



Fresh Thinking about DC

Aaron Overy
Northern Trust





There are 2 good times to plant a tree

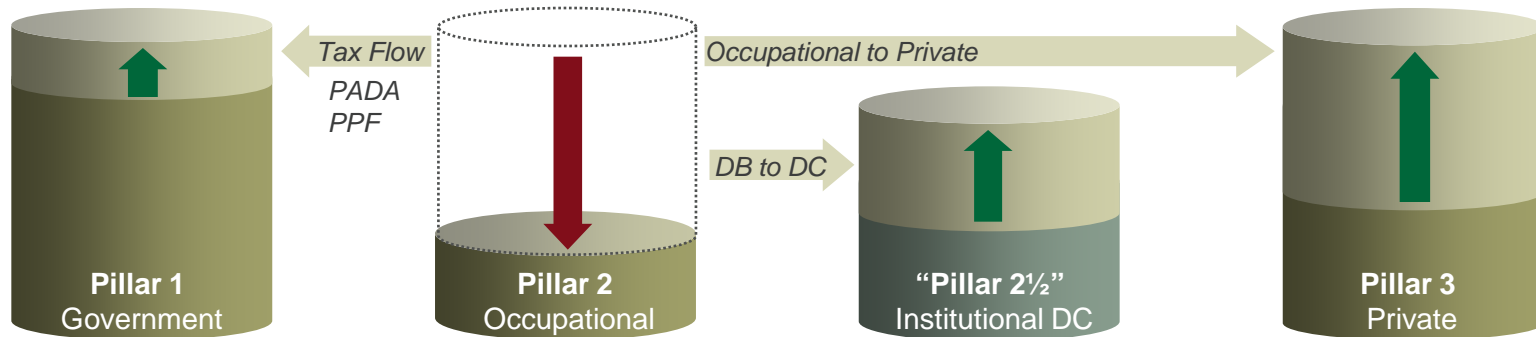
Now and.....



20 years ago



Asset flows in 3 Pillar



Market influences

- Longevity
- Dependency ratio
- Buy-outs
- Increasing retail influence
- Funds moving to daily environment
- DB to DC and private plans
- Shifting demographics
- Pan-European pensions
- Funding gap

Legislation and regulation

- MiFID / SORP
- Personal accounts by 2012
- Treating Customers Fairly
- Deficits
- Governance
- Conflicts of Interest
- Local government reforms
- Risk management

Investment influences

- Separation of alpha and beta
- Increased use of derivatives
- Short and long converging
- Shifting asset mix
- Matching liabilities more effectively
- SRI/climate change issues
- Challenging markets
- Need to manage / control costs



Institutionalisation of DC

Building Retirement Solutions: the development of a pan-European pension platform

As multinational corporations continue to develop a global presence, their desire to offer a single, global pension investment platform has grown. Such a consolidation would reduce overhead costs, simplify administration and ensure tax efficiency. Yet these multinationals face considerable challenges in achieving this consolidation. Not only must they consider cross-border legal and tax issues, but various countries and corporations are in different stages of converting from defined benefit (DB) to defined contribution (DC) pension schemes.

To facilitate the pan-European aspect of this consolidation, multinationals are increasingly turning to pension pooling, which permits companies operating in several countries to pool their scheme assets into a single cross-border vehicle. New directives coming from legislative reform are providing opportunities to combine schemes in this manner.

In conjunction with cross-border pooling, multinationals also want to find a way they can offer DC plans alongside DB plans. For doing so, multinationals could pool both kinds of vehicles into a single investment platform plan that would offer benefits to both the company and its employees.

The history of free economic movement in Europe

Recent progress in the development of a consolidated pension scheme has its foundations in Europe's history. In March 1957, the Treaty of Rome established the European Economic Community (EEC) to bring about economic integration between Belgium, France, Germany, Italy, Luxembourg and the Netherlands. The EEC established a single region of free economic competition founded on the famous 'four freedoms' of people, services, goods and capital.

Not despite the efforts of the treaty's signatories, actual economic freedom frequently did not hold for the lofty goals of the treaty, and tax discrimination and barriers to full integration were quite common.

For instance, it was not until 1986 that the EU Council granted retired citizens the right to receive an occupational state pension from one EU country while living in a different EU country. In May 2003, the Council took this a step further by adopting the Institutions Occupational Retirement Provisions (IORP) directive. In establishing a general framework, it enabled multinational companies employing staff from different European countries to create a single point of employee pension administration through a pan-European pension plan.

