

SOLVING THE GLOBAL DEFINED CONTRIBUTION PUZZLE

Guiding principles help companies identify and tackle challenges



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Managing defined contribution (DC) retirement programs across multiple countries can be a challenging process. Variables such as local regulations, government policies and cultural differences can have an impact on a company's goal to offer consistent, scalable and cost-effective benefits globally. But the biggest hurdles that multi-national corporations face in maintaining a global DC approach often are less-tangible. Local culture and customs, interpretations of company philosophy and interdepartmental communication, for instance, may differ markedly across borders, complicating efforts to offer a DC program that works equally well in all locations.

When determining a framework for a successful global DC program, the **Defined Contribution Institutional Investment Association (DCIIA)** Global Committee suggests taking a five-step approach to setting up strategies:

1. Establish a global philosophy and guiding principles.
2. Set retirement benefits program objectives and design country by country.
3. Form a governance oversight structure.
4. Create objective measures of success.
5. Assess the considerations involved in implementing the DC program.

The first step – establishing a global philosophy and guiding principles – can help a company organize and manage its global DC program and provide a framework and common approach to employee benefits to help maintain global consistency.

“The DC program as a retirement option is at different levels of acceptance and maturation around the world,” said the director of retirement benefits for a large multinational corporation and a representative on the DCIIA Global Committee.¹ “With this difference, multinational companies need to have a common philosophy and guidance around what to offer their employees so there is parity in benefits. A well-defined guiding principles document can be the benchmark that companies use as a launch point for designing their global retirement benefits program.”

The DCIIA offers its members a template that plan sponsors can use to help them take inventory of their various global DB and DC programs.

ESTABLISH A GLOBAL PHILOSOPHY

A global philosophy helps a company guide its country programs toward a consistent vision of employee benefits. In planning this philosophy, the company needs to determine how it views the provision of DC benefits. Does the company take a paternalistic approach that tasks it with automatically enrolling employees and educating them about their savings options? Does it also go a step further and teach retired employees how to access and budget their funds so they last throughout retirement? Or is the company's stance more practical, viewing employees as independent savers who make their own decisions and its DC program as a competitive benefit designed to attract talent?

¹ Representatives of the DCIIA Global Committee participated in a teleconference discussion held by Northern Trust in its Chicago headquarters in 2014.



Each corporation can benefit from determining what its philosophy is and ensuring that the philosophy is consistently applied globally via a governance oversight committee. That group might consist of representatives from the company's Human Resources, Treasury, Finance and any other departments considered part of the decision-making hierarchy.

The company also must be cognizant of any deeply held philosophical differences in local or regional culture that might make it socially unacceptable to implement a blanket program on a global basis or suddenly replace a defined benefit (DB) program with a DC program. It's important to understand not just the regulatory requirements but also the societal and political norms and expectations around retirement funding in the various countries where the company operates.

For example, before recent pension reform, many workers in Greece assumed they could retire as early as age 56 with up to 80% of their pre-retirement income even though Greece's fragile social security system was too fragmented and economically unsustainable. As the social security system teetered near insolvency, Greece was forced to cut and cap benefits and significantly raise retirement ages, moves that sparked widespread worker and retiree protests.

By contrast, German workers typically expected to contribute more to their DC programs, retire later and receive less-generous payouts than did Greek workers. The German government also enters into the equation regarding payouts, requiring that retirement funds be dispensed through an annuity.

If differences such as these make it difficult to work around a single or consolidated societal norm, plan sponsors might want to take it up a level and instead consider retirement program structures consistent with a country's overarching economic norms.

GUIDING PRINCIPLES

While there is no definitive step-by-step primer to help global companies structure their DC programs, clearly articulated guiding principles can provide direction and help them avoid bumps along the way.

We advocate taking a holistic approach to incorporating the guiding principles² into your company's benefits program. None of these steps exist in a vacuum; they influence the others in some way. Also remember that the guiding principles should be a living, evolving document that is flexible, responding to the changing needs of the company and its employees as well as regulatory and economic changes over time. Here are seven suggested principles:

1. Design programs to target appropriate member outcomes. The programs should be designed to provide good absolute outcomes for members, country by country, given different retirement needs. For example, do you provide program designs and investment options that can help employees accomplish a goal of replacing 60% to 80% of final pay throughout retirement? Do you take into consideration the differences in each market and what investment options are most appropriate for a specific market? Do you incorporate your employee demographics, such as age, compensation level, participation in other retirement programs, medical needs, etc.? Program design is crucial to ensuring successful adoption by employees.

