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Global retirement and pensions challenges: a multinational view

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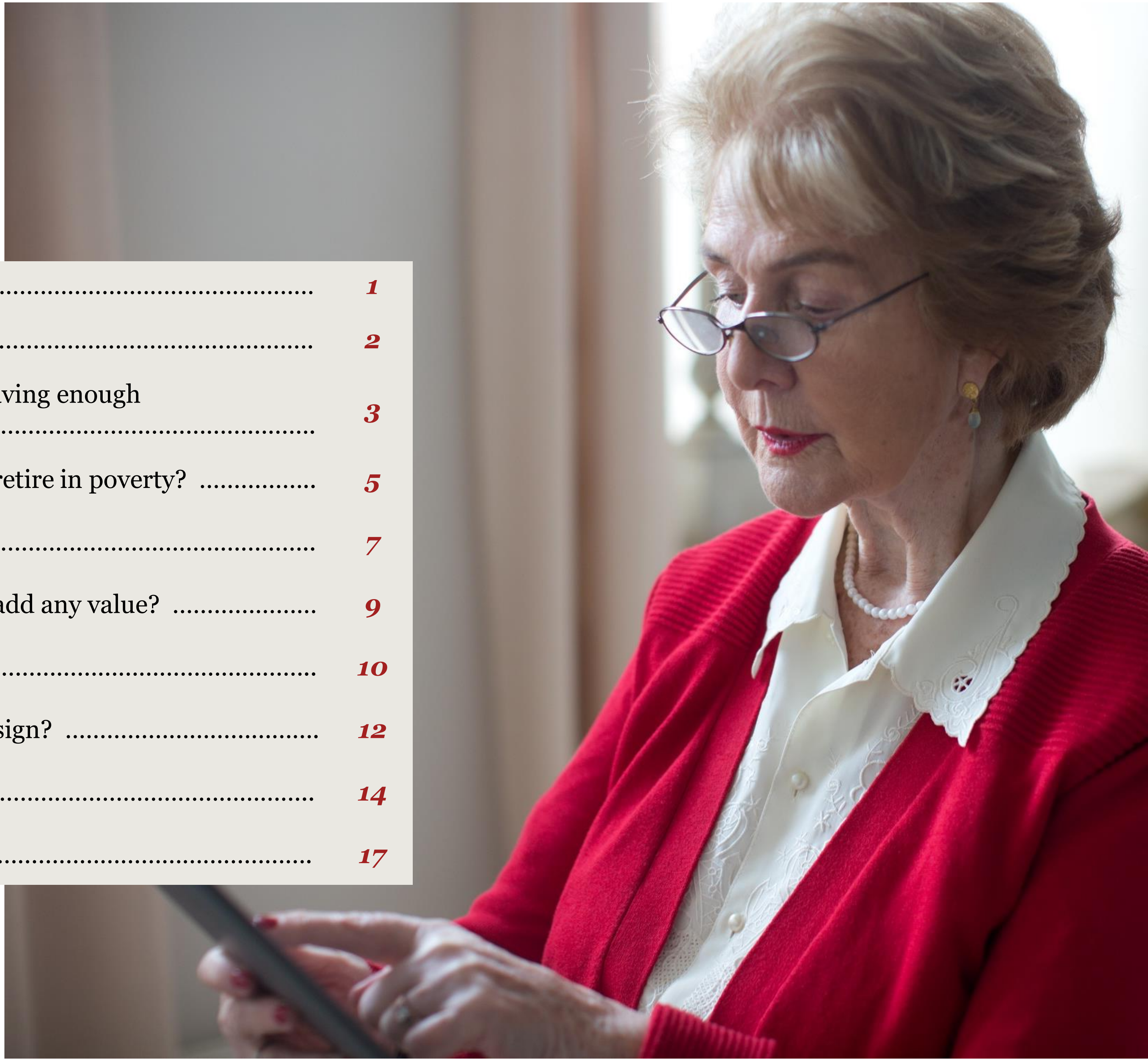
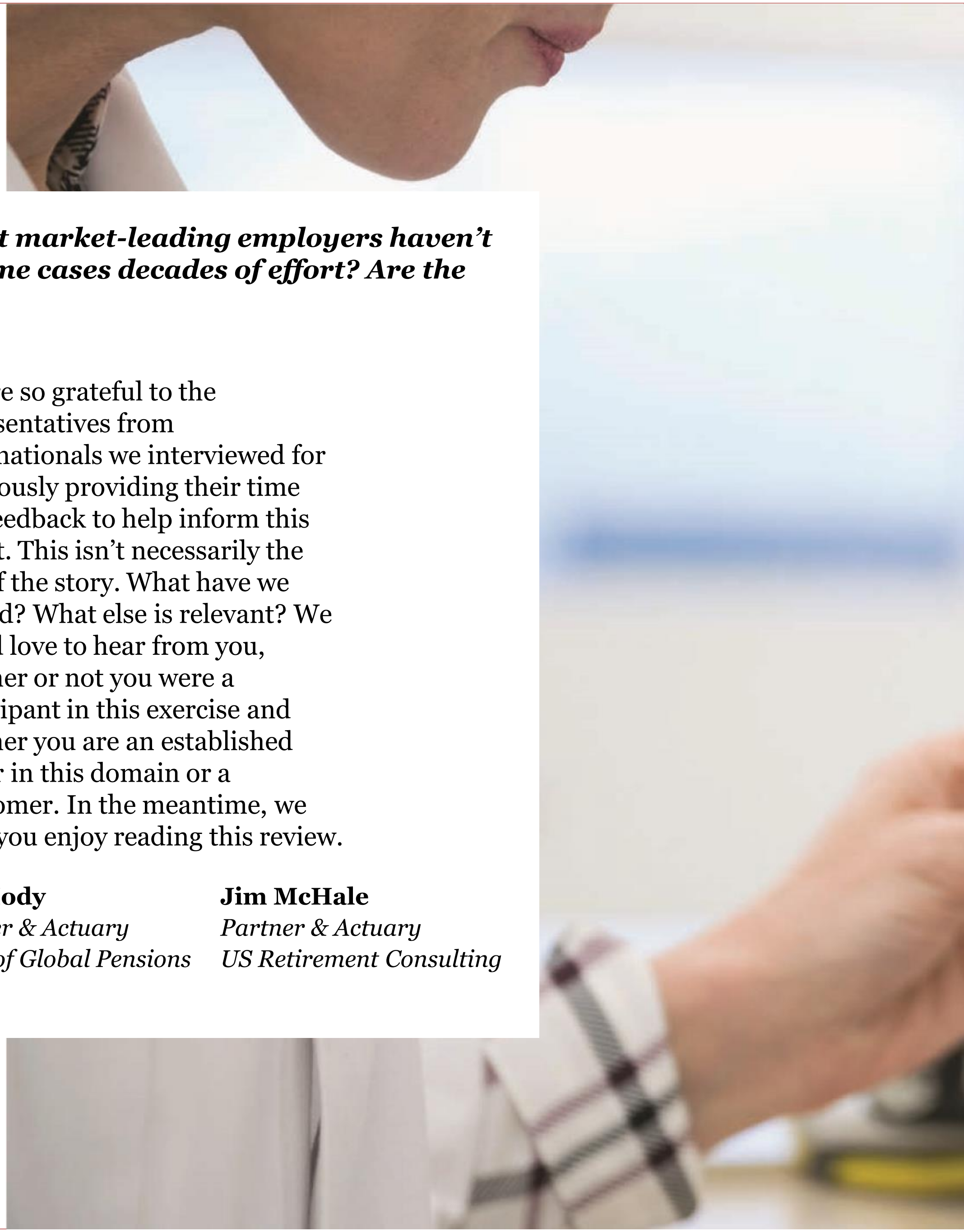


