Fidelity Workplace Consulting

International Defined Contribution Newsletter

July - August 2019

Fidelity's international retirement newsletter focuses on the key issues surrounding employer-sponsored retirement plans globally.

This month's feature article informs readers on the increasing international prevalence and adoption of Target Date Funds and how they may support employees in meeting their retirement goals.

In the legislative realm, China has passed new legislation to reduce Social Security contributions. The Netherlands is currently working through major pension reform, and Dubai has proposed that end-of-service gratuities must be funded on a DC basis.

What's Inside

Fidelity INVESTMENTS

Legislative Updates

China

In China the "Comprehensive Plan for Reducing Social Insurance Rates" notice has been approved by the State council, resulting in lower Social Security contributions from employers. As of May 1, 2019, the following changes are applicable:

- The city average earnings (CAE) figure will now take into consideration the earnings of both full-time public and full-time private workers. The CAE determines employee and employer social security contributions and used to be based on only full-time public worker earnings.
- Employer retirement contributions to Social Security have reduced. Previously, maximum contributions were 20% of covered wages; however, this figure has been lowered to 16%. It is the responsibility of each region to create a transition plan and make relevant adjustments.

Further changes to wider Social Security contributions are expected throughout 2019 as the Chinese government continues to reform the system, with the ultimate goal of reducing employer costs.

Action Required

Implement – take necessary actions

Dubai

The Dubai International Financial Centre (DIFC) has proposed that end-of-service gratuities must be funded on a DC basis, moving away from the current unfunded DB design. The plan will be known as "DIFC Employee Workplace Savings (DEWS) plan", which will be a master trust arrangement. Joining the plan will be mandated, unless an alternative savings plan is offered.

Contribution levels for DIFC-based employers are expected to be at least equal to current end-of-service gratuity accrual rates and it is expected that the scheme will roll out in January 2020. For simplicity, companies with operations both within and outside the DIFC may want to move to a funded model for all employees.

Action Required

Monitor – await further announcements

Netherlands

In mid-June 2019, major pension reforms were agreed in principle by the largest union federation in the Netherlands. Changes are as follows:

- The National Retirement Age (NRA) has been frozen for two years at 66 years 4 months. In 2024 it will increase to 67, and thereafter it will increase by 8 months for each additional year of life expectancy from age 65. It was decided that the NRA should be frozen before any further discussions are had around reforming supplemental pensions.
- In the future, early retirement will be possible without a tax penalty. In the meantime, individuals who work in labor intensive jobs will be able to take early retirement 3 years before the NRA and receive a salary of up to €19,000. Employers will be able to pay this transitional salary tax-free.
- DC plans will no longer be allowed to increase contribution rates in line with increases to a member's age. In DB plans, it will no longer be permitted to set the pension accrual rate independent of member age. This structural accrual change means that DC contributions will move to a flat rate and DB accruals will be weighted so that they're higher for younger members and lower for older members. This is the most significant change and will require radical revision to supplementary pension plan designs.

It is expected that the changes will be formally implemented from 2022 onwards. In addition, the Dutch government has proposed the ability for lump sum payments to be made at retirement, a major change from previous approaches. These proposals may result in a comprehensive rethink of retirement benefits in the country.

Action Required

Monitor – await further announcements

Target Date Funds: An International Tool to Support Employees in Meeting Their Retirement Goals?

Multinationals are continually exploring ways to support their employees in achieving their retirement goals through better education, provision of corporate sponsored plans, and providing adequate and appropriate investment options. This month's article looks at the increasing international prevalence in the availability and use of Target Date Funds ("TDFs") as investment options within employers' local defined contribution ("DC") plans.

A TDF is an investment in which the underlying asset allocation shifts as the fund approaches its target date. Traditionally, TDFs are heavily weighted in riskier assets, such as equities, during the accumulation phase and then move into lower risk assets, such as bonds or money market funds, over the course of the fund's time horizon ("Target Date"). Their popularity in the United States has grown over recent years, as illustrated by the following[1]:

- 98% of DC retirement plans in the United States offer a TDF as an investment option.
- Of these plans, 90% utilize the TDF as the default investment option which, in the case of no election, automatically invests participant's assets into the fund closest to their anticipated retirement age.
- 53% of plan participants are fully invested in the TDF associated with their projected retirement age, up significantly from 37% and 18% five and ten years ago, respectively. This prevalence increases to 70% for millennials.