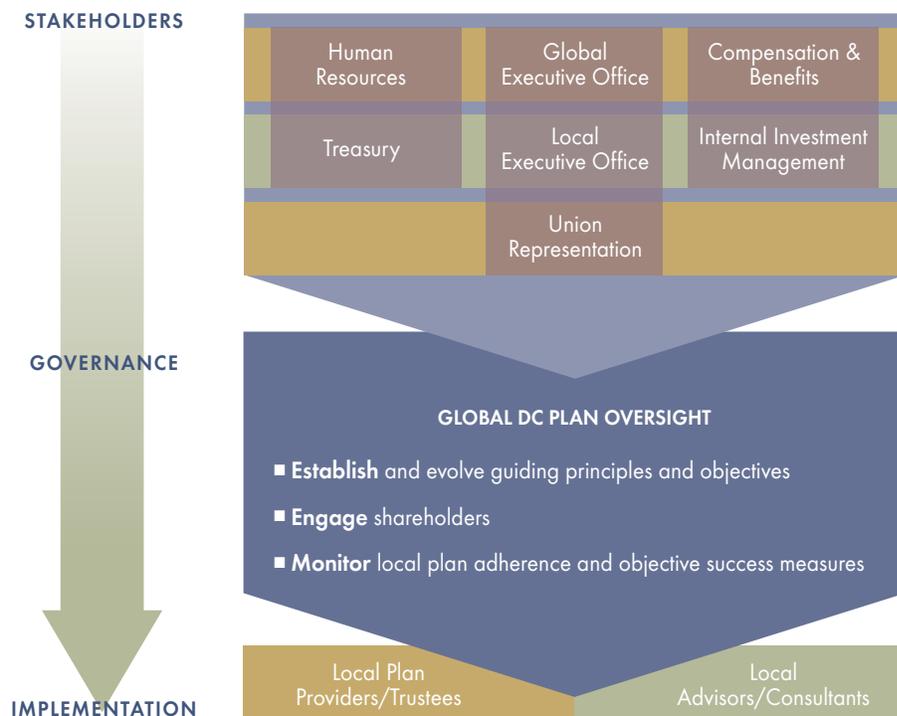
² These guiding principles were inspired partly by principles and guidance published by The Pensions Regulator, the body regulating occupational and personal pension programs offered via employers in the United Kingdom, as well as by best practices observed in key DC pensions markets globally.

Programs should identify, evaluate, monitor and manage key DC risks. DC risks entail more than just market risk. They also encompass specific risks to long-term savings from economic trends, price and market volatility, rising inflation and employee longevity. All are factors that should be considered when making investment menu choices available to employees via local programs.

There also should be a system in place, such as through periodic employee and peer group surveys, to provide metrics gauging the program’s performance to determine whether it is on-target. Data-gathering should cover areas such as employee participation rates; employer match rates among industry peers; and projections about whether the average employee contribution rate is sufficient to provide enough income during retirement.

2. Put in place a clear governance structure with transparency and accountability across the global program. This helps the company organize a global reporting framework that ties together the responsible stakeholders, accountable decision-makers by location and business function (HR, Finance, etc.) as well as those in the organization who simply are consulted and informed about decisions. This group might report to a steering committee comprised of company directors or other C-level decision-makers. This overarching structure (see Figure 1) can provide benefits of scale to the company while also fostering discussions about expectations and priorities for governing the DC program.

FIGURE 1: CREATE A GLOBAL GOVERNANCE OVERSIGHT STRUCTURE



Source: DCIA, PIMCO

3. Provide program fiduciaries with ongoing governance, as well as regulatory and investment training. Stakeholders must have knowledge of – and may need training in – DC fundamentals. “The language of DC differs across borders, and there needs to be a common understanding of industry terms,” said Marla Kreindler, attorney with Morgan Lewis & Bockius LLP and DCIA Global Committee member. “Additionally, legal and regulatory differences exist country to country. For that reason, it is helpful to have a process to identify updates on local regulatory changes and to clearly understand the features and investment choices available to employees.”

4. Set up a global DC oversight committee to annually review the program design, investments, service providers and fees. The committee should include representatives from human resources, relevant outside consultants, the treasury department and possibly a union representative. It should conduct regular reviews of the program’s structures and functioning to help the company see where it can improve the program, make it more cost-effective and efficient, and meet the goals and objectives of the guidelines. This committee also is closely tied to the program’s fiduciary responsibilities spelled out by various countries’ laws governing retirement savings programs.

SEMANTICS MATTER

Financial industry terms that seem commonplace in one country or region could elicit puzzled looks or mean something entirely different in another country. So it’s important to vet carefully the words you use when you’re trying to communicate about your DC programs to a global audience.

Here are some terms that have alternative meanings or connotations from one country to another.

Retirement Plan (U.S.); Pension Scheme (U.K./Ireland); Superannuation Fund (Australia/New Zealand) – Different countries use different terms to refer to their pensions programs.

Checking Account (U.S.) – It’s called a “current account” in the United Kingdom.

Mutual Funds (U.S.) – In Europe, these are more commonly called “pooled funds” or “unit trusts.”