Foreword



Why are retirement and pensions issues so challenging? Why is it that market-leading employers haven't been able to tackle and resolve their issues in this space, despite in some cases decades of effort? Are the problems solvable at all or here to stay for decades to come?

To collect insights into this topical matter, PwC's global retirement consulting practice conducted a dialogue with multinational companies with significant pension liability footprint around the world.

We spoke with leaders and decision-makers at 30 major companies covering pension commitments in over 80 countries with around $700 billion of defined benefit obligations.

Rather than collecting statistics to pre-determined questions, we had face-to-face open-ended dialogues, which enabled us to take the discussions whichever way our interviewees wished to go. What was really on their minds? We wanted to get to the heart of organisations' strategy and their business reasons for setting their strategy for dealing with retirement liabilities.

We then synthesised all the input we heard and this report is our write-up of the key themes. The macro trends we discovered in our last global review in 2014 still mostly stand, but it's more evident now that there are vastly different reasons across organisations for why they are where they are and why they are heading in the direction they are.

We have tried to distil everything we heard under seven key topics. We believe they form essential prompts for any organisation wanting to develop a capable strategy for their retirement and pension challenges around the world.

We are so grateful to the representatives from multinationals we interviewed for generously providing their time and feedback to help inform this report. This isn't necessarily the end of the story. What have we missed? What else is relevant? We would love to hear from you, whether or not you were a participant in this exercise and whether you are an established leader in this domain or a newcomer. In the meantime, we hope you enjoy reading this review.

Raj Mody
Partner & Actuary
Head of Global Pensions

Jim McHale
Partner & Actuary
US Retirement Consulting

Executive summary

Our dialogue with the executives of many companies across the globe resulted in a number of common themes, regardless of the employer or geography. Many of these themes provide opportunities to each company to assess their strategy around their retirement provision, determine the level of spend that is appropriate for the provision, how to organise it and to determine if the appropriate level of value is added for the cost incurred. The themes included the following major points:

Employers do care about their employees, their financial wellness and their success at the company. This is proven by the fact that employers are willing to spend a significant amount of time and money (well beyond the statutory minimum) on retirement provision and the belief that it is a key part of a remuneration package. What employers want to avoid are the financial risks and legacy liabilities that are often created with the retirement provision. This report gives employers a chance to step back and re-examine their retirement spend to determine if it meets the overall objectives of the employer and if the programs are efficient at accomplishing these objectives.

Employers are taking actions to assist employees in saving for retirement and managing employer-provided retirement provisions. However, most employers are not sure how to implement a comprehensive and coordinated approach to providing the retirement provision and educating their employees to ensure success. Stepping back and developing the objectives that the employers want to achieve and developing a comprehensive plan on how to meet those objectives can be a valuable exercise.

Most of the companies were uncertain if their advisers fully understand their business context and if they are adding sufficient value in what they do. This should lead to a “question everything” approach to any spend. Understanding all adviser spends, including direct fees, back-end fees, commissions and so on, and determining if the return justifies the spend is an important task to undertake. Only complete, rounded advice that looks at the overall picture can provide real value to an organisation.

Plan governance is not always where it needs to be and many employers feel that more needs to be done in this area to avoid any internal conflicts, avoid adverse legal or regulatory outcomes and to ensure all decisions are made with a keen focus on the overall objectives of the company for their retirement provision. There is no one-size-fits-all approach for the right governance. Central will be the nature of the business and how labour-intensive it is or has been in the past.

1. Do companies really care about employees having enough income in retirement?

... Yes, but for very different reasons

"We are not the kind of company that is looking into retirement benefits with the aim of being the best in the market."

Businesses are under pressure to focus on what really matters today and tomorrow. So what is the role of business in providing for the long-term challenge of their employees' retirement? Shareholders of public companies may ask: why should we carry risk and responsibility for former employees who no longer add value to the business?

Many companies have tried hard to move away from traditional defined benefit (DB) plans towards less risky, sometimes cheaper, alternatives. Less risk in this context invariably means less short-term financial risk for the employer. That's not always the same thing as truly less risk. Our 2014 global survey found that only 6% of companies saw defined benefit retirement plans as their preferred approach to providing post-employment benefits to employees. The role of employers in providing for retirement has changed: their willingness to contribute has remained, but their willingness to underwrite risk has declined.

One reason for this is the change in relationship between employers and employees. Traditional paternalism has declined: individuals are increasingly looking for multiple career experiences rather than a job-for-life. Corporates also have a better understanding and more focus on risk – lifelong promises are seen as expensive and open-ended and bring uncertainty.

So should businesses really care for their employees' post-retirement financial health?