While TDF popularity in the United States may be partially attributable to the legislative environment and their ability to help satisfy key fiduciary responsibilities, it also reflects that individuals see it as a valuable option to support them achieving their retirement goals while managing their risk.

While TDFs are expanding in popularity in the world's largest DC market, it begs the question: "Are TDFs a viable solution which can be replicated in other countries?"

International Expansion of Target Date Funds

We have examined the TDF market across five countries where each market is exploring or seeing an increased interest in TDF use to support employees in managing their retirement risk.

Canada

DC Assets are a relatively small proportion of the total pension assets in Canada making up approximately 5% of the market[2]. However, TDFs have more than tripled their market share of the DC landscape growing from 5.6% in 2011 to 17.1% in 2017 and the number of available funds increasing from 165 to 346[3].

The size of the DC asset base does not tell the entire story; the retirement plan landscape in Canada has been changing for some time shifting from defined benefit ("DB") plans to DC plans. As of 2017, 21% of plan participants are participating in DC plans, with increasing rates of new participants entering DC plans[3].

While the starting base for TDFs in Canada was relatively small, the pace has accelerated, and it is estimated that roughly 54% of DC plans in Canada have a TDF as their default investment option[3]. As the Canadian DC market shows similar trends to the US on the popularity of auto-enrollment, this necessitates the need for plans to have default investment options that provide employees with funds that align most appropriately with their risk profiles. We therefore expect to see a continued increase in the use of TDFs within the Canadian market.

[1] Fidelity Market Research Data 2019
[2] Global Pension Assets Study 2019
[3] Group Retirement Savings and Pensions Report; 2018, SI Research

Germany

In Germany, longstanding legislation results in corporate DC plan sponsors choosing the investment funds. This results from a requirement to offer an investment return guarantee; it also means the investment portfolios are very risk averse to minimize the risk on the company of negative returns.

In 2018, legislation was passed introducing pure DC schemes without guarantees and auto-enrollment (one of the conditions of such plans is that they must be agreed upon between the employers and the unions 'social partners' and are collective in nature – meaning one strategy for all employees). The first of these plans are not expected to be launched before 2020.

With respect to TDFs in Germany, the asset allocations are traditionally 100% equity at least 20 years prior to the target date. Within 20 years of the target date, the asset allocation is de-risked through purchasing fixed income and eventually resulting in a 100% cash allocation at the target date – when the funds are redeemed. While TDF plans are available they are not commonly adopted by DC plan sponsors due to the associated investment risk.

For the new DC design, the use of TDFs is something the social partners will need to consider as they explore the investment options available to participants. Multinationals may well use their learnings from other countries and provide their employees with TDFs as one of the viable options for managing their investment risk.

Hong Kong

In 2008, TDFs were first introduced into the Hong Kong Mandatory Provident Fund (MPF) market. TDFs were well received in the market place as MPF contributions were being defaulted into conservative short-term funds that produced low returns. TDFs brought to the market, for the first time, an investment product that facilitated greater growth potential in the earlier years of the fund's time horizon, and then slowly wound down risk through the purchasing of fixed income. As member engagement in Hong Kong has been traditionally low, the introduction of TDFs in the MPF market offered members a simplified solution to grow their retirement assets, especially for those that have little investment knowledge or interest in managing their investments.

However, as of April 1, 2017, the Mandatory Fund Provident Authority ("MPFA") introduced a Default Investment Strategy ("DIS") that mandates a set of parameters on all default investment option by which every MPF master trust is obligated to offer:

- Capped investment management fees as 0.75% per year and fund expense ratios of 0.95%,
- Automatic de-risking between the age of 50 and 64, and
- The fund must be comprised of a Core Accumulation fund and an Age 65 Plus fund.

