as deductible from taxable income for the employer. An employee can also make voluntary, tax-deductible contributions to a corporate pension plan (if one exists) up to about $1,900 per year. There are no provisions in the tax law for the capital gains (profits made from the sale of an investment) of a pension fund to accrue tax-free.

15 Book reserve is a system of recognizing pension liabilities through the creation of a reserve on the employer’s balance sheet. The corresponding reserves usually are not segregated from the assets of the employer. In some countries, it is possible for the employer to take a deduction for income or other taxes, even when assets are not segregated.

16 Exchange rate: Lire 1,301 = $1.00 (June 10, 1987).
The latest proposal for social security reform included the possibility of establishing private-sector pension plans to supplement social security. However, enactment of legislation reforming the social security system is not imminent and specific pension legislation may be a ways off. There is some support in Italy for new legislation creating individual retirement accounts, along the lines of U.S. IRAs.

Spain

Spain has enacted new legislation, effective on June 29, 1987, establishing the framework for voluntary, funded, self-administered corporate pension plans, and specifying that favorable tax treatment will only be accorded to pension plans conforming to the new law. Implementing regulations are expected to be issued within six months. The new law for self-administered pension plans is a significant step toward encouraging the funding of pension plans in Spain. Formerly, plans were unfunded or book reserved. For an unfunded plan, the employer received a tax deduction (as a business expense), for pension payments when paid out at retirement. For a book-reserved plan, there has been a shift back and forth over the years as to whether an employer received a tax deduction at the time of the allocation of the liability to the book reserves. The new law makes it clear that unfunded and book-reserved plans can continue to exist, but the employer will not receive any tax deductions until benefits are paid out.

The new law provides for the establishment of self-administered corporate pension plans, subject to certain rules and regulations. The pension law permits either defined benefit or defined contribution pension plans. Either type may be contributory or noncontributory (i.e., employees may or may not be eligible to contribute to the plan). The retirement benefit may be paid out as either a lump-sum payment or as an annuity at age 60 or later.

A Spanish pension plan must be nondiscriminatory, but this term has none of the elaborate restrictions of the nondiscrimination rules in U.S. pension plans. It merely means that all employees with at least two years of service must be permitted to participate in the plan.

All pension plan assets are specifically designated as belonging to the active and retired participants of the plan, and cannot revert to the employer. All contributions are immediately vested and portable to another approved pension plan upon termination of employment.

The law sets a maximum contribution, for the employer and employee combined, of about $6,000 per year, per employee. There appear to be no provisions in the legislation for indexing this amount.

For a U.S. audience, the significance of the Spanish pension legislation is less in the details than in the fact that it demonstrates formal government encouragement of funded, private-sector pension plans.

Portugal

In Portugal in the late 1970s, many collectively bargained pension plans were established under the labor law for the employees of nationalized industries (more than half of the Portuguese economy was nationalized at the time). Some of these plans provided for a total retirement benefit, including social security, of 100 percent of the employee's final salary at retirement. Other plans provided for extremely generous early retirement and disability pensions. However, these pension plans were often unfunded and virtually unregulated. There was no security of pension payments in the event the company was unable to meet its commitments, and sometimes the pension liabilities


18 Exchange rate: Psas. 125.10 = $1.00 (June 10, 1987).
were not even known. The potential for large, un-
funded corporate pension liabilities has caused great
concern.

Several attempts over the years to correct this situation
have resulted in a new pension law on November 25,
1986, which sets the framework for the establishment of
insured or funded, self-administered pension plans. A
large part of the law concerns the financing of the
pension plan and the management and investment of
the pension fund assets. Much of this is still in an
earlier, developmental stage, and therefore there are no
detailed provisions in the law concerning eligibility of
employees, level of contributions or benefits, or vesting
provisions. (See Cordovil, May 1987 for a further
description of the pensions situation in Portugal and a
translation of the text of the law.)

One of the reasons for the government to encourage
funded, corporate pension plans is its desire to develop
the capital markets in Portugal. Although the tiny
Portuguese stock market has done well in the past year,
partly due to foreign investment, the government
believes the market needs to be supported by long-term
Portuguese investment monies, such as that in pension
funds.

The significance of the Portuguese pension legislation
for other countries is the fact that the government is
responding to the economic and social needs of its
people through support of the voluntary, private-sector
pension system.