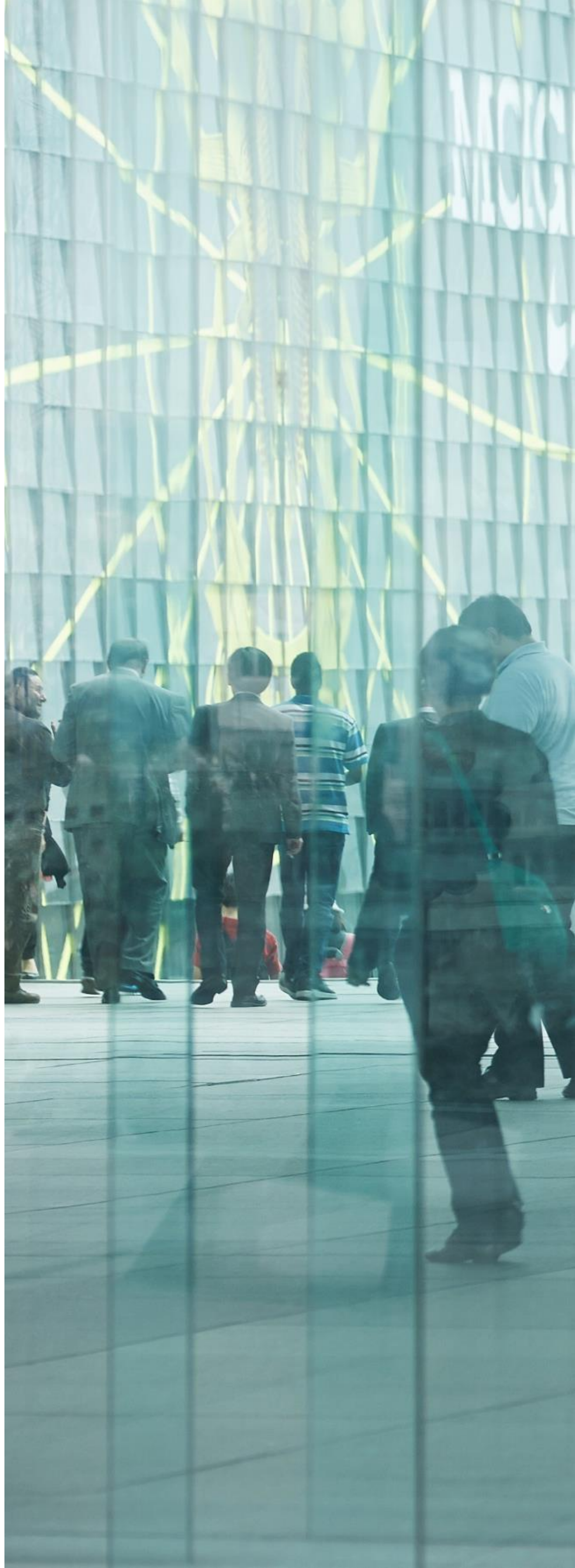
What companies told us

Some companies still stand by a paternalistic corporate culture. They remain willing to take on responsibility and risk for their employees' retirement outcomes.

This approach appears to be more prevalent, although not exclusively, in Asian-headquartered companies and family-owned businesses.

The majority of companies adopt a balanced approach. These companies still have a strong focus on controlling costs and continue to move away from legacy DB arrangements to cut risk, but they also have a desire to do more than the minimum required retirement provision.

In fact, none of the companies we spoke with had a strict global policy of doing just the absolute minimum. Why?



We found several reasons why companies spend time and money on employee retirement welfare:

Market competition

Retirement benefits are recognised as part of a competitive remuneration package. The weight companies place on this varies, but most monitor their level of retirement benefits relative to key competitors.

Employee relationships

Showing concern and providing means to help employees attain retirement security in the future promotes good relationships with employees now.

Social responsibility

Many employers recognised the potential for a future retirement crisis and believed that employer retirement provision would have to be at least part of the solution.

Workforce management

Some companies are looking at retirement benefits as a workforce management tool. They recognise that employees eventually need the financial means to prepare for their own retirement and ignoring that need would eventually result in additional costs or lower productivity. Addressing this need does not mean universally more generous benefits, but means analysing data and member choices to spot trends and identify when retirement outcomes are failing.

2. Is the next generation of employees going to retire in poverty?

… Yes, unless there is co-ordinated and drastic actions to address this problem waiting to happen

“Our ‘1% more’ campaign, where we showed employees the impact of 1% more of their salary in pension contributions, was a real success. We saw take-ups of up to 70% in some territories – even members who were projected to be relatively well off in retirement.”

– Global chemical company

“The fact that someone retires after 20 or 30 years of service and leaves the company grateful, and also receives a benefit that allows them to maintain their living standard, is a recommendation letter for future generations.”

– European beverage company

At first sight, the retirement outlook for the next generation is not good. The closure of corporate defined benefit pension plans has exposed individual pension outcomes to investment markets, demographic changes and interest rates. Retirement outcomes from DC plans are failing.

Asking people to save more is critical, but it cannot be all of the solution. For the vast majority of people this is a challenge in a time of rising prices, but stagnating real wages.

Current and future generations will have to remain in employment later into their lives than their parents. Some countries are seeing significant increases in the ‘working retired’. In South Korea, 30% of over-65s are employed, albeit often in part-time roles.

