Achieving Global Consistency, Operational Efficiency and Strong Cross-Plan Governance

Multinational companies create employment for thousands of individuals globally and facilitate the retirement of hundreds of thousands more. These firms are looking to ensure employee pension provision at a time when they face numerous pension challenges, including volatile financial markets and increased longevity.

At the same time, for many multinationals the global nature of their pension plans continues to expand as they enter new markets and position themselves for growth. Today’s environment is creating a greater drive to achieve consistency, operational efficiency and strong governance across pension plans globally and to ensure effective decision-making, whether decisions impact the long-term liability and risk management of a Defined Benefit (DB) scheme or the design of a new Defined Contribution (DC) plan. There are different ways to achieve these objectives, and each multinational company will have their own views, although many of the same considerations apply.
The multinational pensions’ journey — the route to consistency

We often talk of a “journey” toward consolidation and centralisation of pension plans. This centralisation occurs to varying degrees and can mean anything from the creation of central guidelines or statements of intent through the establishment of corporate boards that have a high degree of control over the day-to-day management of pension plans. For many, the journey typically commences with the corporate centre recognising that there are distinct advantages in placing their plans under some level of centralised control or oversight, particularly if they seek to mitigate pension risks and maximise transparency.

Typically, the corporate centre initially focuses on examining its pension structures and exposures across countries for its DB plans, supported by a centralised and consolidated information reporting framework.

Whatever level of centralised governance is undertaken, there are two key points to consider. First, strong elements of localisation need to remain in place given that local legislation, regulation and the responsibility of fiduciaries differ country-to-country. Second, any coordinated pensions’ strategy needs to support both local and global business strategies and fit into the firm’s corporate culture.

Ultimately the multinational sponsor is aiming for consistency across all of its plans, both DB and DC, a consistent approach to investments, asset allocation and risk strategy, and a consistent approach to appointing and negotiating with service providers, including asset managers, custodians and advisers. This uniformity and coordination across plans enhances information flows and importantly improves the quality of information, which can be used to drive operational efficiencies. For some multinational pension sponsors, the journey can extend to more complex cross-border asset and risk pooling and pension plan consolidation if permitted by local governing statutes.

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The governance framework

Governance is a key tool for moving toward a more centralised and consistent approach. Numerous multinationals advocate strong pensions governance led by the corporate centre. This will generally consist of a governance framework that keeps key stakeholders informed and focuses on best practice policies to achieve consistency across plans.

The governance structure will be supported by two key business teams who share complimentary goals: the finance department (or treasury) whose aim is to ensure operational efficiency and effective risk management, and human resources whose objective is to ensure that pensions outcomes support talent and reward strategies, given that pensions provision forms an increasingly important part of the total benefits package.

The key to effective pensions’ governance for many multinationals is to set a framework and standards from the centre while allowing regional solutions and local flexibility. Some multinationals may create specialist teams to ensure best practices and risk reduction for their individual country pension plans. These in-house teams can provide consultancy services at both the global and local level on global benefits information, regulations and policy.

The shift from DB to DC plans

Any discussion of pensions would not be complete without mentioning the continuing shift from DB to DC pensions’ provision. The magnitude of this shift is country-specific; the United States, the UK and Australia are examples of more mature DC pensions’ markets, while other countries, including Argentina, Brazil and South Korea, inter alia, are at earlier stages of DC pensions’ development. Despite this shift, DB is still a major component of the pensions’ resource is spent managing these substantial long-term liabilities. Therefore, streamlining, coordinating and achieving greater consistency across DB plans on a global basis will remain a key focus for the corporate sponsor.

That said, the current trend for many multinationals — which emerged nearly a decade ago — is to move exclusively to offering DC schemes for the future accrual of pensions’ benefits, even if the historic accrual has been on a DB basis. For the corporate sponsor, this shift to DC transfers the management of risk and liabilities from the corporate sponsor to the individual employee, and places the onus on the employee to make informed investment decisions. However, the corporate sponsor remains responsible for ensuring that DC members are engaged and are provided with the appropriate information and tools to achieve better retirement outcomes. This requires strong employee communications, which often fall within the remit of human resources supported by external retirement solution providers and pension platform providers.

Many corporate sponsors and advisers are thinking about the adequacy of DC pension provision and use
the more mature DC markets as models for provision in other countries. Unless the corporate wishes to increase pension contributions, one of the most effective ways to improve DC retirement outcomes is to improve operational efficiency and thereby drive down costs. This has been an important area of focus in the United States. Another key approach is to improve member decision-making through communication. Australia is an example of a country where pension funds are looking to increase engagement with their members, so that participants take a more active role in reviewing their own pension needs. Yet another focus of the U.S. DC market is to reduce risk and create greater certainty of outcomes for the individual. For this reason there is a drive for stronger default options that include target date funds. However, some human resource departments may themselves need further education on lifestyle or target date funds, and this is where investment advisers can play an important role.

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The era of asset pooling?

