EBAP/99/139

December 10, 1999

To: Members of the Executive Board

From: The Secretary

Subject: **Contractual Employees Retirement Plan**

The attached paper on the reformulation of the pension arrangements for contractual employees is being circulated for the information of the Executive Directors.

Mrs. Shannon (ext. 37258) is available to answer technical and factual questions relating to this note.

Att: (1)

Other Distribution:
Department Heads

INTERNATIONAL MONETARY FUND

Contractual Employees Retirement Plan

Prepared by the Human Resources Department

Approved by Ulrich Baumgartner

December 10, 1999

Contents Page

I. Introduction

1. The purpose of this paper is to inform the Executive Board of the introduction of a defined contribution retirement plan for Fund long-term contractual employees. This Plan replaces the current payments in lieu of pension for these employees. Establishing such a Plan provides for consistent and equitable treatment of different types of contractual employees and reduces the administrative burden on Fund staff in managing the various lump-sum payment arrangements made available to contractual employees in the past. The Plan does not entail significant additional costs for the Fund. It is expected that the Plan will be put into place effective March 2000. The new Plan was developed by an interdepartmental working group which consulted with relevant departments and various groups of contractual employees.

2. The general terms and conditions of employment for contractual employees, including benefits such as insurance coverage and payments in lieu of participation in a pension plan, have been established or approved by management, through the Director of the Human Resources Department (formerly the Administration Department), with the Executive Board

being informed of significant modifications. The intention to establish such a Plan has been shared with the Board on several previous occasions.[1]

II. Present Situation

3. There are currently about 450 long-term contractual employees, including technical assistance experts that are not eligible to participate in the Staff Retirement Plan (SRP). However, in keeping with market practice, the Fund has provided some pension-like benefits to long-term contractual employees.

4. Most contractual employees (about 300 persons) other than technical assistance experts receive a lump-sum payment upon separation equal to 5 percent of their final annual salary multiplied by their years of service, provided they have worked for the Fund for at least one year. A number of different options are available for long-term technical assistance experts: a lump-sum payment at the end of the assignment; a contribution to the purchase of an annuity, usually at the conclusion of each year of service; or a contribution to the pension plan in the organization in which the expert has previously been employed. These options are subject to different caps on the Fund's contribution.

5. The current arrangements give rise to three issues.

- The present set of arrangements is complex and results in inequities among contractual employees.
- Serious, adverse tax consequences arise for U.S. nationals when they receive lump-sum payments. The lump-sum payment is fully subject to U.S. income tax in the year in which it is received. U.S. nationals, therefore, must pay a large portion of this benefit immediately in taxes, and the additional income normally puts the employee in a higher tax bracket. Although the lump-sum payment for U.S. nationals is based on gross pay, the resulting after-tax benefit is significantly less than that of their expatriate colleagues.
- The multitude of, and the differences in, the current arrangements places a significant administrative burden on both the Human Resources Department and the Treasurer's Department.

---

[1]Human Resources in the Fund: Issues and Policies (EBAP/98/45 May 8, 1998); Categories of Employment: Facts, Issues, and Proposed New Framework (EBAP/98/137, December 4, 1998); and Administrative and Capital Budgets for FY2000 (EBAP/99/35, March 31, 1999).

III. NEW ARRANGEMENT

6. A uniform defined-contribution retirement plan, 401(k) plan,[2] that is suitable for all groups of contractual employees has been designed. Under this Plan, the Fund, as employer, makes contributions to the Plan, which are tax-deferred income for the employee in the year that they are made.[3] The Plan also allows participants to make contributions through salary deferrals, so that the amounts deferred and any earnings are excluded from gross income, which reduces income taxes in the year that the contributions are made. (Taxes are not payable until funds are withdrawn from the Plan, typically at age 60 or later.) This type of plan is highly portable and allows an employee to either transfer the funds to a new employer's plan, to roll them into a tax-deferred Individual Retirement Account (IRA), or to take a lump-sum payment upon termination of employment. U.S. income taxes are paid when the funds are withdrawn from the Plan or from the plan into which the money was transferred. Non-U.S. nationals will be subject to tax only on the investment earnings. Another feature of the Plan is that the employee can direct the contribution (both his own and that of the employer) among a number of investment options.