**Individual Retirement Plans**

A relatively recent trend in pension practice around the
world has been for governments to provide incentives
for individuals to assume more responsibility for their
own retirement benefits, rather than relying entirely on
social security or employer-sponsored pensions. Al-
though individual retirement accounts have been
available in the U.S. (IRAs) and Canada (RRSPs) for
some years, this type of personal tax incentive for
retirement savings has not been available in other
countries until very recently. Ironically, some countries
appear to be imitating the U.S. IRAs at a time when the
U.S. is restricting the tax deductions for them. The
foreign plans are sometimes, however, more restrictive
regarding preretirement access to monies in individual
retirement plans.

Governments worldwide are providing incen-
tives for individuals to assume more responsi-
ability for their own retirement benefits, rather
than rely entirely on social security or em-
ployer-sponsored pensions.

During 1986-1987, Switzerland and Belgium both
introduced a type of individual retirement account for
the first time. France has a new individual retirement
plan proposal under discussion, which is likely to be
effective in 1988. In the United Kingdom, the much-
publicized new personal pension plans will become
available January 1988. Some of the features of each of
these individual retirement accounts are described
below.

**United States**

The U.S. established provisions for IRAs for the first
time in 1974, as part of ERISA, to provide tax-deferred
pension contributions for employees who were not
covered by an employer-sponsored pension plan.

In 1981, all employees became eligible to establish an
IRA regardless of whether they also participated in an
employer-sponsored pension plan. The tax-deductible
amount that could be contributed to an IRA was raised
to $2,000 for an individual employee (or $2,250 com-
bined for an employee and nonemployed spouse).
After a few years, the revenue loss from IRAs was far
greater than expected and the persons choosing to
establish an IRA tended most often to be the higher-
paid employees. (See EBRI Issue Briefs for March 1987,
October 1986, March 1986, and July 1984 for more
details on the development of IRAs in the U.S. and
recent changes affecting them.)
The Tax Reform Act of 1986 was a partial return to the 1974 law. The full $2,000 deduction is retained for single wage earners and married couples who are not active participants in an employer-sponsored pension plan. Active plan participants can also make the full $2,000 deductible contributions if their adjusted gross income is below specified levels ($25,000 for single taxpayers, $40,000 for couples). Above those income levels, $1 in IRA-deductible contributions is lost for each $5 in adjusted gross income. Active participants with adjusted gross incomes above $35,000 (single) and $50,000 (married couples) can make no tax-deductible contribution, but a maximum $2,000 nondeductible contribution is allowed, with deferral of investment earnings, to the extent an individual wage earner is precluded from making deductible contributions.

Belgium

In November 1986, the Belgian government introduced a new type of individual retirement account, called an "epargne pension," which combines the features of saving for retirement and investing in the stock market.

The provisions of the new accounts are as follows.

- An individual can contribute up to about $550 per year to an epargne pension and receive a deduction from taxable income for the contribution. A household is limited to $1,100 per year. However, the maximum contribution for an individual is scheduled to be increased gradually to $1,100 per year.

- Contributions for the 1986 tax year were permitted to be made until February 14, 1987, as a special provision because of the late introduction of the legislation. Contributions for the 1987 and future tax years must be made by December 30 of each year.

- For the 1987 tax year (but not for 1986), government employees and members of company pension plans are limited to a contribution of about $270 each.

- Assets accumulate in the accounts tax-free, providing they are held until age 65 or death. Otherwise, income tax at the regular personal income tax rates must be paid on early withdrawals.

- Withdrawals from the accounts after age 65 or upon death will be taxed at the special lump-sum tax rate of 16.4 percent. However, only a theoretical amount is actually subject to tax. This amount is calculated as the contributions, plus 6.25 percent interest per year, regardless of the actual value of the assets in the account.

- A minimum of 30 percent of the assets of the account must be invested in Belgian stocks, and a maximum of 10 percent of assets can be invested in foreign stocks. There is no limit on investment in bonds.

Banks, insurance companies, and other financial institutions are offering a range of investments to meet the requirements of the new plans, including special mutual funds. Insurance companies can also offer life-insurance-policy-linked savings plans, which qualify for the new contributions.

By mid-March 1987, the finance ministry estimated that about 880,000 Belgians had opened individual retirement accounts under the new rules, and assets were estimated at more than $450 million.

