Tackling the global retirement benefits challenge

Insights from a global dialogue with senior executives of multinational companies

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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 or here to stay for decades to come?

PwC's global retirement consulting practice spoke with leaders and decision-makers at 30 major companies with pension commitments spanning more than 80 countries and around US$700bn of defined benefit obligations to find out how they are addressing these issues. These in-depth, face-to-face dialogues get to the heart of each organisation's strategy for dealing with retirement liabilities.

This report is our write-up of the key themes. The macro trends we discovered in our last global review in 2014 still stand[1]. But there are profound differences in the ways different companies are tackling the issues.

We've distilled what we heard into five key topics. We believe they form the essential prompts for all companies to develop a robust strategy to address their retirement and pension challenges around the world.

We would like to thank the representatives from the multinationals we interviewed for generously providing their time and feedback to help inform this report. This is a critical time for organisations dealing with their retirement and pensions challenges: there is a real need for a continuing and open dialogue among corporates, their stakeholders and advisers. We believe that every organisation has a unique starting point in dealing with its retirement issues, so if you would like to add your voice to the debate, we would be delighted to hear from you. You can find the contact information for our retirement and pensions leaders around the world at the end of this report.

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1 https://www.pwc.com/gx/en/hr-management-services/publications/assets/global-pension-survey.pdf

Key findings

From our discussions we have distilled five common themes, which provide the essential prompts for organisations to assess their retirement provision strategy, determine the level of spending that is appropriate for the provision, think carefully about how they organise it, and consider if the level of value added is appropriate for the cost incurred. These are:

Companies are prioritising retirement provision

Employers are willing to spend a significant amount of time and money (well beyond the statutory minimum) on retirement provision in the belief that it is a key part of overall remuneration.

Unaffordable liabilities are top of mind

What employers want to avoid are the financial risks and legacy liabilities that are often created with retirement provision. Pension costs and the risk of unaffordable liabilities are still seen as major challenges, as they were in our 2014 survey. Companies feel the impact in financial reporting, M&A activity, dividend payments and debt levels.

Companies are helping employees save

To prevent a future crisis, employers are taking actions to assist today's employees to save for retirement as well as managing employer-provided retirement provisions. However, most are not sure how to do both in a comprehensive and coordinated way that meets the company's overall pension funding strategy.

Pension advice must be holistic

Most companies doubt whether their advisers fully understand the unique requirements of their business and therefore whether they are adding sufficient value. Such doubts should lead to a "question everything" approach to all adviser spending: only holistic advice that looks at the entire retirement picture in the context of the overall business strategy provides real value.