There is some evidence that recent rapid improvements in life expectancy have slowed. But even so, life expectancy is still improving at a faster rate than typical retirement ages are increasing.

What should companies do about this emerging societal change?

What companies told us

A number of employers we spoke with view the lack of retirement readiness and resulting risk of not being able to bring in the next generation of talent as a key risk. Evidence of this risk was particularly stark after the 2008 financial crisis when plummeting balances in DC plans meant employees could not retire. To frustrate matters, this came at a time when jobs were scarce and employers were under pressure to cut costs.

Even though many employers we spoke with identified the problem, few have yet taken action or truly understand the magnitude of this risk.

From our conversations, the following trends are likely to emerge:

Analysing outcomes

We see an increasing number of companies analysing expected retirement outcomes at an individual level and comparing these to desirable outcomes. This can be used to target specific groups of individuals either with education or incentives to save more.

Increased incentives to save

Companies are willing to pay more if employees do. In the US and UK this is common.

However, some companies (and countries) think such matching programmes misdirect limited resources to the wrong employee population.

Auto-enrolment

In countries where employees have traditionally had to opt in to retirement plans or higher savings options, companies are automatically opting employees in, pushing them to higher savings levels. This is partly driven by legislation.

Financial education and wellness

Some companies are investing in employee education and awareness around financial matters, including retirement readiness.

For a few companies this includes providing employees with modelling tools to help them better understand the impact of and need for extra savings.

3. Has anybody solved the risk problem?

… No, it just continues to be passed between the different stakeholders

“Currently, all our efforts are focused in reducing risk, simplifying the benefits structure, reducing managing costs and maximising tax efficiencies. Getting all internal stakeholders working with the same commitment and speed is becoming a real challenge.”

“If someone says would you like to reduce risk, then the answer is of course yes, but that’s not the whole story. What does pension valuation volatility even mean for a company with a multi-billion dollar market cap?”

– Global oil and gas company

Providing for retirement is a challenge for society and not just individuals or corporations. National and intra-national government bodies are in a key position to decide on the right balance in providing retirement benefits. Often this pushes the challenge on to corporates.

What companies told us

Companies still cited pension cost and risk as a major challenge to their business, as they did in our 2014 survey. This impacts the business adversely on the fronts of financial reporting, M&A activity, dividend payments and debt.

Governments have taken a combination of approaches

State benefits

Most states provide (usually unfunded) retirement benefits directly to their citizens, either at a flat-rate or linked to income. Some, like Italy and Germany, provide relatively high levels of state-backed promises. Countries now face the economic challenge of financing this ‘debt’ from current taxation proceeds.

Market forces

Some states have heavily left retirement provision to markets – a competitive employer should supply good benefits, a talented employee should demand them. These countries now face the biggest risk of retirement poverty as information asymmetry means an imperfect market.

Mandatory employer requirements

Some countries, including Australia, Switzerland and Chile, have imposed mandatory requirements on employers. Sometimes this involves underwriting guarantees. Another solution, built around theories of behavioural economics, has seen employers required to automatically register employees for their plans.

In the end, the task of delivering retirement benefits can only be borne by three or potentially four parties: the state, the employer (and their shareholders), individuals (and their families) or third parties. Third parties have moved in and out of the retirement liability market. Insurer appetite varies from time to time and by market. It is also heavily influenced by legal and regulatory forces, for example to hold reserves against risks. In some territories, financial innovation and the burden on employers mean some private investors are willing to take on risk or act as a financial backer of pension plans looking to consolidate.

It’s worth noting that whilst most studies look at individual retirement outcomes, this can be misleading, as in many cultures income and outgoings are shared between families or across generations.

Most companies have taken steps to reduce the risk in their pension plans, although to varying extents. Typically this means passing risk to individuals by phasing out DB plans and introducing DC plans in place. Some have made institutional risk transfer to third parties. This is not always insurance providers. Many Dutch employers have transferred their (relatively) well-funded plans into collective arrangements, where employees as a group bear the risk, or into industry-wide solutions.

Some insurance solutions can seem expensive, at least relative to current levels of funding. But they are also more secure, which should mean that employee benefits are more likely to be protected and the risk of come-back on the employer is low. We found only a handful of companies that have taken the decision to move risk wholesale to insurers wherever possible. Some have used insurance selectively where a combination of competitive prices, and perceived high local regulatory and funding complexity, means the economics work.

