Multinational Corporations: Paths To Improved Retirement Plan Oversight

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Multinationals are striving for greater global oversight of their retirement plans, strengthening governance, reducing costs, and ultimately securing better outcomes for their members and beneficiaries.

Retirement plan oversight has never been more important to multinational corporations than it is today. A powerful combination of regulatory, economic and business factors is prompting corporates to seek enhanced visibility of data relating to performance, risks and compliance, both at an individual plan and at a consolidated level. The market volatility caused by COVID-19 and the need for prudent financial management are now making it even more important for corporates' headquarters to accurately assess retirement plan risks and obligations.

Fortunately, the opportunities to improve oversight by making changes to the structure of pension plans, working with a global custodian or through more effective use of technology have also never been greater.

Digitalization and developments in data management are creating new options for replacing legacy technology systems. Significant improvements in plan reporting solutions are enabling multinationals to fulfil their fiduciary and reporting duties at lower cost and with far greater efficiency.

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THE CHANGING REGULATORY LANDSCAPE

The drivers for improved oversight are many and varied. Following the 2008 financial crisis, many countries introduced reforms that directly and indirectly impacted institutional investors. Increased governance demands have had a proportionately bigger impact on smaller pension funds, making it harder for them to remain viable and meet their responsibilities. The expectation is that compliance obligations will continue to increase in the coming years. As the Canadian investment industry works through the market turbulence, early indications are that investors may see this as an inflection point to secure increased transparency. From gathering information to assist in various risk and performance scenarios, to launching separately-managed accounts with trusted asset managers, initial feedback is that investors are keen to further the gains they have made in enhancing control in recent years.

Moving forward, pension leaders are identifying the need for greater regulatory capacity and coordination in the pension space. The Canadian Association of Pension Supervisory Authorities (CAPSA) recognizes these challenges and is working on facilitating harmonization through its federal, provincial and territorial representation. To further these initiatives, CAPSA issued a new strategic plan focusing on priorities that foster the collaboration of rules and jurisdictional frameworks.

With the broader financial system restructuring their regulatory regimes, Canada's regulatory stakeholders continue to place a high premium on governance. The environments continue to evolve: for example, the province of Ontario introduced a new regulator, the Financial Services Regulatory Authority (FSRA), which replaced the Financial Services Commission of Ontario (FSCO) and the Deposit Insurance Corporation of Ontario (DICO).

Demand is growing around the world for investors to take Environmental, Social and Governance (ESG) factors into account due to interest among pension plan members and other stakeholders to align investment decisions with their values. In Canada, Ontario has taken the lead as the only province to legislate ESG reporting requirements for pension funds. The regulations under the Pension Benefits Act require pension plan's statement of investment policies and procedures to include information as to whether ESG factors are incorporated into the plan's investment policies and procedures and, if so, how those factors are incorporated. The ESG conversation in Canada is accelerating further. In recent months a number of highly influential pensions and asset management entities have issued declarations related to ESG, including NetZero Commitments. 36 institutional investors representing $5.5 trillion in assets issued a joint statement on climate change.

Manitoba's pension standards legislation permits plan administrators to use nonfinancial criteria in the formulation of investment policy subject to the provisions of that province's Pension Benefits Act, including the prudent investor standard.

From a global perspective, similar pension regulations are in place in the United Kingdom, European Union, Germany and South Korea. Furthermore, growing interest in ESG investing has prompted the establishment of the United Nations Principles of Responsible Investments, a multilateral global initiative that sets out investment principles to guide signatories in incorporating ESG issues into their investment practices, and to which several Canadian universities are signatories. Over the last decade, new reporting requirements related to governance and transparency, such as the ESG acceleration in Canada, have put additional pressure on plan costs and resources.

> Around the world, pension plan sponsors, members and stakeholders, continue to seek solutions that can help deliver retirement income that is sustainable for both members and sponsors.

THE IMPACT OF DEFINED BENEFIT (DB) OBLIGATIONS

While regulatory changes may have put enhanced pension oversight front of mind for multinationals, the most significant driver behind greater supervision is the financial challenges DB plans impose on corporate balance sheets. Over the last decade, the challenge of providing DB plans has been exacerbated by historically low-interest rates, which have expanded the gap between assets and liabilities for many funds and necessitated increased contributions from companies.