Governance must be improved

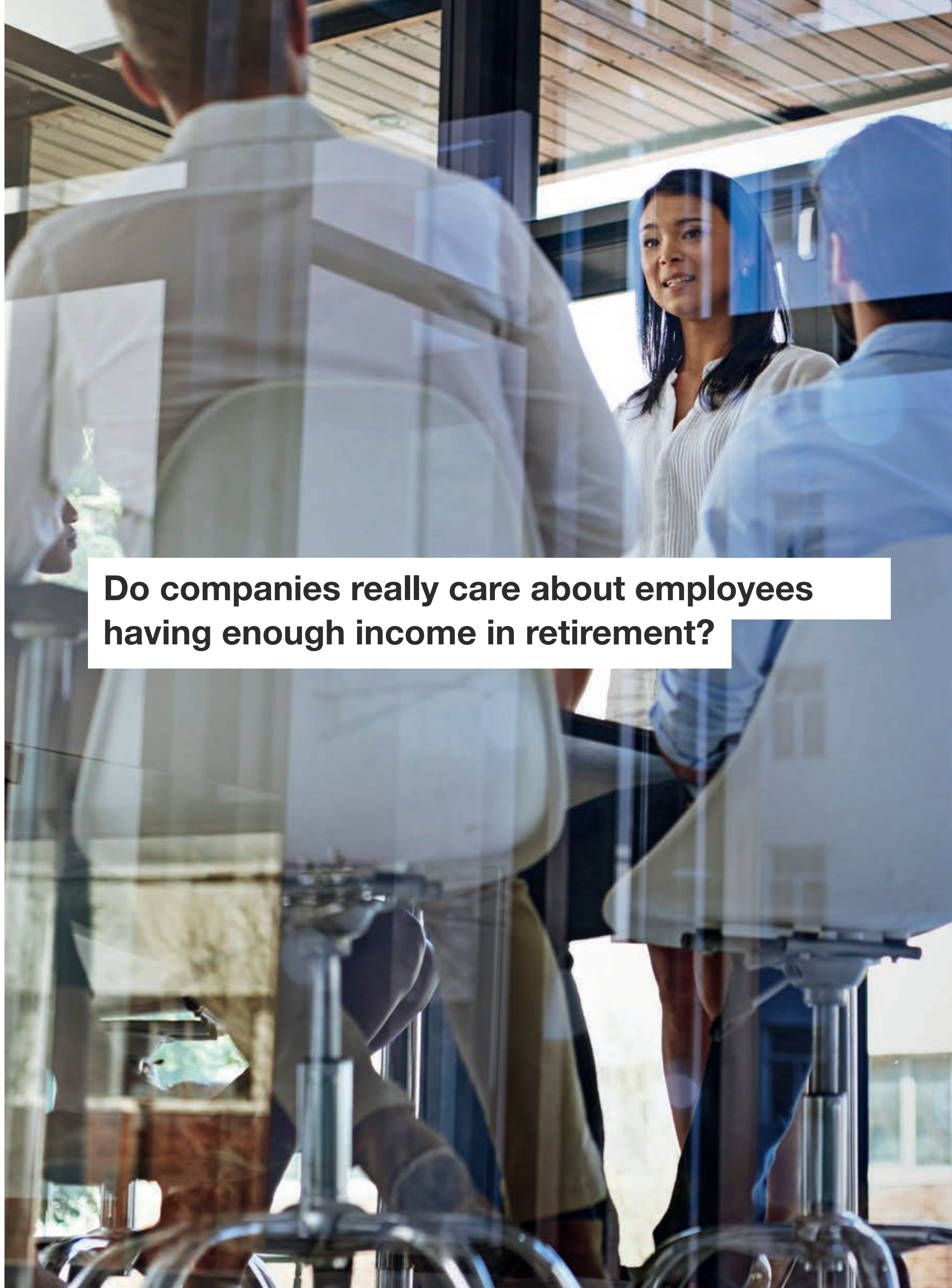
Plan governance is not always where it should be and many employers feel that more needs to be done in this area to avoid any internal conflicts and legal or regulatory problems. A keen focus on the overall objectives of the company for its retirement provision means there is no one-size-fits-all approach for the right governance. Central will be the nature of the business and how labour-intensive it is or has been in the past.

The role of companies in providing for retirement

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 lower risk.

Companies are still exposed to longer-term financial risks if employees are left unable or unwilling to retire and to workforce risks related to talent attraction and retention. There are also broader economic risks if the state is required to pick up the tab for retirement provision. 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 is making way for a new relationship between workers and employers: individuals are increasingly looking for a variety of experiences throughout their career rather than a job-for-life. Corporates also have a better understanding of and more focus on risk – lifelong promises are seen as expensive and open-ended and bring uncertainty. So should businesses really care about their employees' post-retirement financial health?



What companies told us

- A paternalistic corporate culture in which the employer is willing to take on responsibility and risk for their employees' income in retirement does still exist in a minority of the companies we spoke to and is more prevalent among Asia-headquartered companies and family-owned businesses.
- The majority of companies have a strong focus on controlling costs and continue to move away from legacy DB arrangements to cut risk.

None of the companies we spoke with had a strict global policy of doing just the minimum required when it comes to retirement provision.

"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."

Global beverage manufacturer

"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

"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."

Global drinks and brewing company

The reasons 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 will have to be part of the solution.

