Closing The Retirement Savings Gap

Mobility, demographics and pensions are changing at a global level, and as they do so they are creating a web of interconnected risks for employers and employees.

In this article, we will explore these changes by identifying the trends and looking at the impacts – both positive and negative – that they could have on companies operating across international borders. We will then consider the issues from an employee's perspective and make proposals on how employers can help, based on our own experience and the market generally.

2020 – The Future Workplace

By 2020, the over 50s will make up almost one-third of the working population. As people work for longer, employers will need to accommodate a more diverse workforce and the retirement needs of three distinct populations:

- Baby boomers, reaching retirement
- Generation X, those born in the late 60's, 70's and early 80's with established careers
- Millennials/Generation Y, those born later in the 1980s to the early 2000s.

Due to the age and personal circumstances of each group they understandably have very different requirements and reward drivers. For example, Generation X are motivated by paid sabbaticals and income accumulation/retirement planning, Generation Y prefer career development opportunities and cash incentives, whereas the Baby Boomers focus is medical benefits. One incentive they all have in common is work/life balance and the opportunity for flexible working hours.

The Ageing And Greying Workforce

To what extent are we already starting to see evidence that the workforce is ageing?

The greying of the workforce is well observed in northern Europe and to some extent North America. In a Zurich survey last year asking multinational companies for their thoughts on ageing and greying workforces, 71% of respondents said that they expect the number of over 60s in their workforce to increase this decade.

To accommodate this greying workforce, 48% of employers said they would be looking to change their benefits structure in the future. Respondents cited healthcare (60%), group life insurance (40%), critical illness and disability benefits (40%) as being impacted, with expected increases in cost.

While increased longevity is a well-known trend - 78% of employers said that they believed that employees are aware of it – the implications are being overlooked by many. Only 36% of respondents to the Zurich survey said they thought employees understood how much more they needed to fund a longer retirement.

In addition, there was a clear message from employers that they would not be contributing more to retirement savings plans – 81% said they would not be increasing levels of retirement funding to offset the impact of increasing longevity. Instead 89% of employers plan to promote their retirement savings plan and encourage employees to save more themselves.

Adapting Mobility Policies To New Challenges

Current challenges around compliance and cost pressures mean organisations must adapt their mobility policies.

The Brookfields 2014 Global Mobility Trends Survey saw an increase in the number of people that had standardised their policies on a global level versus regional or divisional – 90% of respondents indicated that their assignment policy and programme decisions were made globally, which was a sharp increase from 80% the previous year.

The stakes for non-compliance are higher than ever, as companies need to keep up with rapidly increasing regulatory requirements. To address this, companies are using programme standardisation and centralised decision-making to address the need for mobility programmes to be built on solid and compliant foundations.

However, this move to instigate greater control has not translated into a trend for policies with more rigid guidelines. In fact, companies are embracing policies and programmes that allow greater flexibility, such as a mix of one-way permanent transfers, local plus, and localisation depending on the situation.

One of the main reasons for this is cost, which is the biggest challenge for companies when dealing with international assignments – 72% of those asked said they had reduced costs in the last two years.

So essentially, cost control is driving the trend towards greater flexibility, but employers are unsure of how to go about it and have limited capacity and resources.

The Changing Pensions Landscape

Funding gaps in both social security and pensions and retirement promises can make up a major percentage of long-term liabilities for employers.

For over a decade, a large number of baby boomers have retired, or are now preparing for retirement, expecting payments from governments' social pension systems, public sector pension funds or voluntary pension and retirement accounts. Many companies have been struggling with the financial aspects of longevity and financial well-being during retirement.

The aftermath of the global financial crisis, including lower than expected investment returns and volatility, as well as increased regulation, has forced many governments, public and private sector employers, and pension fund providers to reassess their current solutions.

Central control, cost reduction and improved governance are all driving demand for pension solutions that work on a global level. But achieving this is actually becoming harder due to national pension regulations, plan design and tightening of tax rules.

Consequently many multinational organisations are:

- Carrying out a global audit of pension provision
- Ensuring any compulsory requirements are in place
- Amalgamating pensions across jurisdictions where possible, e.g. UK/ Ireland
- Retaining employees in the home plan where viable
- Establishing a host plan where necessary
- Otherwise establishing an international pension plan.