Around the world, pension plan sponsors, members and stakeholders, continue to seek solutions that can help deliver retirement income that is sustainable for both members and sponsors. As populations continue to enjoy increasing longevity, this also introduces additional pressure on the sustainability of pension plans.

Some of the challenges faced by multinationals are also key considerations for Canadian plan sponsors. The process of planning for a stable stream of income during retirement can be challenging, so some plan administrators in Canada have adopted a hybrid approach, including decumulation solutions such as variable benefit payments. Canadian plans have evolved as arms-length, jointly-trusteed, independent organizations able to invest patiently across long horizons, manage their associated investment risk appetites and achieve strong governance over their sophisticated investment and operational activities – in turn positioning them to deliver on their pension promises over the long term.

POTENTIAL FOCUS AREAS AS PENSION STAKEHOLDERS CONSIDER THEIR FUTURE OPERATIONAL STANCE

Governance	• How will consolidation impact our governance requirements? • What are our stakeholders' needs for transparency, oversight and compliance?
People and organization	• Do we have the necessary internal expertise to move or organization forward? • How will our talent needs evolve? • What is the right organizational design to set us up for the future?
Investments	• Do we have the scale and expertise to succeed? If not, how can we access it? • How are we evolving our asset allocation strategy? • What asset classes or strategies should we manage in-house? • Where will we rely on external managers?
Administration	• How do we deliver high quality service to plan members or stakeholders? • What is our technology strategy? • What is our data strategy?
Plan design and funding	• Is our organization appropriately aligned to its core mission? • How have our assumptions been confirmed or challenged by market turmoil in 2020? • How are we measuring, monitoring, mitigating and sharing risk?
Regulation and public policy	• How is our organization maintaining the trust of our stakeholders? • How are we navigating the regulatory and legislative environment? • How will we continue to operate at the highest standards?

ONGOING BUSINESS PRESSURES

At the same time, given the competitive business environment, multinationals are under constant pressure to better manage costs and root out inefficiency at the local plan level. Without effective oversight, it is difficult to ascertain a true picture of costs – which can be significant given the need for local reporting – or take action to reduce them. The need to scrutinize and manage costs is also prompting multinationals to assess retirement policies and design, to understand their cost implications and potentially standardize them.

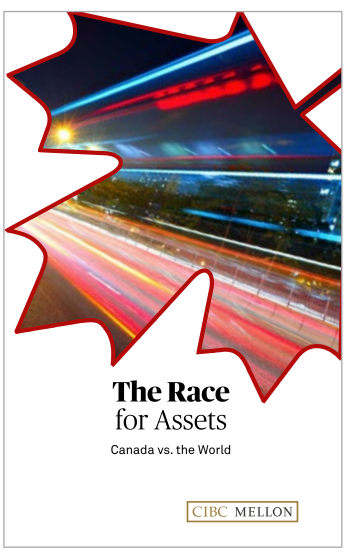
Another important driver is risk management and financial oversight; multinationals have an obligation to report value-at-risk from market events and assess the ability of their pension funds to meet their liabilities in specific modelled scenarios. Local regulators such as the Canadian Association of Pension Supervisory Authorities have stress tests modelled against historical events. Multinationals must comply with requirements in the country where their headquarters is located and in every jurisdiction where they have a local plan.

A lot of companies still rely on excel for consolidated reporting, which is time-consuming and more likely to generate errors. In recent years, more sophisticated reporting solutions have emerged, which significantly reduce these issues.

In some circumstances, local funds themselves are acting as a driver for more proactive and overarching supervision. The low yield environment has prompted many to explore opportunities to increase allocations to alternative asset classes, such as private equity and real estate, in order to meet their obligations.

According to research conducted for CIBC Mellon's report "The Race for Assets: Canada vs. the World," technology and data are rising in focus as pension plan leaders look to achieve their strategic goals and navigate a rapidly shifting risk and opportunity landscape. Almost a third of pension funds (30%) see innovation that delivers lower investment charges as a key theme of the next couple of years. New models of service delivery, underpinned by advances in technology in areas such as data science and automation, could provide funds with the cost efficiencies they are seeking.

Routes to Enhanced Oversight



CANADIAN PLANS HAVE A STRONGER FOCUS ON DIRECT AND CO-INVESTMENT STRATEGIES THAN MOST OTHER INSTITUTIONS.