The new "retirement plans" are being marketed mainly as tax shelters, and appear to be designed to boost investment in the Belgian stock market, more than to provide savings for retirement. They are not expected to have any effect on company pension plans.

The new retirement plans are intended to absorb some of the funds initially invested in stocks under the DeClercq legislation of 1982, which permitted individuals to take tax deductions of up to about $1,100 per year for stock purchases, providing the stocks were held for at least five years. Nearly $2 billion is estimated to have been invested in the stock market between 1982 and 1985 under the DeClercq provisions. The legislation expired on December 30, 1986, and first liquidations of stock were permitted in May 1987. Although there are no specific provisions for rolling over this cash from one vehicle to another, the new individual retirement plans are expected to absorb some of these funds.
and to support the Belgian stock market in the long term.

France

In August 1986, the National Credit Council in France recommended that tax incentives be given to individuals to encourage personal saving for retirement. Following this on October 27, 1986, the French minister for finance and economy presented proposals for new individual retirement accounts, called “plan d’épargne retraite” (PER).

The proposed provisions include the following.

- Individuals would be permitted to contribute up to about $1,000,20 per year to a retirement account and receive a deduction from taxable income. Married couples could contribute up to $2,000 per year, plus an extra $500 if they have three or more children.

- Interest and capital gains on the accounts would be deferred until withdrawal, if the assets are not withdrawn until age 60.

- There would be a penalty of 10 percent on withdrawals made within 10 years of opening the account, and a penalty of 5 percent if withdrawals were made after the account had been open 10 years but before the individual was age 60.

- Withdrawals from the accounts at retirement would be taxable as regular income, regardless of whether the benefit is withdrawn as a lump-sum payment or paid out as an annuity. The individual would have the option of electing a flat-rate tax of 36 percent at age 60, scaled down to a tax of 30 percent at age 65.

- To encourage deferred retirement, the government would pay a bonus of 5 percent of the assets of the account if they were kept until age 63 and a 10 percent bonus if they were kept until age 65. (Normal retirement age for social security is age 60 for men and women.)

Details of how PER would operate are still under discussion, but some version of individual retirement accounts is expected to be introduced by 1988.

Switzerland

Switzerland has had a long-standing government policy (known as the three-pillar concept) that responsibility for retirement benefits is to be shared by the government, the employer, and the individual. Individual retirement savings plans, however, did not become formalized until January 1, 1987, when so-called “Ordinance 3” became effective. Prior to this, individuals could save for their retirement by accumulating property, securities, or savings deposits, or by buying an individual annuity from a life insurance company. Only the premiums for an annuity, however, received tax concessions.

Ordinance 3 authorized the establishment of new individual retirement savings accounts with the following provisions.

- Contributions up to 8 percent of salary are deductible from taxable income; salary for this purpose is limited to about $35,000, per year; therefore, the maximum contribution to the retirement savings account is about $2,800 per year. Married couples who are both employed may each claim the deduction on their joint tax return. Self-employed persons who are not covered by the mandatory “second pillar” pension legislation may contribute up to 40 percent of their annual income up to $35,000, making a maximum contribution of about $14,000.

- Interest on the retirement savings account is tax deferred until assets are withdrawn.

- Banks, savings associations, and insurance companies may offer the new retirement savings accounts.

- Assets of these accounts cannot be withdrawn until age 60 for men and age 57 for women (5 years prior to normal retirement age), except in special circumstances such as emigration, becoming self-employed, or (for women only) upon marriage and cessation of employment.

- Withdrawals from these accounts will be taxed at special, favorable rates upon retirement.

20 Exchange rate: FF 6 = $1.00 (June 10, 1987).
United Kingdom

A new type of individual retirement account, called a personal pension plan, will be introduced in the United Kingdom in 1988. Employees who are not currently members of an employer-sponsored pension plan, or who voluntarily participate in an employer-sponsored pension plan and choose to opt-out, may open one of the new personal pension plans starting January 4, 1988. Employees who are currently members of an employer-sponsored pension plan that has mandatory participation will be eligible to opt-out of their employer-sponsored pension plan, starting April 6, 1988, providing they open one of the new personal pension plans. Mandatory participation in an employer-sponsored pension plan will not be permitted after that date.