There are many risk reduction strategies being employed by companies, either as one-off exercises or as part of a long-term strategy. Examples include benefit changes, plan closure, retirement age increases, liability and cash flow matching, member options, lump sums, annuity purchases and longevity swaps.

Notwithstanding the residual risks still faced by companies, are the strategies being put in place really a solution to the overall risk problem? The evidence might suggest not. The move to Defined Contribution plans has simply resulted in an almost total transfer of risk from companies to the employees, bringing about the challenges flagged earlier.

4. Do retirement and pension advisers actually add any value?

… Yes, but only if they fully understand the business context

“As advisors seek to compete in an increasingly challenging market, solutions appear more and more complex. Information provided can seem increasingly incomprehensible with little value to actual decision-making.”

“We kept on paying advisers to calculate the VaR on our Plan until one day we asked the question ‘what are we actually doing with this information?’. We then realised we didn't actually use any of the reports or output in our decision-making processes so we stopped calculating it, immediately saving on all the fees which went with it.”

– Global manufacturing business

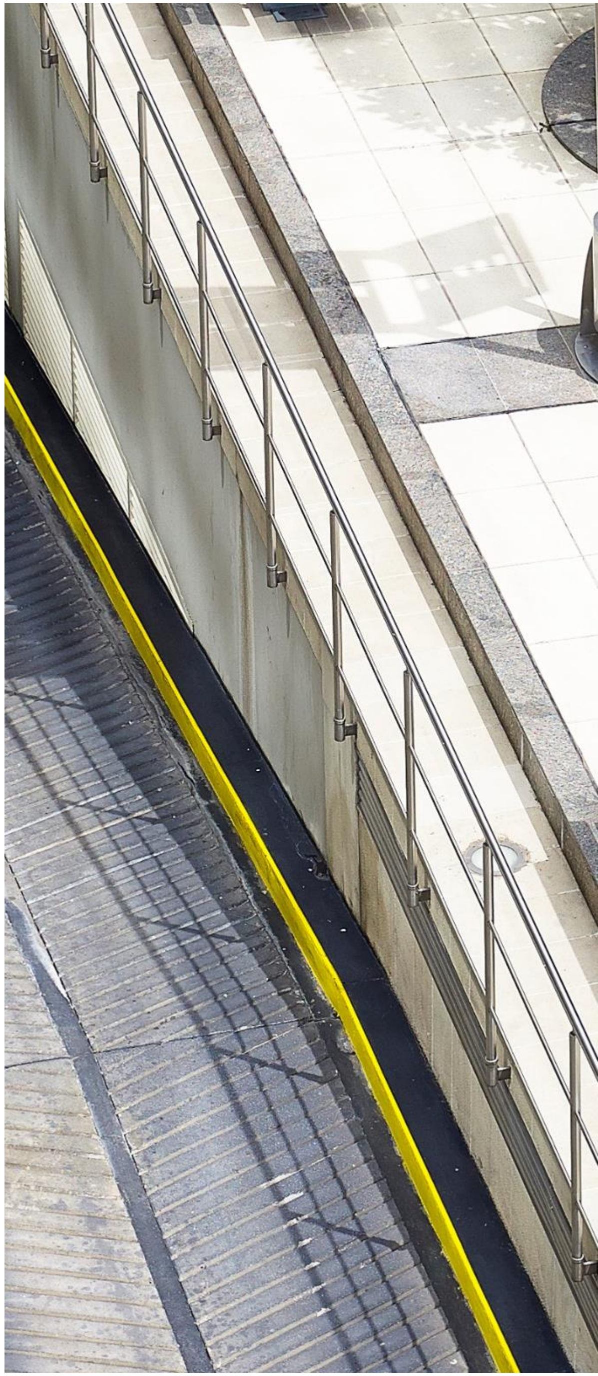
Advisers have long played an important role in supporting companies and pension funds given the highly technical nature of the risk, governance investment, legal and actuarial challenges they face. But questions can be asked of these experts: why didn’t advisers see deficits coming and predict the issues impacting pensions plans today?

Technology has also made the provision of information faster, more frequent and more easily accessible by management through self-service portals. This has eroded some of the traditional areas where advisers might have added value to a pension fund or its sponsoring company. Advisers are investing heavily to catch up, but clearly face a threat and an opportunity.

A further change is the shift from defined benefit to defined contribution plans. DC plans often need much less advice than DB plans. In response, some advisers have chosen to increasingly focus their business on brokering and money management. They believe this is where they add more value to their clients. These areas are lucrative and can lead to a lack of transparency around pricing and costs, and conflicts of independence.