58% **of pension funds believe the push for lower investment fees will be a crucial theme for their sector over the next two years, while 30% cite the increasing role of new technologies.**

64% **of pension funds say they have had concerns about liquidity during the pandemic and almost all say their future investment decisions will be influenced by this experience.**

Multinationals with global pension plans that wish to improve oversight have a number of options available to them.

PENSION INDUSTRY CONSOLIDATION

One consequence of COVID-19 is likely to be that many pension funds and their sponsors will take time to review their strategies and operations. Plan consolidation has experienced growing take-up in global pension markets, and its proponents say consolidation can enhance investment returns, reduce operational expenses and support plan sustainability over time.

Multinationals may choose to physically consolidate their European pension schemes into a single Institutions for Occupational Retirement Provisions (IORP) fund. This can lower fees by improving economies of scale, facilitating more efficient asset allocation, and making it easier to enforce a standard investment process or single ESG policy. As outlined previously, IORP II seeks to encourage cross-border pension provision. Many multinationals are thought to be considering the creation of a single EU fund based in Belgium as the country's OFP (Organism for the Financing of Pensions) structure is seen as ideal for cross-border asset pooling. According to the European Insurance and Occupational Pensions Authority (EIOPA), 30 per cent of the €3.7 trillion in assets held by European pension funds are linked to multinationals' pension plans. Belgium's pension fund association, PensioPlus, aims for 10 per cent of those multinationals to set up a pan-European pension fund in Belgium by 2025.

Some of the key pension-related regulatory and public-policy developments that are relevant to large Canadian public pension funds include changes to allow for the growth of existing public pension organizations. This has included rules to facilitate the merger or consolidation of plans. It has also included rules that allow certain public pension organizations to provide services, such as third-party asset management, to others beyond the plan's existing membership.

In recent years, Canada has seen the rise of an array of new consolidating entities and strategies in the retirement space. These include government-sponsored entities and arm's length non-profit government backed corporations with mandates to gather assets from public entities; independent jointly-sponsored pension plans opening their doors to merge in other plans; corporate entities launching external pension asset management arms; and even retail mutual funds designed to offer risk pooling - all this is in addition to existing options such as annuitization. For multinational corporations, increasing availability and awareness regarding advanced pension offerings in Canada may create pressure from local market stakeholders regarding Canadian pension offerings - as well as potential opportunities for collaboration with Canadian providers.

VIRTUAL CONSOLIDATION

Various factors mean that an IORP fund may not be feasible for all multinationals or circumstances. An alternative route to achieving improved visibility while maintaining local plan structures is to work with a global custodian, who can offer virtual consolidation through sophisticated reporting. This may present a more cost-effective and less complex route to enhanced oversight than physically combining pension plan assets.

Advances in technology – specifically digitalization – and developments in data management, driven both by service providers and institutional investors, have resulted in significant improvements to retirement plan reporting over the last few years.

Huge data volumes have become a defining characteristic of the financial services industry in recent years. The arrival of new and more granular data sets means that reporting is now far more comprehensive than it once was. For corporations, enhanced and improved steering data, such as ESG scoring and analytics, risk analysis and universe benchmarking, provide headquarters with greater transparency, allowing them to conduct a more detailed assessment of retirement plan performance. Moreover, data can now be more easily integrated into existing information sources.

Advances in technology are creating new options for replacing or collapsing legacy systems. New reporting solutions enable multinationals to fulfil their fiduciary and reporting duties at a lower cost and with far greater efficiency.

Institutional investors' demand for more frequent reporting has increased. The tough economic environment of the last decade and volatile markets mean many corporates are seeking a better understanding of what is impacting performance on a more immediate basis, so they can accurately model and quantify risks and monitor ongoing viability more closely. For those responsible for retirement plan oversight, it is important to assess the costs and benefits of faster and more granular data options, as they can be expensive.

Finally, there have been vast improvements in the way data is delivered. Just a few years ago, reports were typically presented in tabular formats as PDFs. They had limited interactivity, and the stakeholders involved in plan management would have to run multiple reports to gain the insights they wanted. Over time, online portals have become more sophisticated, and interfaces have become more intuitive, enabling institutional investors to navigate their data more efficiently, access information in different ways and generate reports in the format of their choice. The increasing use of widgets has made persona-driven reporting possible; individuals ranging from the operations managers of local plans to more senior stakeholders, such as the group head of pensions, can build dashboards specific to their responsibilities and based on the insights that matter to them. New business intelligence tools go one step further and enable corporates to manage how the data ultimately appears.