As every master trust within the MPF space is now mandated to use the DIS as the default option, growth of TDFs has been dampened; however, they are still available for participants to utilize through active investment elections. Having a legislated default investment strategy should prompt employers to think about their employee demographic and encourage them to study their needs. Despite, being mandated by law, engaging with employees and educating them that TDFs may be a tool to help them select a more personally tailored plan for retirement based on their unique circumstance is an area we expect to see explored as part of an increased focus on financial well-being.

Japan

The retirement landscape in Japan has similarities to Canada, the proportion of DC pension assets in Japan is low (estimated at 5%[2]). Further, employees have tended to hold a much higher share of their investments in relatively low capital-risk funds. Approximately half of invested funds are in deposit or guaranteed interest contracts, with bonds constituting 18% of the remaining mutual fund investments[4]. Looking at investment solutions which have a higher risk content therefore requires an investment in employee education.

TDFs are relatively new to the Japanese market and currently less than 10% of plans offer TDFs in their investment lineup. We expect this to grow over time as education and the track record of growth-orientated assets influences employee's behaviors.

United Kingdom

In the UK, approximately 18% of pension assets are in DC plans, amounting to over $500bn[2]. TDFs are not as common in terms of their usage and availability in the UK compared with the United States primarily due to the relatively high prevalence of lifestyle funds which serve a similar purpose.

Lifestyle funds offer a structured approach to reduce the exposure to more volatile investments as participants approach retirement. However, the primary difference is the flexibility in the age which is targeted for de-risking. TDFs allow participants to target a specific retirement age where as lifestyle funds assume everyone retires at a common age often State Pension Age.

The UK retirement industry monitors international best practices and it's likely that the prevalence of TDFs will increase in the UK with their ability to enable tailored retirement planning.

The International Application of TDFs

As multinational corporations continue to promote financial well-being for their employees while balancing their fiduciary responsibilities, employers are increasingly providing their employees tools that may help to plan for their retirement. Although much of the focus on retirement plans has been on plan design and retirement modelers, revisiting the investment options within country and supporting individuals to manage their investment risk may be the next step in further supporting a well-rounded global financial well-being program.

We are seeing increasing use of TDFs as one of the options to do so and there is an expectation that their popularity in the US will be replicated internationally as it continues to trend in an increasing number of countries.

[4] Nomura Fundmark, FIL Japan

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About Fidelity International Workplace Consulting

Fidelity's International Workplace Consulting team is independent and focuses on supporting clients in meeting their business objectives through the provision of impartial, but tailored, advice reflecting market trends and best practice.

Global Benefits Governance	International DC Governance	International Retirement & Financial Wellbeing	International Health care & Wellness	International Miscellaneous
Design/ implementation of a tailored global benefits governance structure International audit and compliance review of overseas plans Benchmarking and development of global policies and standards Independent ongoing support to global benefits committees Advice on global financing opportunities, including risk financing Training on best practices in international benefits management	Developing fiduciary and compliance oversight and policy for international DC plans Cross border implementation of best practice and group policy Development of preferred provider arrangements to drive operational and financial efficiency Support on enhancing employee experience through developing & implementing communication best practice Ongoing support to global benefits committees	***Financial Wellbeing*** Benchmarking/ implementation of global best practice Design/ implementation of programs to support financial well-being Vendor selection and oversight for globally consistent local implementation ***International Retirement*** Benchmarking/ setting of globally consistent financing assumptions Advice on opportunities for de-risking in respect of retirement plans Consolidation of financial reporting & budgeting	***International Health care*** Vendor selection for international health care policies Advice on strategies to improve employee behaviors and reduce health care costs Development of health care policies to improve financial/ operational efficiency ***Wellness*** Global wellness education strategies & programs Benchmarking and deployment of global wellness programs Vendor selection for International providers	Development of global insurance programs to reduce costs/commissions and improve operational efficiency Advice on country benefits practice (both Mandatory and typical practice) Support for benefit aspects on mergers, acquisitions and divestitures/splits Independent second opinions on local advice Strategy to respond to legislative changes Facilitation of global stock plan advice On-site support and benefits leadership

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