Companies are increasingly scrutinising the advice they receive. Many have considered the value they derive from the information provided and in some cases have stopped paying for certain pension-related services which have little meaning or influence on business objectives. Complex analysis that provides little value to decision-makers and treats the pension plans in isolation to the actual business is not of much use.

To derive real value from advice, companies that appear to get most value from their advisers have highlighted that it must be framed in the context of the corporate agenda. Only then do the solutions and ideas brought forward meet the requirements of key stakeholders and align the pension strategy to the business strategy.



5. Is anybody's house completely in order?

… Unlikely – it's pretty hard to find the perfect approach in action

Financing and managing the legacies of past promises, while providing outcomes and retirement plans that remain competitive and don't store up issues for the future, can represent a toxic challenge in the current economic environment. Like it or not, no company can fully ignore retirement benefits. Getting governance right is also key to success.

What companies told us

Even within the same geographic region, different companies have different answers due to the wide range of influences which impact retirement benefit provision. Although there are geographical differences. US owned companies tend to take most direct control over foreign pension plans. Swiss companies tend to be de-centralised. Asian companies often adopt regional structures to manage the globe.

The majority of companies we spoke with have set a global pensions and benefits strategy. Where decisions are made locally, headquarters still provide some input through a review and approval process. Some companies still lacked an adequate framework.

Most companies have carried out inventories of their global pension plans, but only a few have used this effectively to adjust their approach or take actions centrally on opportunities. More often opportunities and changes were driven by local management adapting to local market conditions.

We also saw in some companies a different approach being taken in the headquarter location compared to the rest of the organisation. Headquarter pension plans are often involving the most senior management of the business either in a decision-making capacity or member of the plan. In some cases HQ gets left out of attempts to better manage pensions – this can lead to accusations of conflicts of interests and affect employee relations.

We only identified a handful of companies who were truly satisfied with the state of their pension governance.

> *"Management of the pensions provision ends up like a football – it gets passed between the Financial, HR and Legal divisions and they each apply their own spin, but no-one ever takes full responsibility or ownership and actually runs with it."*
>
> ***– European Food Production Company***

> *"I'm in a privileged position that I don't have to worry about the financial impact of pensions on the business as it is a drop in the ocean for us. I probably spend only 1% – 2% of my time on pensions, which reflects the 'insignificance' of the pension issue within the business."*

The right approach to governance depends on a range of external and internal factors. Central will be the nature of the business and how labour-intensive it is or has been in the past. After all, more employees means more retirement planning. There's no one-size-fits-all approach. We see the following topics as key components to any governance set up:

Culture of the organisation: paternalistic or individualistic – this drives how much support the corporate wants to offer and how much.

Managing internal conflicts – this in practice means recognising and working with conflicts, not pretending they don't exist, nor trying to eliminate them altogether.

Balancing control – local vs. central authority.

6. Does anybody have the perfect retirement design?

... It seems to be more about progress than perfection

“We are far less paternalistic than most of our competitors. Retirement readiness is not part of our responsibility or philosophy. Ultimately we do not believe playing a role in this area is in the interest of the company or employees.”

– Global aerospace and defence company

“Our pension plan has been designed with employees in mind: in this company we have a saying, all who pass through here, from the job application to the day they leave, should have a nice journey.”

To achieve optimal retirement design, businesses must balance the external demands and influences with internal corporate objectives and financial resource constraints. These requirements can also be impacted by a range of external factors, either directly – through regulatory or legislative change, or indirectly – due to macroeconomic changes and other market influences. There will be conflicting demands and constraints, as well as periods of change and uncertainty.

Many companies have accepted the need to move away from DB and adopt DC (or similar) structures to provide employees with retirement benefits and now stand at a crossroads. As employee working patterns change and the number of jobs individuals work in during their lifetime increases, the role that companies play in providing retirement benefits will also evolve.

We are also moving away from the concept of an ‘age of retirement’ and instead moving to a world where we encourage people to continue to work for longer, but in different capacities.

As countries and societies move towards this new environment, companies who position themselves to meet the demands and expectations of their global workforce can build a competitive advantage in attracting and retaining talent while addressing the requirements of shareholders and other key stakeholders.

What companies told us

The companies interviewed had a range of responses. Some companies, especially those with well-established DC plans and limited levels of DB exposure, were pleased with their arrangements and felt that they were fit for purpose. However, many of those interviewed still had DB obligations which continue to cause a degree of pain, either related to balance sheet risk management or from cash demands on the business.