Going forward, the need for more comprehensive data – presented in a convenient and digestible way – is likely to increase. Pension professionals increasingly expect to be able to access the same detailed data and analytical functionality on their smartphones and tablets as on their desktop. Moreover, as a new generation of people moves into senior roles in the retirement industry, expectations and demands around data and reporting will change.

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Overcoming Potential Hurdles to Oversight

While multinationals have different options available to them to improve oversight, some obstacles remain.

A common challenge is the cultural differences between organizations in different jurisdictions. Irrespective of whether multinationals choose to physically consolidate pension plan assets or adopt a more sophisticated reporting solution, it is important to ensure that plans are open to accommodate different ways of working or expectations. This is especially important in decentralized companies, where there may be considerable autonomy at the local level; headquarters must clearly communicate the benefits of improved oversight to persuade local plans to cooperate with a new approach.

A further challenge is that many corporates have relatively small teams responsible for pensions plans. At the same time, a project manager and consultant may be appointed to implement change at the headquarters level. Limited resources are often a challenge at the local plan level, where staff have to implement a new solution while doing their day job. A lack of internal capacity may hinder the adoption of a new approach that may ultimately result in greater efficiency.

It is also essential to recognize the specific requirements of the various regulatory environments where local plans operate. As mentioned, some European countries have rigorous reporting requirements, which must be considered and managed on an ongoing basis as companies migrate to a new solution.

Similarly, each jurisdiction in Canada has its own set of legislation and regulations governing pension plans. Generally, pension plans must comply with the legislation and corresponding regulations of the jurisdiction in which the members are employed.

Provincial legislation may take its cues from its federal counterparts. For example, private pension plans in Ontario, British Columbia, and Alberta must invest their plan assets in accordance with Schedule III of the federal Pension Benefits Standards Act (RSC, 1985, c 32).

Alberta and British Columbia brought their private sector pension legislation into concordance in order to align pension regulation in each province.

In Nova Scotia, regional consolidation has allowed legislation to permit participation in the region's Public Service Superannuation Plan. Consequently, this allows for Universities, Government Agencies, Municipalities to join the province's largest plan.

Each jurisdiction in Canada has its own set of legislation and regulations governing pension plans.

Conclusion

The imperative to improve oversight has never been greater. Multinational corporations are finding it harder than ever to manage the financial burdens and risks associated with DB plans. The low-interest rate environment and changes in the business environment, which are resulting in greater competition and putting further pressure on costs, reinforce the need to root out inefficiency at the local plan level.

Meanwhile, the regulatory landscape – particularly in Europe – is becoming more onerous as a result of new rules, such as IORP II. Additional requirements focused on investor protection and financial stability were recently announced by EIOPA and the European Central Bank. ESG-related reporting burdens are also expected to increase.

A global shift to DC is helping to relieve the funding burden from corporates and de-risking their pension plans, but it does not cut complexity. Corporates that want to maintain attractive retirement benefits and promote better retirement outcomes for individuals, as well as deliver value and risk management for shareholders, need to prioritize enhanced oversight.

This is particularly true in Canada, where a rising cadre of innovative pension structures is bucking the global trend by expanding availability of pooled risk and defined benefit offerings to more Canadian workers - a trend not lost on many workers and labour stakeholders.

Some multinationals may be able to simplify their global pension provision to gain economies of scale, lower costs, improve efficiency and facilitate greater investment in technology by physical consolidation of assets in an IORP fund. However, for various reasons, this option may not be feasible for all multinationals. An alternative option may be to work with a global custodian and leverage advances in technology and developments in data management to implement a more sophisticated reporting solution. The progress now being made in terms of the range, depth, speed and customization of data are significant and represent a real, potentially simpler and more cost-effective alternative to physical consolidation.

The goal of enhanced oversight of retirement plans is now within reach of all multinationals regardless of the jurisdictions where they have local plans, operational structure, or custodial arrangements. Companies should consider their options and act accordingly for the benefit of existing and future pensioners and multinationals' efficiency and risk objectives.

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