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## **Global DC Developments** Implications for multinational plan sponsors

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## The retirement world is moving to Defined Contribution...

“The world of retirement has changed and we live in a defined-contribution world now”

Karen Salinaro, IBM's VP of Benefits and Compensation

“Today almost all countries around the world that are establishing pension systems are doing so on a DC basis”

State Street: The Pensions Industry, Bridging the Gap, May 2008

“Globally, DC schemes are rapidly catching up with DB arrangements in terms of AUM, up from 34 percent of the global total 10 years ago to 42 percent at the end of 2006. Although much of this wealth is concentrated in US-based arrangements, DC is now a prevalent model worldwide and will be the most common vehicle for pension savings in the century ahead”



## And we can learn from each other...

“Deficient European DC can learn from Australian success”

European Pensions & Investment News, July 2008

“The United States needs a pension system that addresses 21st century needs... one way forward, following the lead of a new system to accelerate the growth in personal retirement assets about to be implemented in the United Kingdom”

State Street Report, May 2008

“Ministers are being urged to monitor New Zealand’s Kiwi-saver pension scheme to help them judge the success of the UK’s own plans

Professional Pensions, 2006

It is recent UK experience that most closely parallels the current Canadian situation. In short, the UK is well-underway to implementing its own version of what we call the Canadian Supplementary Pension Plan in this paper

The Canada Supplementary Pension Plan (CSPP):  
Towards an Adequate, Affordable Pension for All Canadians  
Keith Ambachtsheer

## The world is flat!

Benefit adequacy concerns – will DC schemes deliver?

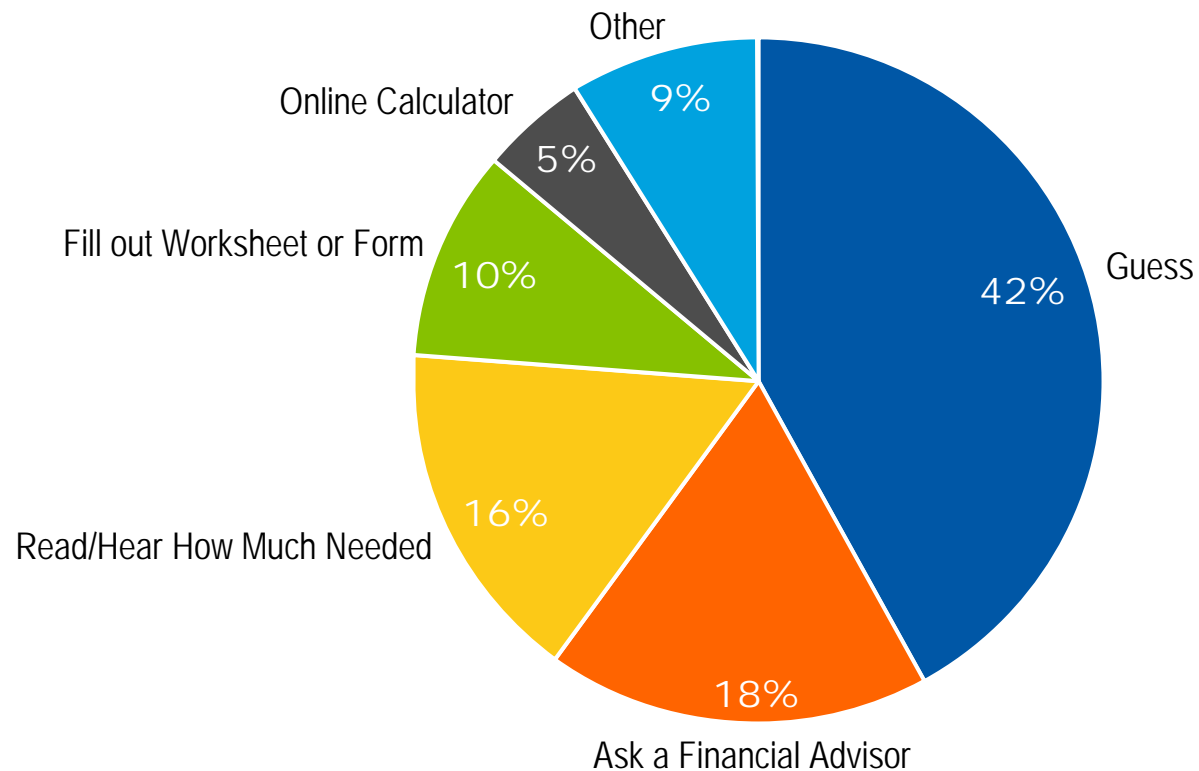
- Contributions insufficient (often less than DB), or not even enrolling
- Poor investment performance
  - Asset allocation too conservative, not enough diversification
  - Returns are too low
  - Fees are too high
  - Insufficient management of investment manager line up
- Leakage through pre-retirement withdrawals and borrowing, especially in tough times
- Retirement planning – “good bye and good luck”
- Cyclical retirements
  - Will people simply not retire in a slow economy?
  - Will they all retire if returns are really good?