Workforce management

Some companies are looking at retirement benefits as a workforce management tool. They recognise that employees need to have enough money to retire and ignoring that need would eventually result in additional costs or lower productivity. Addressing this need does not mean providing more generous benefits, but analysing data and member choices to spot trends and identify where retirement outcomes are failing.

Taking action to prevent a future retirement crisis

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 the volatility of investment markets, demographic changes and fluctuating interest rates. Retirement outcomes from defined contribution (DC) plans are failing.

Asking workers to save more is critical, but it cannot be the whole solution. For the vast majority of people this would be difficult at a time of rising prices and stagnating real wages. Working longer is another factor: 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, for example, 30% of over-65s are employed, albeit 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 going up.

What companies told us

- The lack of retirement readiness and resulting risk of not being able to bring in the next generation of talent is a key problem. There was stark evidence of this after the 2008 financial crisis, when plummeting balances in DC plans meant employees could not afford to retire at a time when jobs were scarce and employers were under pressure to cut costs.
- Many employers we spoke with identified this problem, yet few have yet taken action to address or truly understand the magnitude of this risk.

"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."

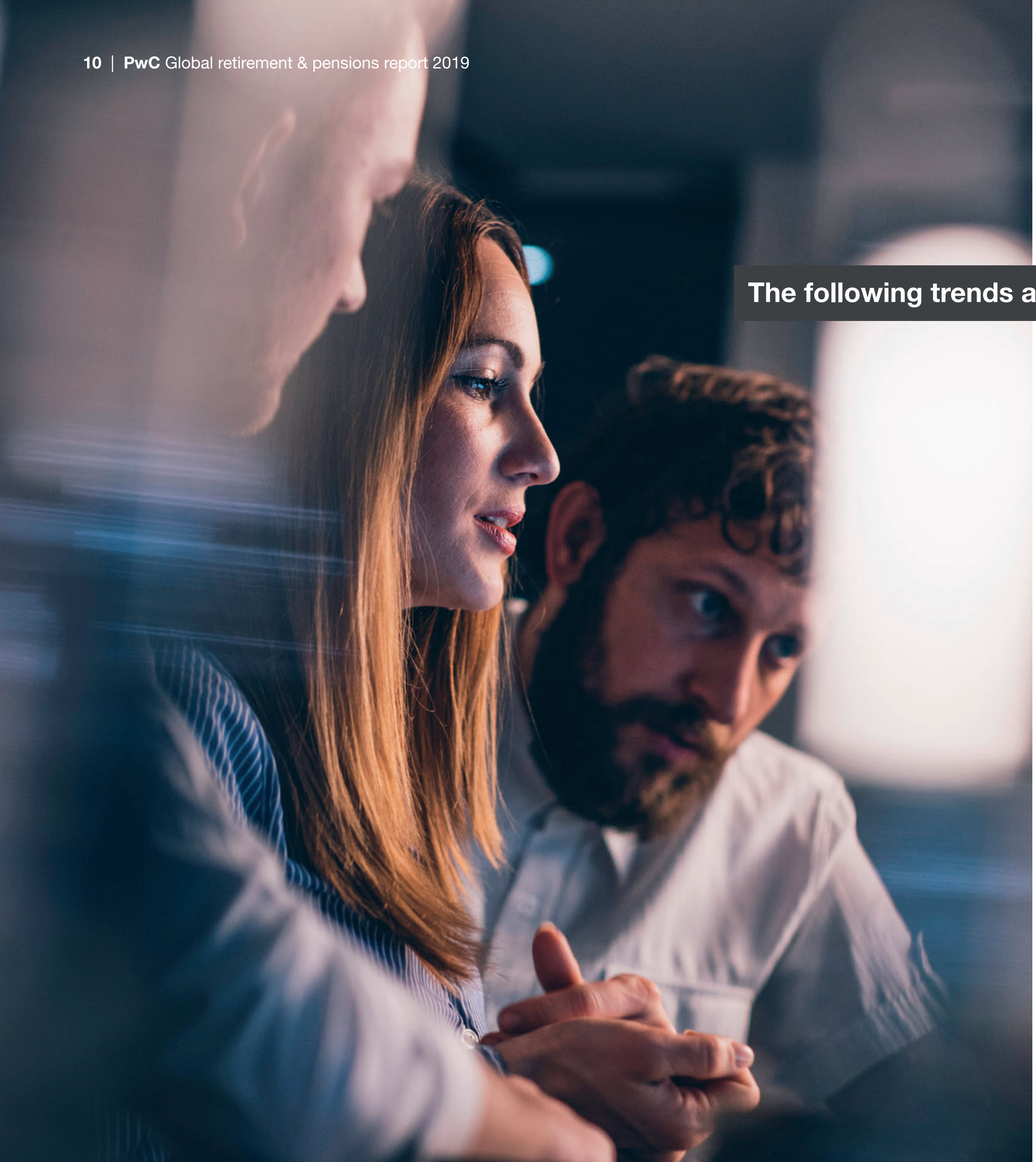
Global chemical company

"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."

Global beverage manufacturer

"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



The following trends are emerging:

Analysing outcomes

An increasing number of companies are analysing expected retirement outcomes at an individual level and comparing these to desirable outcomes. The results can be used to target specific groups of workers with either education or incentives to contribute more.

Increased incentives to save

Companies are willing to pay more if employees do. In the U.S. and U.K. this is common. However, some companies (and countries) think such matching programmes direct limited resources to the wrong employee populations.

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 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.

Managing pensions risk

Providing for retirement is a challenge for society, not just for individuals or corporations. In the end the task of delivering an income for those past working age must be borne by the state, employers (and their shareholders), third parties such as insurers or by individuals and their families.

The organisations we talked with still cited pension cost and risk as a major challenge to their business, as they did in our 2014 survey. Pension liabilities harm the business when it comes to financial reporting, M&A activity, dividend payments and debt.

