



## MARKET LEADER



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# THE RENEWED APPEAL OF PENSION POOLS

PENSION POOLING: THIS TIME ROUND IT'S DIFFERENT

Until recently it looked like pension fund pooling had fizzled into insignificance even before it had managed to enjoy prime days. In part this was due to events beyond the immediate control of those major international firms which had spearheaded the movement, or the banks which supported them. The reasons lined up like regular extras in movies: the financial crisis, poorly defined tax incentives and high set-up costs appeared to scupper the enthusiasm of firms that were set to follow major firms such as Unilever and Nestlé along a pension pooling track. However, as Neil O'Hara finds, it did not fade away at all and pension pooling looks to have become more popular among multinationals than ever before. Neil A O'Hara reports.

**F**OR MULTINATIONAL COMPANIES, pension plans can be a nightmare. A company that has grown organically has at least one pension plan for each country in which it operates. If it has grown through acquisition, it likely has multiple plans of varying size with different qualifications and benefits in every country. With a little help from legislators, multinationals can now use more efficient pooling structures to mitigate the expense.

The impetus toward pooling also derives from the increasing mobility of labour at the managerial level. John Whitworth, a partner in the insurance practice at Oliver Wyman in London, notes that more European manufacturers operate in multiple countries and managers often move

from one to the other. "It is possible to deliver a pension that looks and feels like it gives them continuity," he says. "There may be different pools of money in different countries but behind that is a single asset pool and a single investment philosophy."

As a first step, multinationals abandoned local and regional custodians for global providers like Northern Trust and BNY Mellon that can service their plans around the world and use the economies of scale to offer more favourable pricing. They also centralised the appointment of asset managers, picking a stable of managers with global reach instead of local firms in each country. While this "virtual" pension pooling offers some savings, it does not address the inherent inefficiency of so many legal entities controlling their

own assets. If the parent company chooses PIMCO as the preferred fixed income manager, each plan still has to negotiate a separate contract—and although the fee may be lower than it would be for a standalone entity it is still higher than it would be if the plan assets were pooled.

The biggest obstacle to asset pooling used to be withholding tax. In most countries, pension plans can reclaim from the local tax authority any withholding tax on dividends paid by domestic companies. Depending on the provisions of the governing double taxation treaties, plans may be able to recover withholding tax (typically 30%) on foreign dividends, too—provided they own the shares directly. If the parent company established a separate legal entity to pool ►►



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its pension assets, that entity was not a qualified pension plan and could not reclaim withholding tax.

The solution demanded a new legal structure. Certain European countries—Ireland, Luxembourg and the Netherlands, soon to be joined by the United Kingdom—have created vehicles that offer complete tax transparency for pension plans, enabling multinationals to pool assets from different countries without a tax penalty. “The numbers add up very quickly if a plan gives away 30% of its dividend income every year,” says Kerry White, head of business strategy and development at BNY Mellon Asset Servicing. “That is why these vehicles are so interesting.”

Asset pooling allows the parent company to negotiate a single global investment management mandate for each asset class or strategy at a lower price based on the value of all covered assets. Trading costs drop, too, particularly in fixed income where small orders are expensive to execute. For

smaller plans in the pool, the structure gives them access to best in class managers who might not otherwise take them on—or even to asset classes like hedge funds or private equity for which they could not qualify on their own.

The advantages to the parent company may be obvious, but the upfront cost can be significant: one large BNY Mellon client shelled out more than €1m just to get all the required tax rulings. The pooled vehicle has to apply for tax relief in every country in which it wants to invest, and in every country from which it draws assets. While some tax authorities grant the approvals within two weeks, others may take months. “If a pooled vehicle wants to invest in 80 countries and sell fund shares to participating plans in 10 countries it can take a while,” says White.

The impetus for asset pooling comes from corporate headquarters, but the parent cannot force plans to participate. Local trustees, who owe a fiduciary duty to plan participants, must agree to invest in the pooled vehicle—not always an easy sell because they cede control over where the money is invested. Companies often start small and then expand coverage. One Northern Trust client that set up a common contractual fund in Ireland and started with two equity sub-funds (one for ERISA plans and one for all others) recently added a fixed income fund. “In every case, our clients have grown their pools over time,” says Gwyn Koepke, business development director at Northern Trust. “They demonstrate the efficiency gains and then bring in more investors and strategies.”

In some countries, asset pooling can offer additional cost savings. For example, many European countries levy VAT on fees paid to an investment manager, while those same fees paid inside a tax efficient commingled vehicle are exempt. In Switzerland, a traditional segregated managed account has to pay stamp duty on every trade it makes—but if the assets are in a pooled vehicle, the duty is paid only



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on cash flows in and out, not on trades executed by the pool. “Stamp duty can be significant for Swiss plans,” says Koepke. “Tax advisors have told our clients they have saved hundreds of thousand of francs every year.”

Northern Trust began working on asset pooling ten years ago and helped a client launch its first pooled vehicle in 2005. The process has become easier as tax authorities grew familiar with the concept and law firms developed templates for the paperwork. “It is a well-travelled path for us, at least,” says Koepke. “Typically, we don’t see implementation taking more than four months.” Northern even has a dedicated team of tax experts who focus on double taxation treaties. It has a sophisticated accounting system, too, capable of handling pools that have multiple plans investing in them, multiple sub-funds for different investment strategies, multiple managers for each strategy and multiple countries in which the pool invests.

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For all the advantages asset pooling offers to large multinationals, it leaves the underlying plans intact, responsible for their own liabilities and administration. Within the EU, it is now possible to merge both assets and liabilities to create a truly cross-border European pension plan known as the Institution for Occupational Retirement Provision (IORP). Technically, the legislation made every EU pension plan an IORP but Paul Bonsor, US practice leader for international retirement and investment consulting at AON Hewitt, estimates that only 80 or so out of 140,000 have taken advantage of the ability to cross borders. He counts no more than 10 true cross-border pension vehicles set up for that purpose, including funds established by BP and Nestle, both AON Hewitt clients.

The ability to merge liabilities may enable the sponsor to escape jurisdictions that impose unusually high funding requirements—the Nether-

lands, for example. "If a company can finance defined benefit obligations in a jurisdiction that has a lower funding requirement, it can reduce short term cash requirements, enable full payment of benefits and mitigate potential build-up of trapped surplus in the future," says Bonsor. It's a form of regulatory arbitrage: it affects the timing of cash flows but does not affect the ultimate pension liability.

The potential savings from pooling depend on how centralised pension administration is at the outset. Andrew Warwick-Thompson, global defined contribution leader for international retirement and investment consulting at AON Hewitt in London, says a company that already negotiates asset management mandates on a global basis may clip five basis points (5bps) per annum off its costs, while a less streamlined organisation may recoup up to 20bps, numbers that are still meaningful for large defined benefit plans. For DC plans, which are priced

as retail products in many countries, the administrative savings can be much higher—200 bps or so, albeit on a much smaller asset base because these plans have a shorter history than most DB plans.

The potential savings have prompted companies to rethink how they handle defined contribution plans. In many cases, multinationals outsourced these plans to insurance companies or banks, retaining little control over how the assets are managed or administered. Warwick-Thompson says companies now recognise that high costs will eat into the final benefit employees can achieve—but do not want to increase contributions. "The best option may be to restructure the plans," he says, "We will see a move towards unraveling many of the third party DC programs because they are inherently bad value for money." That may explain why AON Hewitt sees more interest in pension pooling among multinationals than ever before. ■

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