Many companies are still in a transition phase and are currently facing the challenge of balancing employees' retirement benefits across multiple territories with both DB and DC structures.

A small number of those interviewed had not yet assessed whether their approach to retirement benefits was appropriate from a global perspective, instead relying on local management to meet local requirements for each territory.

Other companies, especially those which did not view retirement benefits as a core part of their reward offering, were less concerned around whether it was necessarily viewed as 'perfect', while, of course, still waiting to cover regulatory obligations regarding mandated contributions and enrolment.

Meanwhile, a number of those interviewed have been starting to find out that they definitely do not have a perfect approach, as unforeseen issues predominantly related to DB plans have begun to surface. These were often in relation to legacy plans acquired through historical M&A activity.

7. Is all of this worth the trouble?

… Yes – the matter of long-term savings position is too important to ignore

“We get the feeling that with young people we have to convince them that [the pension benefit] is an important benefit. Young employees often just focus on current salary as opposed to retirement benefits, although in recent years these have attracted more focus.”

– Food processing business

“Compensation format ‘same benefit for all employee’ should be changed, we should be able to offer a bespoke menu of benefits with options according to the employee’s needs.”

– Beverage company

“If robotics and AI become used widely, employees who are replaced by them will have to be retrained. Retirement plans will have to become more adapted to employment mobility. As for portability, it is difficult in DB, but easy in DC.”

– Global manufacturing business

“We realise that there are common responsibilities in relation to retirement benefit provision, but currently we do not provide services or advice to employees to help them prepare – we more just state that is what they should do.”

Companies are increasingly under public scrutiny and a socially responsible approach to retirement benefit provision may become a focus area as population ageing continues across the developed economies. The ability of companies to be transparent and provide employees with the flexibility and education to make informed decisions about their retirement provisions is therefore likely to become increasingly important.

Through the interviews, companies have highlighted the importance of developing and defining retirement benefit strategies as part of the broader corporate strategy.

Many businesses have seen first-hand the impact of failing to appropriately assess and control risks posed by the provision of retirement benefits. The impact of legacy DB plans continues to weigh on many corporates, and this risk will need to be appropriately managed and mitigated over the coming years.

The transition to a fully DC-type environment will also pose new risks for employees, and companies must be agile and cognisant of these.

Taking a holistic approach to retirement benefit design will be critical to ensure a balance is achieved.

As the composition and role of the workforce continues to change, and age, the ability of a corporate to react and address new demands and risks will be critical.

This will also need to be considered in an economic environment, where shareholder activism continues to rise and the importance of retaining adequate resources to ensure businesses are fit for growth will be key.

The significance of long-term savings to the wider economy and society cannot be underestimated. Companies have an opportunity to get this right for the next generations and set a template for the future, but need to understand what role they will play and how to execute this in the new and changing economic and technological landscape.

Contacts

Raj Mody
United Kingdom
+44 (0)7974 969320
raj.mody@pwc.com

Jim McHale
United States
+1 (516) 650 7421
jim.mchale@pwc.com

Jack Abraham
United States
+1 (312) 952 1395
jack.abraham@pwc.com

Adrian Jones
Switzerland
+41 79 792 6097
adrian.jones@ch.pwc.com

Wim Koeleman
Netherlands
+31 (0)6 5181 4081
wim.koeleman@pwc.com

Mischa Borst
Netherlands
+31 (0)6 2013 9261
mischa.borst@pwc.com

Marcus Kok
Singapore
+65 9831 4716
marcus.mk.kok@sg.pwc.com

Catherine Nance
Australia
+61 419 867 691
catherine.a.nance@pwc.com

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PwC's global retirement & pensions leadership team would like to express our thanks to all those involved in compiling this paper. Reports like this do not come together easily. The matrix of interviews with organisations around the world requires careful planning. We are very grateful to the interviewees who gave up their time to share their perspectives which have informed our findings. Without exception, every interview was full of thoughtful and considered remarks. Identifying common themes from that variety of viewpoints takes some effort and expertise, when not otherwise resorting to simpler quantitative reporting. We wanted to go deeper than conventional benchmarking reports typically allow, in order to unlock insights around what's really driving strategy and decision-making at leading multinational organisations. We did not know what our final report would look like when we started out with this exercise. For bearing with us through such an iterative process, we would also like to thank sincerely our team members Peter White, Advait Rao and Lily Dobrevska for all their efforts.