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. Companies are also using other risk reduction strategies either as one-off exercises or as part of a long-term strategy. These include closing their pension plan, benefit changes, retirement-age increases, lump sums, annuity purchases, liability and cash flow matching, member options and longevity swaps.

Companies should consider carefully whether these strategies offer a solution to the overall risk problem. There is evidence to suggest they do not. The move to DC plans, for example, has simply resulted in an almost total transfer of risk from companies to the employees, bringing about the challenges flagged in the previous chapter.

A second option is for employers to transfer the institutional risk to third parties. These are not always insurance providers. Many Dutch employers, for example, have transferred their (relatively) well-funded plans into collective arrangements, in which employees as a group bear the risk, or into industry-wide solutions.

Has any organisation solved the risk problem?

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 made the decision to move risk wholesale to insurers. Some have used insurance selectively, in cases where competitive markets or savings from removing local regulatory costs or complexity makes the economics work.

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, where there is a requirement to hold reserves against risks. In some territories, financial innovation (including technology-enabled solutions and derivative instruments) 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.

Finally, it's worth noting that whilst most studies look at individual retirement outcomes, this can be misleading, because in many cultures income and other financial resources are shared among families or across generations.

"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 multibillion-dollar market cap?"

Global oil and gas company

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

Global utility 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."

Multinational advertising company

Government policies and retirement benefits

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 nations have left the majority of retirement provision to the private sector. A competitive employer should supply good benefits; a talented employee should demand them. These countries now face the biggest risk of retirement poverty, at least for those who do not have access to employer-provided benefits.

Mandatory employer requirements

Some countries, including Australia, Switzerland and Chile, have imposed mandatory requirements on employers. Sometimes this involves underwriting guarantees. In other countries, such as the UK, Australia and New Zealand, employers are required to automatically register employees for retirement plans – meaning workers who don’t want to participate must opt out, which behavioural economics tells us they’re less likely to do.

Ensuring retirement and pension advisers add real value

Advisers have long played a role in supporting companies and pension funds because of the highly technical nature of the risk, governance, investment, legal and actuarial challenges involved. But the companies we spoke to said the advice they value most lies in solutions and ideas that align the pension strategy with the overall business strategy and meet the requirements of key stakeholders.