After four sets of draft regulations and other consultative documents, the final regulations governing personal pension plans under the 1986 Social Security Act were introduced into parliament in July 1987. Changes in how the plans will operate may still occur before the implementation date.

Self-employed persons and those persons not covered by a employer-sponsored pension plan in the United Kingdom have always had the opportunity of making their own pension arrangements by taking out an approved annuity contract with a life insurance company. A maximum contribution of 17.5 percent of salary has been deductible from taxable income each year for persons born in 1934 or later. Persons born earlier have been entitled to make higher annual contributions up to 32.5 percent of salary, depending on age. If a person wishes to manage his own investments, he can have an insurance company set up a separate fund and choose his own investment manager with the help of the insurance company handling the administrative arrangements; however, this method of management has not been particularly common.

A very large number of people who were eligible for this type of individual retirement plan did not take advantage of the possibility in the past. As of the 1982-1983 tax year, only about 743,000 individuals had this type of pension arrangement, including both self-employed persons and those not covered by employer-sponsored pension plans (United Kingdom, Government Actuary, 1986). In comparison, at least 10 million people were estimated not to be covered by a corporate pension plan, plus additional numbers of self-employed persons. One of the results of the discussion and publicity surrounding the new personal pensions has been new interest in making pension arrangements for themselves, by people who were already eligible.

The government’s objectives in introducing the new personal pension plans are to reduce the number of persons participating in the State Earnings-Related Pension Scheme (SERPS) in order to reduce future government obligations for benefits; to give employees freedom in choosing their own pension arrangements; and to encourage employees to take more responsibility for their own retirement income and to be less dependent on government-provided benefits.

Employees who are now members of a contracted-out, employer-sponsored pension plan may choose to opt-out of their employer-sponsored plan providing they open a personal pension plan.

Employees who remain in their employer-sponsored pension plan may open a free-standing, additional

21 Social Security Acts in the United Kingdom contain provisions covering both social security benefits (new benefit levels for the year, technical changes, etc.) and changes in the rules for corporate pension plans, called occupational pension schemes. The tax year in the United Kingdom runs from April 6 through April 5 of the following year.

22 These were referred to as Section 226 contracts from the section of the Income and Corporation Taxes Act of 1970, which granted the tax deduction for the contribution.

23 Company pension plans can be "contracted-in" or "contracted-out" of SERPS. SERPS is a second-tier, earnings-related portion of the social security retirement pension. A contracted-out company plan replaces SERPS benefits with a company benefit that is usually more generous.
voluntary contribution plan, which is similar to a personal pension plan, except for maximum tax-deductible contributions.

Employees who are not members of an employer-sponsored pension plan and therefore are now participating in SERPS, and employees who are members of an employer-sponsored plan that is contracted-in to SERPS, may choose to opt-out of SERPS, providing they establish their own personal pension plan. They cannot choose to remain in SERPS and establish a personal pension plan, since one of the objectives is to reduce the number of participants in SERPS.

Self-employed persons (never eligible to participate in SERPS) will be able to establish personal pension plans in lieu of the former annuity contract arrangements.

Personal pension plans will only be available to persons who are employed and paying social security contributions (i.e., homemakers will not be able to contribute).

The minimum required contribution to a personal pension plan will be 3.8 percent for the employer and 2.0 percent for the employee, of the employee’s annual salary between about $3,350 and $25,450. These percentages are set by the government and are approximately the amount saved because the employee does not participate in SERPS. Employers may contribute to their employees’ personal pension plans at a higher rate, but are not required to do so. In addition, the government will pay an extra incentive of 2 percent of the same covered salary to each employee’s personal pension plan for a five-year period. However, this 2 percent incentive will not be available to employees who opt-out of their employer-sponsored pension plan after having been a member for two or more years. This last restriction was the result of extensive lobbying by companies and pension industry groups who wanted to prevent an exodus from employer-sponsored pension plans by employees merely wishing to earn the 2 percent incentive.

An employee who does not also participate in an employer-sponsored pension plan may make contributions to a personal pension plan in excess of the minimum amount and will receive tax relief on the total contributions within the following limits. (These limits do not include the 2 percent incentive payment from the government.)