## The world is flat!

DC funds transfer key retirements risks to members

- Many workers set goals through guesswork...

**Methods used to Determine Savings Needed for Retirement, 2006**





# Global DC Themes

## Global Themes

Recent regulatory or government reviews are increasingly about DC

### US

- Pension Protection Act

### Canada

- Ontario Expert Commission
- Alberta/BC Joint Expert Panel
- Tax Free Savings Accounts

### Europe

- Pan European developments
- EFAMA Report: DC Schemes: Risks and advantages for occupational retirement provision

### United Kingdom

- Push for improved DC governance
- Cessation of DC contracting by 2012
- Statutory requirement to provide DC projections annually
- 2012 Personal Accounts
- 2010 Savings Gateway

### South Africa

- Holistic review of retirement funding and social security

### China

- Enterprise Annuity

### Hong Kong

- Proposals:
  - Voluntary MPF contributions
  - Choice of MPF Trustee

### Indonesia

- 2008 DB funding requirements may lead to more DC conversions

### Thailand

- Revived discussions of MPF

### Australia

- Tax incentives
- Looking to simplify – ease of consolidation

### Chile

- Realization that cost structure is too high

### Japan

- 2012 disbandment of tax-qualified pension funds, expect money move to DC

## Global Themes: DC plan management

Heightened scrutiny on plan governance

“The cost of poor governance within pension delivery institutions can amount to 1 to 2 percent of assets”

Ambachtsheer, Capelle and Lum (2007)

- Maturing of DC market brings evolving standards and requirements
- Mandated governance practices in Ireland, Netherlands
- Australia: mandatory licensing of trustees (first among Anglo-Saxon)
- UK
  - Voluntary Employer Engagement best practices released
  - Pensions Regulator to issue guidance on more proactive role for DC plan trustees, raising standards of member education/choice
- Canada: voluntary guidelines in Canada (CAP)

## Global Themes

### DC Investments

- Participants want investment decisions made for them
  - European DC survey
    - Plans offer 15 investment funds on average
    - 75% of plans offer a default option, used by 70% of members
  - UK DC survey
    - 86% of default options are target age funds
  - Workers placed in default investment options tend to remain there
- Trend to reduce the number of funds offered
- Lifecycle/lifestyle/target age/target date funds are universally popular, but not in Australia, and a common default option
- Alternatives are creeping into DC plans, usually as a “bundle”
- Implemented investment consulting – plan sponsors delegate authority to third party
- Countries liberalizing investments
  - India, now up to 15% equity investments
  - Chile, South Africa, Slovakia more flexible or more liberal investment funds

## Global Themes

### Evolution of DC Investments



- Array of investments
- Educate participant on risk and return
- Encourage participant through match
- Online tools, seminars and brochures

- Advice and guidance
- Target date funds
- Automatic rebalancing
- Auto enrolment

- Education focussed on retirement income
- In-plan lifetime income portfolio
- Default or match income
- Show future income on statements

## Global Themes

Responses will differ due to regulatory regimes, but some convergence is likely

- UK/North America
- Target date/ lifecycle funds
- Enormous focus on fees
- Inertia accepted as a reality
- Save more tomorrow
- Conventional assets, fixed asset allocation
- Annuitization (UK)
- Strong employer role



## Global Themes

Responses will differ due to regulatory regimes, but some convergence is likely

### Australia/Hong Kong

- Few options, generally balanced/target risk
- Target date/lifecycle unpopular
- Alternative assets, dynamic asset allocation, diversification (Australia)
- Strong focus on communication, education
- Strong influence of financial planners
- Lump sum payments only (Australia)
- Employer role is marginalized