7. The Fund's contribution rate has been established at 5 percent of net (gross) salary. The Quadrennial Benefits Survey (QBS) conducted in 1997 indicates that U.S. employers contribute between 2 percent and 6 percent of pay for defined contribution plans with most employers contributing on the higher side. Defined contribution plans are not typically available in France and Germany, the two other countries whose benefit practices were also reviewed in 1997. In France, the contribution rate for defined benefit plans is estimated to be 8.2 percent and in Germany to be 10.2 percent.

8. The Plan will be voluntary for eligible long-term contractual employees. Those who choose to participate in the Plan will have the 5 percent Fund contribution directed into the investment option(s) of their choice. They may also contribute additional money into the Plan, subject to the Plan's limitations.[4]

---

[2]Named after the section in the U.S. Internal Revenue Code under which this type of plan is described.

[3]In 1998, the World Bank established a similar plan for its U.S. contractual employees to assist these employees with a tax-deferred savings option, although the Bank does not contribute to the plan. The Inter-American Development Bank is also working on a savings plan for its contractual employees.

[4]The limitations to employee and employer contributions are established by the U.S. Internal Revenue Service. These limitations have to be observed in order to maintain the tax-deferred status of the contributions. The limitation, effective January 2000, on employee salary

(continued...)

9. Those who choose **not** to participate in the Plan will have the option of receiving the 5 percent payment in their regular bi-weekly pay (after the required eligibility service minimum of one year) or of directing the Fund to pay the 5 percent to their former employer's pension plan, if that option is available to them.

10. Because a number of long-term contractual employees are currently under existing and renewable contracts, there will be a period of transition before all long-term contractuals are covered by the new arrangements. Eligible long-term contractual employees who are currently under contract and who wish to participate in the Plan may elect to do so with effect from March 1, 2000.

11. The Plan will be administered by Diversified Investment Advisors, a subsidiary of Aegon USA, headquartered in Baltimore, that specializes in retirement plan administration. Diversified Investment Advisors currently manages over $26 billion in savings plans for some 500,000 participants. Among their clients are CARE, Fannie Mae Foundation, Johns Hopkins Health System, and the Med Star Health Systems. Arrangements are being made to establish a trust for funds to be held on behalf of the Plan participants.

12. Participants will have the opportunity to invest in a full array of Diversified mutual fund investment options from a conservative money market account to higher risk investments. There will also be available two Vanguard index funds, which provide low expense ratio options for participants. In addition, a self-directed brokerage account will be available through an arrangement with Charles Schwab, which will allow participants to select from some 2,500 mutual funds.

13. Information about the Plan will be distributed to contractual employees in the next several weeks with informational and enrollment meetings to be held in January. General and individual account information will be available through the internet, e-mail, and a toll-free telephone number. This is particularly important for the Fund's field-based technical assistance experts who may choose to join the Plan. Using these communication vehicles, participants can frequently and easily check account balances, realign investment allocations, and change investment options. Participants will also receive quarterly statements of account and information and investment newsletters.

IV. EXPECTED PLAN COSTS

14. Establishing the Plan will be cost-neutral compared with the current arrangements. The current Fund contribution for lump-sum payments in lieu of pension payments provided to long-term contractual employees is approximately $1.6 million. There are some initial

---

deferrals is $10,500 and the overall salary deferral (employee and employer contributions) is the lesser of 25 percent of income or $30,000.

start-up costs and on-going costs associated with the administration of the Plan. Given the complexity of the tax regulations that must be complied with in order to maintain the tax deferral advantages of 401(k)-type plans and the availability of qualified experts in the private sector who are able to handle savings arrangements at inexpensive rates, a vendor, Diversified Investment Advisors, was competitively selected to provide these services. These administrative costs are typically absorbed by the employer. The fees of Diversified Investment Advisors are $5,000 per year for account maintenance, $20 per participant, and 1 percent of annual contributions. There are also small fees for reports and analysis that the Fund may require from time-to-time. For those who elect to use the self-directed Charles Schwab accounts, there is a $50 annual fee per person. Diversified has advised us that typically only a few participants opt for this feature. The total costs for the administration of the Plan are expected to be about $20,000 annually. There will be an offsetting saving in staff time due to plan simplification and reduced administrative burden.