Questions can certainly be asked of these experts: why didn't advisers see deficits coming and predict the issues impacting pensions plans today? Advisers are also seeing their own industry disrupted. Technology has made the provision of information faster, more frequent and more accessible through self-service portals. This change has eroded some of the traditional areas where advisers added value to a pension fund or its sponsoring company and they are now investing heavily to catch up.

As advisers seek to compete in an increasingly challenging market, solutions appear more and more complex. The advice provided can seem incomprehensible with little value to actual decision-making.

A further change is the shift from DB to DC plans. Managing DC plans often requires much less outside advice than DB plans. In response, some advisers have chosen to increase their businesses' focus on brokering and money management. They believe this is where they add more value to clients. Although these areas are lucrative for the advisers, this focus can lead to a lack of transparency around pricing and costs, not to mention conflicts of interest.

As a result, companies are increasingly scrutinising the advice they receive and in some cases have stopped paying for services that have little meaning or influence on business objectives. Complex analysis that does not offer value to decision-makers and treats the pension plans in isolation from the actual business is not worth paying for. Understanding all adviser spends, including direct fees, back-end fees, commissions and so on, and determining if the return justifies the expense, is an important task to undertake.

"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

Achieving a retirement approach that's fit for the future

Like it or not, no company can ignore retirement benefits. 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 be a difficult challenge. There is no perfect model, but it is possible to make progress with the right governance in place.

An optimal retirement programme design balances the external demands on the company – regulatory and legislative requirements or macroeconomic influences – with internal corporate objectives and the financial resources available. It includes a sustainable approach to monitoring and managing the risks of financing retirement – with an approach that is realistic for all stakeholders: the employer, employees and their families, and the state or other third parties. Inevitably 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 in this direction, companies that 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.

The right approach varies but certain overarching trends and truths will be nearly universal:

- Employees taking on more personal responsibility will require more retirement planning and education
- An organisation's culture and past legacy will have a heavy influence
- Recognising and working with internal conflicts over how to accomplish change and identify unsustainable risks will be part of the puzzle
- A clear framework for decision-making is needed that balances local market demands and central authority.

Does any organisation have the perfect retirement design?

Is all of this worth the trouble?

What companies told us

- Companies 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 that 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.
- Unforeseen issues, predominantly related to DB plans, have begun to surface at a number of multinationals. These are often associated with legacy plans acquired through historical M&A activity.
- There is a difference in approach between headquarter (HQ) pensions and those in the rest of the organisation. HQ pension plans often involve the most senior management of the business, either in a decision-making capacity or as members of the plan. In some cases, HQ gets special treatment and is left out of attempts to better manage pensions. This can lead to accusations of conflicts of interests and harm employee relations.
- The majority of companies set a global pensions and benefits strategy. Where decisions are made locally, HQ still provides some input through a review and approval process. Some companies still lack an adequate framework.
- Only a handful of companies are truly satisfied with the state of their pension governance. Most have carried out inventories of their global pension plans, but only a few have used those efforts effectively to adjust their approach. More often opportunities and changes were driven by local management, adapting to local market conditions.
- There are geographical differences: US-owned companies tend to take the most direct control over foreign pension plans; Swiss companies tend to be decentralised; and Asian companies often adopt regional structures to manage responsibilities across the globe. But even within the same geographic region, companies behave differently, due to the wide range of specific influences that impact retirement benefit provision.
- Companies that do not view retirement benefits as a core part of their remuneration were less concerned about whether their plan was necessarily viewed as 'perfect', but they still wanted to adhere to regulatory obligations regarding mandated contributions and enrolment.

"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."