It took four additional years for all member states to transpose the directive into national law. Many were forced to do so through injunctive proceedings taken by the European Court of Justice (ECJ) against member countries that continued to use discriminatory practices. Some countries, for instance, continued to collect unreported withholding taxes and conducted hostile taxation of dividends paid to foreign pension funds.

Today, the ECJ continues to force the abolition of unjustified tax withholding across Europe, and countries are starting to align their legislative and case law positions.

A need to combine DB and DC pension plans

The IORP directive allows pooling of contributions and liabilities into a single cross-border vehicle with DB and DC vehicles. As a result of the directive, multinational corporations are increasingly placing interest in the formulation of these plans with common investment platforms.

Because DB plans are maturing and are frequently being frozen, they are as a source of decreasing asset use. One view is that they are not ideal candidates for pan-European plans because the set-up is too time-consuming and expensive, therefore undermining any cost savings and efficiencies.

In addition, in order to move the schemes in compliance with IORP, the schemes would need to be fully funded at all times; the transfer would have to overcome any Pension Capital Transfer issues, and the multinational would have to obtain the agreement of trustees and stakeholders. Moreover, DC plans distributed in countries where DBs are prohibited to keep the greatest benefit from pooled investment vehicles. As an additional benefit, because the no-withholding benefits due to pension funds may now be available via multilateral pooled funds as a cross-border bank, a DB or DC pooled pension fund plan would need to be established with full transparency of investment product so it would not be exposed to unnecessary risk.

Parallel pooling to create a single investment pension platform
DB and DC plans form only part of a potentially greater solution that could be achieved through what we refer to as parallel pooling. As a method of investment of a pan-European pension plan, parallel pooling enables a multinational to sign a cross-border IORP with an asset pooling vehicle. Depending on the country where the plan are based, these vehicles may be termed Tax-Transparent Common Contractual Funds (CCF), Fonds Commun de Placement (FCP) or Fonds voor Gemene Belangen (FGB).

The common investment platforms enable the pooling of DB and DC schemes into a larger cross-border pooling vehicle, resulting in a single global investment pension platform (see Figure 1). Investors could come from multiple countries directly, as an IORP or via feeder funds.

Figure 1. Institutionalisation of DC in cross-border investment platform



Recognising that all their employees, regardless of origin, would stand to benefit from the financial efficiencies and improved service of a single system, multinationals are moving towards single investment platforms in order to achieve:

- Simplified governance and operational oversight
- Fewer providers and interfaces
- Reduced net liabilities – deficits offset by surplus
- Reduced operational risks and costs
- More controlled and efficient assets solutions
- Improved economies of scale
- Reduced internal management time
- Direct cost savings
- Seamless pension coverage for internationally mobile employees
- Consistent administration platform(s) and employee branding
- Consistent framework for implementing change across Europe

The ultimate benefit of such a flexible investment platform is that if DC pooled funds are tax-transparent, a DB plan would be able to invest in them, thereby adding scale to the operation and benefiting the DC members. Under this plan, as the DB plan matures, its assets will be reduced while the DC assets grow, maintaining scale and benefiting the DB members.

Essentially, pooling will provide economies of scale (in the costs of auditing, custody, investment advisers and legal services) and access to best-in-class investment managers and a range of asset types. This pooling process will enable the 'institutionalisation of DC funds' by offering a comprehensive investment product returned as defined, banked DC, target-benefit or lifetime fund.

Summary

Greater acceptance for the cross-border pooling of pension schemes across leading multinationals to explore and develop methods of more effective management techniques of their DB and DC pension schemes across Europe. Legislative reform such as the IORP directive have provided an opportunity to combine DB and DC schemes in pan-European pension plans that can be structured as part of a broader single investment platform. Supporting indirect and direct investments in one scheme provide a single point of pension solutions, benefiting multinational corporations and their employees.

For more information, please contact Aaron Overy of Northern Trust's Retirement Solutions Practice at +44 (0)20 7982 2514 or aaron_overy@ntr.com



Asset Servicing | Asset Management | Wealth Management

Utilise DB Experience
Create scale for DC
Best in class
Tax Efficient
Oversight
Banked DC



Cross Border Matters



Copy 401k?

What should a default fund look like?

Equality?