<table>
<thead>
<tr>
<th>Age</th>
<th>Maximum Contribution (as percent of covered salary)</th>
</tr>
</thead>
<tbody>
<tr>
<td>50 or less</td>
<td>17.5%</td>
</tr>
<tr>
<td>51-55</td>
<td>20.0</td>
</tr>
<tr>
<td>56-60</td>
<td>22.5</td>
</tr>
<tr>
<td>61-75</td>
<td>27.5</td>
</tr>
</tbody>
</table>

An employee who remains in his or her company pension plan will receive tax relief on his or her contributions to a free-standing, additional, voluntary contribution plan up to a limit of 15 percent of covered salary; this is the same limit currently placed on voluntary contributions within a company pension plan.

Tax on the investment income of personal pension plans or free-standing, additional voluntary contribution plans is deferred until withdrawal. Assets can be withdrawn upon retirement between ages 50 and 75.

At retirement, a maximum of about $249,000 can be withdrawn as a tax-free lump sum from a personal pension plan. The remainder must be taken as a monthly pension and is then taxed at the usual income tax rates. Discussions are still underway as to how limits will be placed on the maximum benefits that can be received from an employer-sponsored plan and one or more personal pension plans or free-standing additional voluntary contribution plans combined.

Banks, savings and loan associations, mutual funds and insurance companies will be permitted to offer personal pension plans. A wide variety of investment choices are expected to be developed by January 1988. Individuals will be able to move the assets of their plan from one institution to another freely.

A clearinghouse system is planned so that employers will be able to make the contribution to their employees’ personal pension plans in one payment to the

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24 Exchange rate: £ 1.00 = $1.66 (June 10, 1987).
Department of Health and Social Security (DHSS) along with their regular social security contributions. DHSS will then redistribute the contributions to the institutions that the employees have chosen to manage their personal pension plans. The administrative details for this arrangement are not yet finalized.

The encouragement of personal pension plans has been a significant policy of the Conservative Party Government of the United Kingdom. During the consultation period, some concessions have been made to public pressure. For example, the government agreed not to abolish SERPS entirely and not to allow individuals to transfer their vested pension benefits from an employer-sponsored pension plan to a personal pension plan while still employed. Employers are now gearing up to inform their employees of their options and of the advantages of remaining in the company pension plan. Many employees are not aware that their employer already contributes to the employer-sponsored pension plan at a much higher rate than that at which they will be required to contribute to an employee’s personal pension plan.

Conclusion

Saying that U.S. pensions represent a significant labor cost and have an impact on the nation’s competitiveness in international trade, the Committee on Ways and Means Subcommittee on Oversight has recently recommended that the Department of Labor report to Congress on comparable foreign pension systems and practices.

This review of corporate and individual retirement plans has shown that corporate pension plans are being encouraged and strengthened in each of the 10 foreign countries discussed, with the possible exception of the United Kingdom. Vesting and portability issues are of concern in the countries where voluntary corporate pension plans have been established for some time, with a trend toward shorter vesting periods or immediate vesting in many countries.

Defined contribution plans are appearing in countries that formerly had mainly defined benefit plans. The United Kingdom will soon permit defined contribution plans to contract-out of SERPS. This was not permitted formerly and led to a significant decrease in the number of defined contribution plans in the United Kingdom since the late 1970s. Switzerland’s mandatory pension plan is established with a defined contribution format, and most new, small plans are likely to be defined contribution plans. Well-established, defined benefit plans, however, have no need to change. Canada is in the process of revising its taxation of pensions, so that the selection of the type of pension plan will not be based on tax considerations. Canada is also in the process of equalizing the tax relief for employees who are and are not members of corporate pension plans.

New pension legislation in Spain and Portugal attempts to encourage the establishment of corporate pension plans, either defined contribution or defined benefit plans, and to encourage the advance-funding of plans by eliminating the tax incentives for unfunded or book-reserved plans.

Defined contribution plans are now appearing in countries that formerly had mainly defined benefit plans.

Five countries (Canada, Belgium, France, Switzerland, and the United Kingdom) are expected to have some form of individual retirement plans available by next year (three more countries than had them in 1985).

None of the major countries reviewed are substantially expanding their social security systems. All seem to be headed toward a combination of public and private retirement income systems—pay-as-you-go basic social security, voluntary corporate pension plans, and tax concessions to encourage individual retirement savings. Mandatory corporate plans do not appear to be on the increase except in Switzerland.
References


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Credits

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