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Many multinationals are exploring asset pooling opportunities to more closely manage costs, enhance performance and mitigate risk with the support of service providers such as global custodians, fund managers and advisers. Multinationals with significant DB pensions are typically more interested in cross-border pooling solutions.

The Pensions’ Journey

Service providers and advisers are increasingly looking to provide innovative and flexible solutions to support multinationals on their pensions’ journey. Highlighted below are some key points for the multinational corporate sponsor to consider:

1. There is no one-size-fits-all solution to centralising pension provision. Decisions are right or wrong at the individual company level.

2. The wider context for multinational sponsors includes asset management, custody, global governance, business strategy and corporate culture. For this reason, each multinational’s pension journey will be unique.

3. Virtual and physical pooling both have their proponents. Multinationals must work with their advisers to determine which one (or combination) suits them best and create the business case for the local plans to buy into.
for both their DB and DC plans. Although the pooling of pension assets is not a new concept, there are different views on how this can be achieved. Two types of pooling structures are being explored: virtual and physical.

**Virtual pooling**

In a virtual pool, assets are pooled only at the accounting level. The assets remain legally and physically segregated, in the ownership of each participating plan, and with no requirement to establish a single, physical investment vehicle.

The local entity or corporate sponsor appoints fund managers in the usual way, as well as a custodian at a global level. The local plans continue to place their investment instructions via the custodian, which processes orders in the usual way and then provides consolidated information reporting to the corporate sponsor.

For some companies, virtual pooling may be a more cost-effective and less complex alternative to physical pooling, given that it overcomes some of the local taxation and regulatory challenges, offers a broader appeal beyond European pension assets (potentially allowing multinationals to pool their plans globally), and can be used equally in a DC and DB environment. Virtual pooling may also offer a more flexible solution for DC assets, including support for both target date funds and lifecycle strategies.

**Physical pooling**

With physical pooling, as the name suggests, assets are physically commingled in a centrally managed legal entity. Pooling occurs at the investment or asset level with liabilities generally remaining separately managed at the local or national level (note however, in the case of an IORP, liabilities may also be pooled). Each local pension scheme holds units or shares in the pooling vehicle and retains beneficial ownership of the underlying assets.

For DB plans, cross-border pooling offers the possibility of enhanced governance as well as increased transparency and efficiency benefits. However, these structures can often be complex to implement due to the disparate tax treatments and regulations that apply in each country. Indeed, if not done properly, physical pooling may create tax inefficiencies. Physical asset pools may also create challenges for the corporate sponsor as local country schemes may be unwilling to enter the pool due to the need to satisfy different investor requirements or retain local fiduciary responsibility. In spite of these hurdles, there are examples of multinationals using physical pooling to great benefit.

Within the European Economic Area (EEA) for example, there is legislation in the form of the IORP Directive which permits cross-border pooling of European assets without fiscal complexity. Commonly used vehicles that facilitate pooling include FCPs (Fonds Commun de Placement) in Luxembourg, CCFs (Common Contractual Funds) in Ireland, and FGRs (Fonds voor Gemene Rekening) in the Netherlands, as well as options under Liechtenstein law. In terms of practical implementation considerations, local plan participation and support, corporate sponsors may choose to take a staged approach by initially pooling specific asset classes that are consistent across local plans.

**Which path to take?**

There is no right or wrong answer that applies to all multinationals. Virtual and physical pooling both have their proponents, and it’s important for the multinational to work with their advisers to determine which one, or combination of options, is most appropriate to meet their strategic plan objectives. Whichever route is taken, the multinational sponsor needs to partner with the right providers and take incremental steps to achieve this objective. The first step may be to consider whether to appoint a single global custodian for ease of consolidated reporting to the corporate sponsor.

For those multinationals with pension plan provision in the EEA, cross-border IORPs remain an important consideration either as a standalone solution for EEA or coupled with a physical or virtual pool in the rest of the world. Used correctly, and cutting through much of their perceived complexity and shortcomings, IORPs can provide a valuable means for multinationals to consolidate the operational and governance functions of their EEA pension provision. Such is the importance and potential of IORPs that EIOPA3 has launched a second consultation with the industry with a view to reviewing the efficacy of the IORPs Directive. The top policy rationale for the consultation is the simplification of legal, regulatory and administrative requirements for setting up cross-border pension plans.

Finally, we should of course highlight that any pooling solution needs to be investigated within the wider context of the multinational’s global governance objectives and should be seen as a means to achieve greater operational efficiency, greater visibility and increased control over the management of asset and liability risks globally.

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1. Institutions for Occupational Retirement Provision. The name IORP comes from a specific EU directive (IORPs, Dir 2003/41/EC). The IORP Directive allows pension funds in one European country to manage the pensions of a company operating within another European member state and also enables companies to create a single pension fund for all their operations in Europe.

2. The European Insurance and Occupational Pensions Authority. EIOPA is part of the European System of Financial Supervision consisting of three European Supervisory Authorities and the European Systemic Risk Board.