Trust vs Contract

IORPs

Move close onshore



Institutions for Occupational Retirement Provision - IORP

Institutions for Occupational Retirement Provision (IORPs)

- First EU Pensions Directive was adopted in 2003 (EU Directive on Institutions for Occupational Retirement Provision 2003. Directive – Dir 2003/41EC)
- All EU member states were required to transpose this into their national law by 23 September 2005
- EEA have also done so

Key characteristics of an IORP

- Pension legal entity to be separate from the plan sponsor
- Provide security for scheme members through minimum common standards of governance
- Must be allowed to operate cross-border

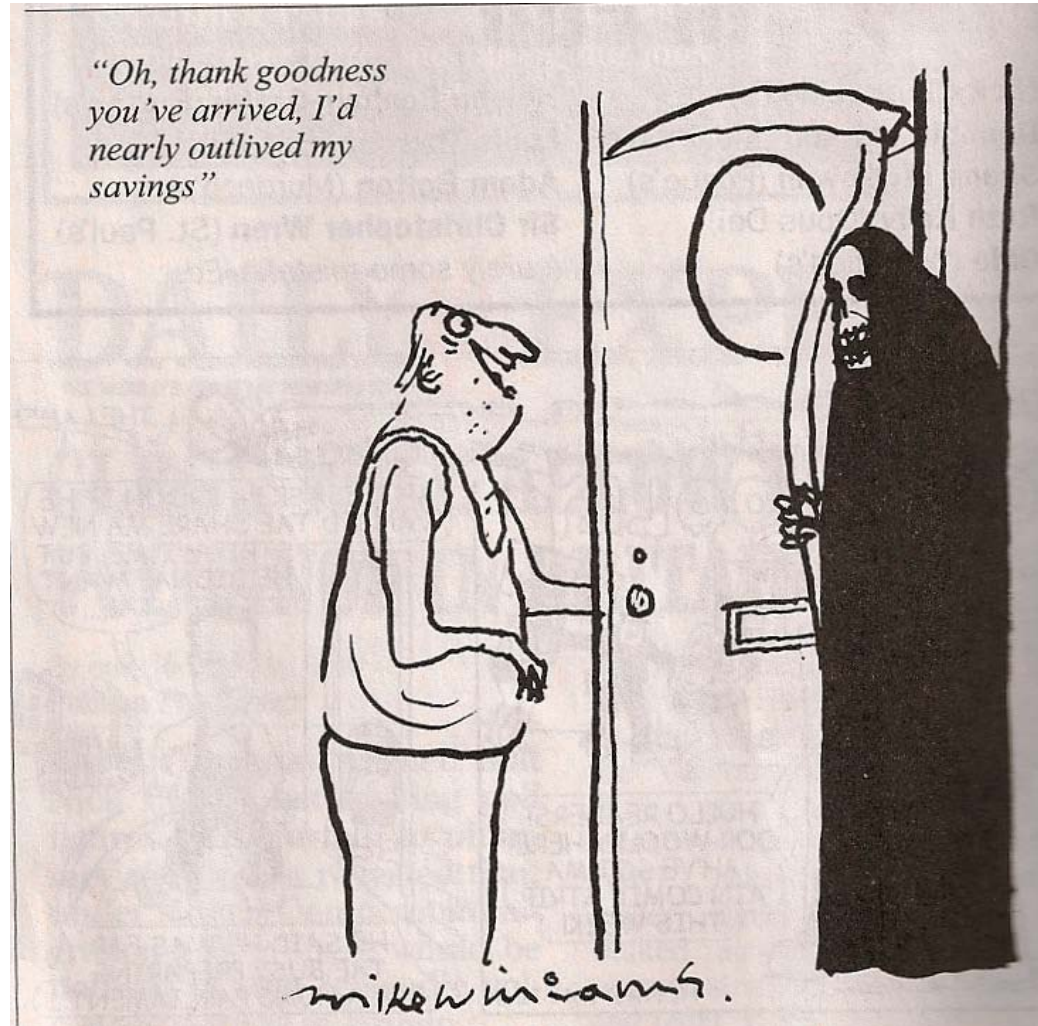
Prime locations identified (EFRP survey Nov 2007)

- Ireland - Trust
- Belgium – OFP (Transfrontières version)
- Luxembourg – ASSEP
- Netherlands – API and PPI (pending legislative approval in the Netherlands)



National Pensions Framework





Northern Trust



Thank You

Aaron Overy
Northern Trust