## Global Themes

### Investment independence and fee transparency

#### Australia

- Complete fee transparency, legislation requires disclosure of admin fees and charges
- 2006 Choice of Fund legislation
- Admin fees shown on acct statements, investment expenses not disclosed
- Financial planner requirements

#### Asia

- Bundled and unbundled arrangements in China, India, HK

#### UK

- Stakeholder pensions have a legislated “cap” on fees
- FSA requirement to disclose commission levels

#### Chile

- Admin fee levied as % of contributions
- Fixed fees ended by legislation in 2008
- Fee levels determined by market forces
- 2008: providers enter bid process for lowest fee, winner is advertised by govt, new entrants enrolled in that provider
- Fees included on account statements

#### US

- Focus on fee disclosure and fee transparency
- DC “unbundling” – highest degree of cost transparency

#### Canada

- Insurance companies control investment manager access
- Fees primarily bundled, must be disclosed to members
- Offer externally and internally managed funds – “sticky money” biases in-house funds



# Emerging DC Themes

## Emerging DC themes

What are consequences if DC (or DB) schemes do not deliver?

- Increased taxes?
- Government gets more involved...mandatory savings
- Increased reliance on automated enrollment and savings features
  - Automated spend-down?
    - US Retirement Security Project – call for automated annuity payments for 2-years
- Increase retirement age (Russia, Czech Republic, Cuba, Germany)
- Increased incentives for voluntary savings

## Emerging DC themes

Protecting DC plan members... Who looks out for the little guy?

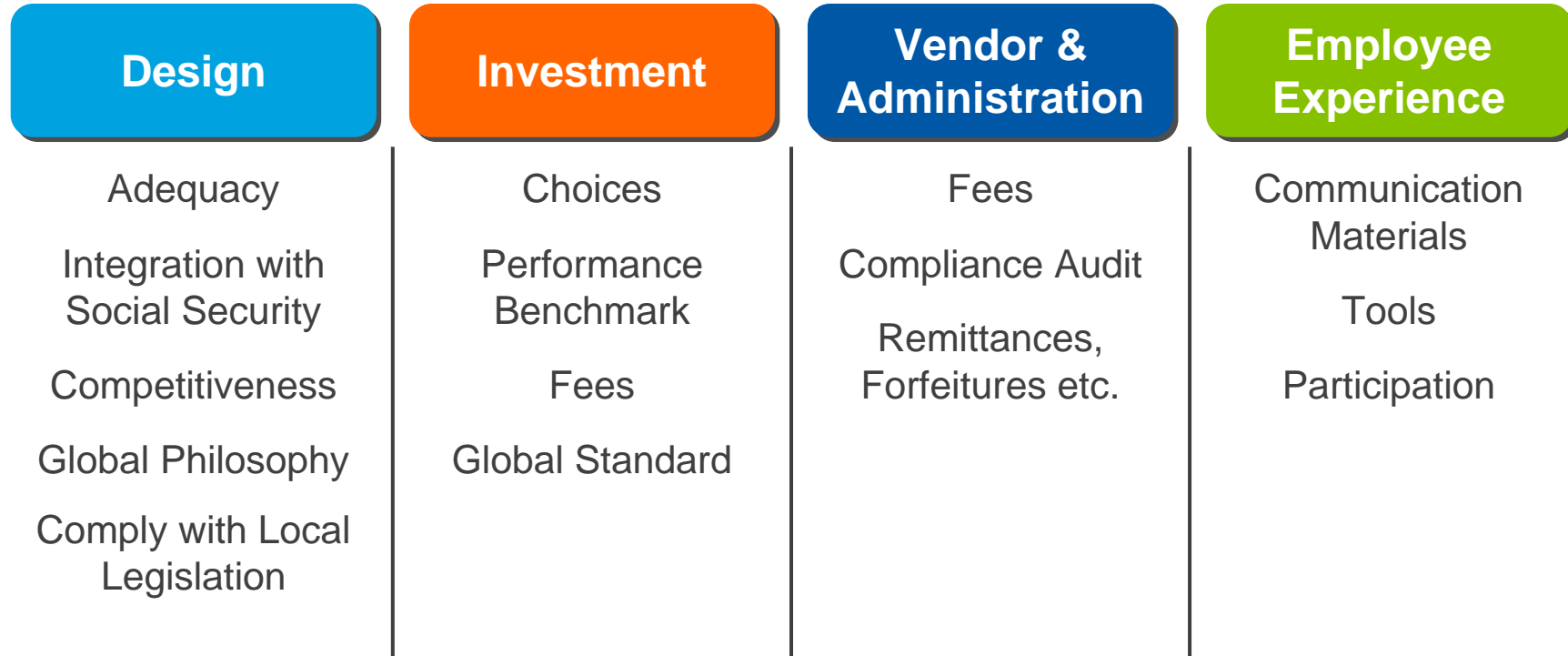
- OECD Working Paper on Insurance and Private Pensions – Pension Fund Governance: Challenges and Potential Solutions 2008
  - Establish independent management committee
  - Create legal environment for employers to monitor DC pensions, guide individual member choices
  - Increase responsibility of private pension providers
  - Strengthen role of pension fund supervisory authority
- Ombudsman/Adjudicator/Regulator bodies to handle member complaints
  - UK for many years had OPRA now Regulator
  - Australia: Superannuation Complaints Tribunal
  - SA: Pension Funds Adjudicator