NAV – In the United States, net asset value typically refers to a mutual fund’s per-share market price. But in the Asia-Pacific region, it often refers to the market value of a total portfolio.

Participants (U.S.) – In all other markets, employees are referred to as “members” of a DC program.

Recordkeeper (U.S.) – In all other markets, these are referenced as “member administrators.”

Scheme – In Europe, the word “scheme” may be used to mean a legitimate business plan; in the United States, however, the word often carries a negative pejorative and is associated with scams such as Ponzi schemes.

Treasuries (U.S.) – Depending on their maturity dates, these U.S. government securities may be the equivalent of gilts in the United Kingdom and bunds in Germany.

Transfer between accounts (U.S.) – In the United Kingdom, this is called an exchange. Additionally, in the United States, the term “exchange” is more commonly referred to as a stock exchange.

5. Seek recordkeepers and other service providers that provide timely, accurate and comprehensive records as well as appropriate disclosure on error resolution, fees and services.

Where possible, select global organizations that can offer consistency and economies of scale.

6. Know that accurate and timely recordkeeping is an integral part of the company's legal, fiduciary and regulatory responsibilities, which may vary by country.

Also, selecting global providers that offer services across multiple markets can help reduce fees and ensure consistency to multinational companies and their worldwide employee base.

7. Use member communications to educate and guide employees toward informed retirement savings and investment decisions.

An effective communications program reflects the company's philosophy and meets the goals that the governance structure has set. Multinational companies should try to use a global approach to communications, training and branding so that the look and feel is consistent around the world and available to all employees and easily accessible via multiple media (in-person, on-line, etc.).

FORMING A FRAMEWORK

These guidelines provide a great starting place for sponsors but don't address common "soft" issues they may encounter as they govern their DC program. During our years of helping companies with their DB and DC programs, we found a number of related challenges and formed recommendations that might help corporations as they manage their DC plans.

Take a hard look at the company's overarching philosophy to ensure it is balanced with the specifics of the DC program. For example, if the corporation generally takes a paternalistic approach to education, then make sure the new DC program incorporates grass-roots employee education. Similarly, if the company wants to ensure that all team members globally are educated similarly about DC fundamentals, it must put appropriate training programs in place across the organization.

AVOID WORK SILOS

The corporation can avoid missteps and working at cross-purposes by creating a multi-disciplinary team with members from different countries to coordinate and track efforts across departments, countries and sub-groups.

Part of that effort means being aware that even small changes can have a big impact. For example, schedule inter-office meetings at times convenient for employees in other time zones and not just when the home office is working.

You also should consider selecting representatives from the following departments to form the Governance Oversight team: Human Resources, Treasury, Accounting, Executive Management (both global and local), Labor Relations, Compensation and Benefits, and Internal Investment Management. These groups are the key stakeholders in delivering an effective global DC benefit and must work together for a common goal articulated by the governance structure.

"When you think about what the biggest issue might be, it would be that different departments work in a silo, isolated from one another at both the corporate and country level," said the director of retirement programs for a large multinational company. "I really believe in a multi-disciplinary team that understands the goals from the beginning and works with the other teams, because global plans can't be developed in silos."

ESTABLISH AND ASSESS METRICS

The importance of tangible metrics that gauge the success of the DC program cannot be understated. The governance oversight committee would benefit from access to metrics that measure retirement affordability and employer return on investment.

“A good set of metrics, reviewed at least annually, will help the plan sponsor know if their DC plan is meeting its targets,” said Stacy Schaus, DC Practice Leader at PIMCO and DCIIA Global Committee Chair in 2014. “Ultimately, the success of a DC plan lies in the outcome for its members. If the number of people who are saving for retirement are able to retire when they choose, then you have attained the goal.”

Finally, treat the guiding principles as a living, evolving document. The governance oversight committee should regularly review the document and associated metrics, and if needed, modify them based on corporate or regulatory changes to ensure that they are used effectively and kept in line with broader industry and economic developments.

KEY METRICS

There are a few key data points that sponsors should harvest from their program’s metrics to determine whether it is hitting its goals.

1. Are you reaching employees’ retirement funding adequacy goals? In other words, do they have enough money to last through their entire retirement years?
2. Demographically, are you touching all key stakeholders and not just workers close to retirement? Don’t overlook the new, younger employees. It’s just as important to educate them early so they become accustomed to contributing to their retirement plan and consider it an important benefit the company offers.
3. If one goal of your retirement program is to attract talent, are you completing a periodic survey of job candidates to see whether and how much the DC program actually is helping draw talent?

The DCIIA will offer further guidance around DC success factors in future publications.

FOR MORE INFORMATION

To learn more, contact your Northern Trust representative or visit northerntrust.com. To obtain the DCIIA publications mentioned here, visit www.dciia.org or email info@dciia.org.

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