The Employee View

To understand the employee view we surveyed over 1,200 members of Zurich's International Pension Plans.

The Majority Of Members Understand And Engage With Their Plan

- 67% know how their plan works
- 64% have read their plan guide

About the survey

Sent to **5,127** plan members, across **10** companies.

1,267 completed the survey (**25%** response rate)

86% respondents were male (as per the industry split, and which is still fairly representative of today's expats)

35% aged **30-39**

37% aged **40-49**

30% said they were looking to retire between **60** and **64.**

Surveys carried out between July and November 2014.

- 41% use the online administration regularly (62% say it's easy to use)
- Only 47% know what funds they are invested in.

Does The Plan Meet Their Retirement Needs?

- 56% have a pre-determined level of retirement income they need to reach
- 45% claim their Zurich plan forms all, or part of their retirement savings plans
- However, only 29% believe they are on track to reach their required level of income
- Despite this, only 12% pay AVCs.

The Employee View On Plan Communication

- There is a clear desire for communication (86% think between monthly and quarterly communication is reasonable)
- There is a clear (98%) preference for email communications which is unsurprising given the nature of the companies contacted.

Given that there is a clear message that employees don't believe they are on track to reach retirement goals, how can employers help to close this retirement savings gap? There seems to be an opportunity to shape plan design to achieve better member outcomes and to empower employees to make more informed retirement decisions.

Shaping Plan Design For Better Member Outcomes

Clearly not all of the issues around pensions are just the employer's responsibility, but employers can certainly help through flexible plan design and regular and effective communications.

International pension plans offer flexibility for mobile employees who are unable to join a locally approved plan, which may be for a number of reasons. There are no prescriptive rules on investment options, contribution amounts, member eligibility, and when and how the benefits can be taken. In addition, members can accrue benefits in a single pot and in a currency that fits with their retirement plans.

However, when it comes to leaving employment and retirement, an international pension plan's flexibility generally stops, with a majority of employers asking members to take their accrued benefits as a lump sum as soon as they leave employment, whether at retirement or earlier.

Therefore, employers can help employees to increase their retirement income simply by allowing them the flexibility to leave their funds invested until they are ready to make a decision or retire, or to allow regular withdrawals from the plan.

Supporting Employees When They Leave Service Or Retire

In many cases, although plan rules may permit members to remain in their plan after leaving employment or retirement, in practice members are given no option other than to take their accrued benefit as a lump sum.

In some cases this could be the right thing to do – for example, if the value is low, if the member has already identified a use for the money, or if retirement is a long way off. But it's also important that the employee understands that they are taking out what should be a large part of their retirement provision.

In a lot of cases though there are disadvantages to taking a lump sum, including:

- Significant tax charges
- What to do with it in the short-term while they decide on a long-term plan
- Very low bank interest rates if bank investment used in the short-term
- A necessity to incur adviser fees in order to find an alternative investment product
- Potentially higher charges for an investment product sourced on the retail market
- An inability to transfer the accrued benefits to their new employer's retirement plan, if applicable
- The potential to miss out on investment growth.

And there are further potential problems at retirement age, such as:

- Trying to source a suitable annuity or income-producing product
- Increasing longevity meaning that a lump sum is likely to be eroded quickly.

Therefore, the best option could be for the employer to treat their international pension plans more like a domestic plan and allow the employee to stay invested until they need the cash, or decide what to do with it.

This gives the member time to properly research other options and their benefits continue to grow, subject of course to market performance. They retain full control over their benefits (including any online administration systems available to manage their investment) and could even take partial cash withdrawals to minimise tax implications.

What Are The Alternatives?

If this option is unavailable, the member can re-invest the value in a retail investment product in their home country. However, there are a number of disadvantages to this approach:

- There is likely to be a need for financial advice and this may be costly
- If re-invested in a bank account, the return may be considerably lower
- Retail investment products are likely to have higher product and fund charges and ongoing costs
- A retail product may not offer the same access and flexibility as an international pension plan
- The member may not have the time or resources to properly identify an appropriate alternative
- There is potential for out-of-market exposure

- There is potential for high currency exchange charges
- The lump sum may simply be frittered away.