# Multinational DC Plan Management

# Multinational DC Plans Management

What are some of the risks and how should they be approached?



# Possible DC Plan Management Approach

## Own, Influence, Monitor

	Own	Influence	Monitor
Plan design	<ul style="list-style-type: none"> <li>▪ Global Design Philosophy               <ul style="list-style-type: none"> <li>– DB or DC</li> <li>– Coverage</li> <li>– Competitiveness</li> </ul> </li> <li>▪ Key Design Aspects               <ul style="list-style-type: none"> <li>– Degree of acceptable risk</li> <li>– Employee cost sharing</li> </ul> </li> <li>▪ Benefit adequacy</li> <li>▪ Approval Process</li> </ul>	<ul style="list-style-type: none"> <li>▪ Aspects of design</li> <li>▪ Immaterial changes</li> <li>▪ Communications</li> </ul>	<ul style="list-style-type: none"> <li>▪ Review               <ul style="list-style-type: none"> <li>– Compliance</li> <li>– Competitiveness</li> <li>– Cost-effectiveness</li> </ul> </li> <li>▪ Compliance with policies, guidelines and the law</li> </ul>
Investment management	<ul style="list-style-type: none"> <li>▪ Global Investment Policy               <ul style="list-style-type: none"> <li>– Investment guidelines and strategy</li> <li>– Guidelines for selection of benchmarks</li> <li>– Measurement frequency and reporting protocols</li> <li>– Prohibited asset classes/types</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>▪ Manager Selection</li> <li>▪ Performance Measurement</li> <li>▪ Default fund selection</li> <li>▪ Custody &amp; Security</li> <li>▪ Synergies and cost savings from global providers</li> </ul>	<ul style="list-style-type: none"> <li>▪ Compliance with corporate policies and guidelines</li> <li>▪ Performance</li> <li>▪ Appropriate use of funds</li> <li>▪ Fees</li> </ul>
Vendor Management, Employee Engagement	<ul style="list-style-type: none"> <li>▪ Communication strategy</li> <li>▪ Guidelines on providing financial advice/education</li> <li>▪ Guidelines/audit to ensure compliance with local legislation</li> <li>▪ Target levels of participation</li> </ul>	<ul style="list-style-type: none"> <li>▪ Service agreement</li> <li>▪ Synergies and cost savings from regional providers</li> </ul>	<ul style="list-style-type: none"> <li>▪ Fees</li> </ul>

## DC plan management for multinationals...taking some steps

- Inventory of DC plans
- Risk Assessment, central management approach
- Consider opportunities to leverage buying power and achieve cost efficiency
  - Cross-borders administration
  - Single investment managers
  - Streamline data collection
  - Fee benchmarking
- Review plans for global consistency, competitiveness, employee engagement
  - Global investment policy (# funds, default option)
  - Consistent approach to manager searches, performance measurement
  - Global approaches to minimize member risk e.g. defaults, autoenrollment
  - DC design philosophy, benchmarking and survey data
  - Update on country and regional best practices, trends and legislative developments
  - Employee advice modelers that could be used cross borders



# Questions?



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