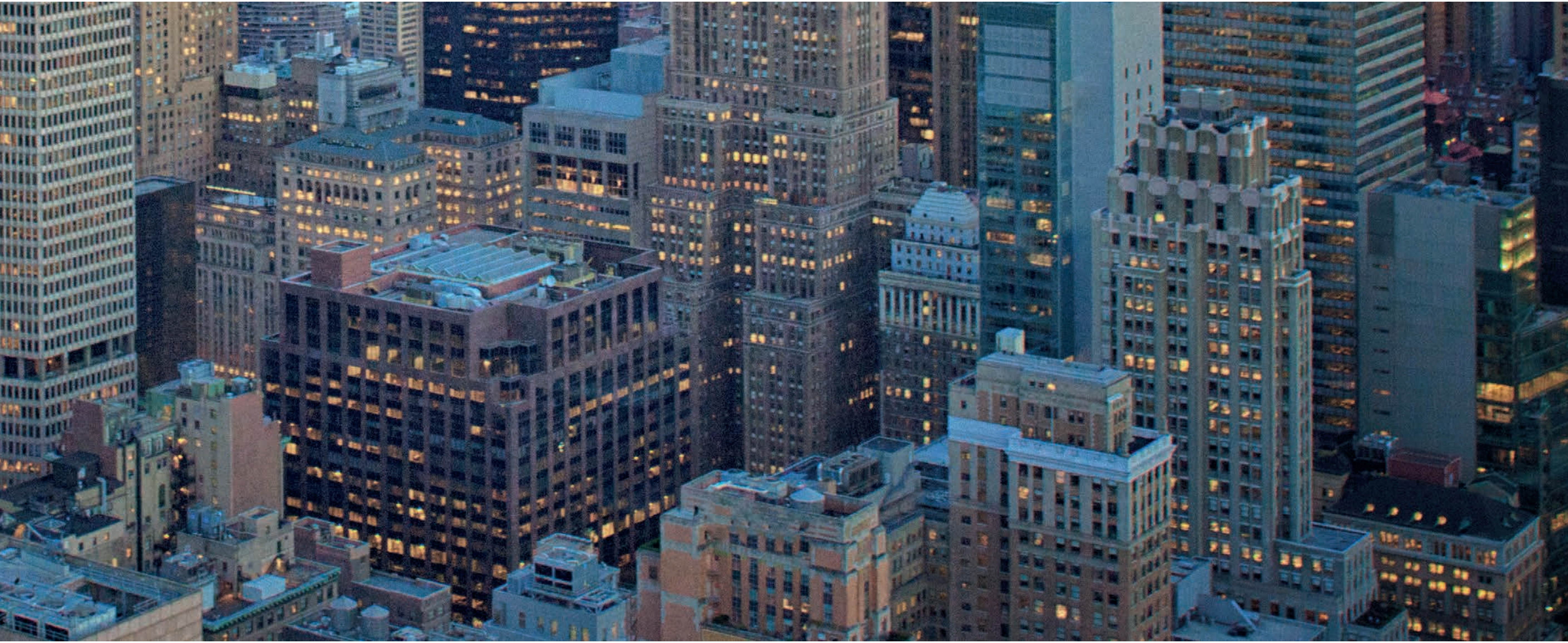
European food production company

"Compensation format 'same benefit for all employees' should be changed. We should be able to offer a bespoke menu of benefits with options according to the employee's needs."

Global beverage manufacturer

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

Global drinks and brewing company



Conclusion

Companies are under increasing public scrutiny over how they meet their social responsibilities, as well as their financial ones. The way employers approach retirement benefit provision is likely to become a focus as populations in developed economies continue to age. The ability to be transparent and provide employees with the right degree of flexibility and education to make informed decisions about their retirement provisions is therefore likely to become increasingly important.

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 environment will also pose new risks for employees, and companies must be ready to act to address them.

In the interviews we conducted, companies have highlighted the importance of developing and defining retirement benefit strategies as part of the broader corporate strategy. In an economic environment in which shareholder activism continues to rise, companies must ensure they do not overcommit on pension benefits and leave the business short of capital to invest for growth.

Companies have an opportunity to get this right for the next generations, but they need to understand what role they will play and how to execute this in the new and changing employment landscape. The significance to the wider economy and society of people having enough money in retirement cannot be underestimated.

"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

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