The Benefits Of Regular Withdrawals

A survey by AON of 2,000 members of defined contribution pension plans found that less than 10% wanted to be able to take the full value of their pension in cash and wanted a steady income instead, but many distrust annuity products. As we are seeing in the UK with the recent UK pension freedoms, would regular withdrawals provide a flexible alternative?

Let's look at some of the benefits of leaving the money invested and taking regular withdrawals:

- Payments can be timed to meet actual needs
- The timing and amount of regular withdrawal payments can be set to minimise tax implications
- The member has the flexibility to amend the frequency and amount of withdrawals, including cancelling them, at any time
- The member can take the full remaining value at any time
- Higher returns from institutionally priced funds
- Benefit can continue to grow subject to market performance
- No immediate requirement to buy an annuity but one can be bought in the future if the member decides to do so.

By offering employees investment funds with institutional pricing, employers can help the investment last longer and provide substantially more income. As an example, the following chart demonstrates the impact upon a fund value of different levels of charges.

This hypothetical example assumes an investment of £10,000 over 30 years. Annual compounding is used for both the assumption of 6% average growth p.a. and the investment costs. Costs are applied to average annual growth of 6% for each year. As it is a hypothetical, this example does not represent any particular investment. (Source: Vanguard, May 2015).

In short, a company sponsored international pension plan is likely to be a lower-cost, more flexible solution than an individual retail alternative.

Looking To The Future, Today

The traditional model of saving for the future has been a defined benefit arrangement (DB), or a defined contribution (DC) plan, targeted to a particular retirement age.

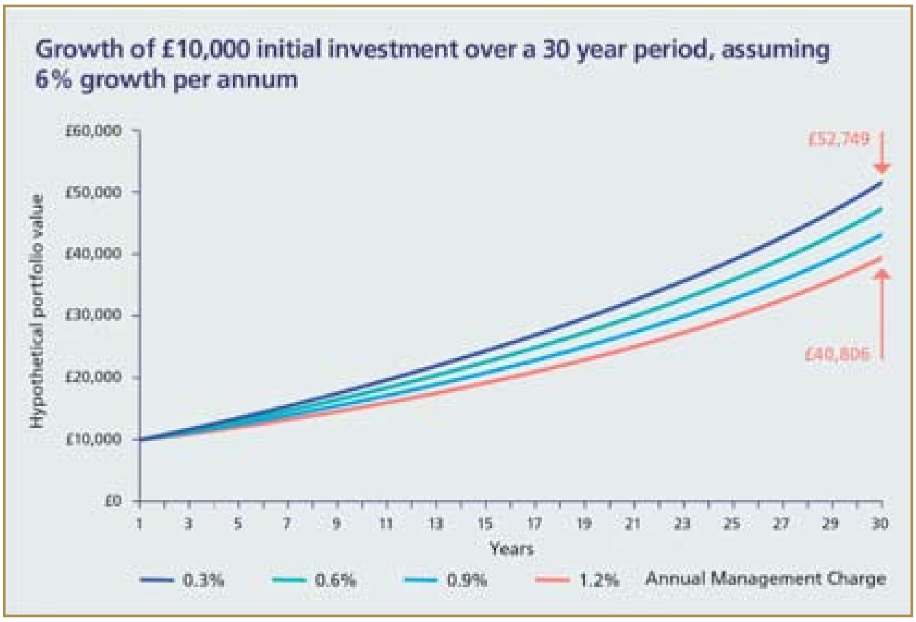
DB arrangements are on the decline worldwide and DC plans have the problem that they transfer the risk onto the employee. In general, the employer's focus is on agreeing the contribution level and plan design, not looking at the member outcome.

Because of increasing longevity, people need to save more, or for longer, so companies face the risk of people staying on in work because they can't afford to retire.

And from a changing workforce perspective, Millennials are not that interested in working for a single employer – they expect to be mobile in the geographic sense and mobile across employers.

So are the long-term savings arrangements being set up today going to be flexible enough to meet the future needs of employees? And how do they satisfy the compliance and cost constraints that companies face?

Through international pension plans, and allowing regular withdrawals, there is an opportunity for employers to shape plan design, close the pensions savings gap for globally mobile employees and empower employees to create the retirement they want.



Stewart Allanson
Zurich Corporate Life & Pensions is a leading provider of international pension plans.
For more information, please email: stewart.allanson@zurich.com or telephone on +44 (0) 1242 664443.