Pensions in Europe

How multinational companies are preparing their pensions in Europe for the future

The AEGON Global Pensions European Pensions Survey

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# Table of Contents

<table>
<thead>
<tr>
<th>Section</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>Introduction</td>
<td>1</td>
</tr>
<tr>
<td>1 Managing pensions in Europe</td>
<td>2</td>
</tr>
<tr>
<td>2 Company culture and pensions</td>
<td>8</td>
</tr>
<tr>
<td>3 The European regulatory environment</td>
<td>15</td>
</tr>
<tr>
<td>4 The road ahead</td>
<td>22</td>
</tr>
<tr>
<td>Conclusion</td>
<td>30</td>
</tr>
<tr>
<td>Bibliography</td>
<td>33</td>
</tr>
<tr>
<td>Acknowledgements</td>
<td>34</td>
</tr>
</tbody>
</table>
Introduction

‘Who do I call if I want to speak to Europe?’ Henry Kissinger’s (alleged) remark highlights an issue that multinational companies often face when doing business in the European Union (EU): the EU is a single economic market but it is also a single market of 27 sovereign states. Although the EU is a common economic space, it is not a common social space. The EU member states share many common rules, but they seldom implement them in exactly the same way. Each EU country is responsible for its own social and labour law and, in addition, regardless of legal differences, people are often simply accustomed to doing things differently from their neighbouring countries.

The complexity of the EU is in few places more evident than in the area of pensions. Although, on the one hand, pensions may be thought of as a financial service (which should be able to operate competitively across the EU), they also fulfil a fundamental social role (and thus fall firmly under the remit of individual countries). For multinational companies with operations and pensions in Europe, the ability to provide pensions in each of the 27 states from a single pension vehicle sounds highly attractive. The reality, however, is more complex.

The EU has moved on considerably since Kissinger is said to have asked his question - for example, the EU now has its own President and High Representative for Foreign Affairs - and change is also afoot in the regulation of European pensions. However, despite considerable initial interest in the potential of pan-European or cross-border pensions, developments in this area over the past ten years have been slow. This paper attempts to address the apparent gridlock in European pensions to see what actions multinational companies and the European Commission are taking now in the area of corporate pensions, and what developments we can expect to see in the future.

Over the course of 2010 and 2011, AEGON Global Pensions interviewed pension directors from 15 leading multinational companies with operations in Europe, six international pension consultants, three representatives of the European Commission, two industry organisations and two representatives of national supervisory bodies. By revealing the hopes, aims, concerns and experiences of these different parties, we wished to come to a better understanding of the current state of European pensions and to see how the many parties involved view the future of European pensions.

This AEGON Global Pensions white paper looks at what multinational companies perceive to be the major issues facing them today with their pensions in Europe, examines what the companies are doing now to improve the management and control of their pensions in Europe and how they are preparing for the future. In addition, the paper examines what the European Commission is doing to help multinational companies, and concludes with five short guidelines on how to assess possible ways to take advantage of cross-border opportunities in Europe. Throughout the white paper, we make use of insights (and quotations) provided by our interviewees.
Chapter 1
Managing pensions in Europe
Accountancy, increasing regulation and the financial crisis have transformed the way companies manage their pensions. Since 2006, under IFRS accounting rules, any funding shortfall in a pension fund is reported on the company balance sheet as debt.1 Volatile pension funds have a direct impact on companies’ profit and loss statements – and upcoming changes to IAS19 accounting rules look set to increase this volatility further.2 This shift has been clearly visible within companies, as pensions management has moved from being a matter for local businesses and Human Resources departments to becoming a major concern for corporate headquarters and the CFO. All of the companies interviewed for this survey had increased their focus on centralised governance of pensions.3 All agreed that pensions had become more important over the past few years and that ensuring good governance and compliance had become more of an issue.

Complexity, governance and costs

As multinational companies expand their operations into new countries or make new acquisitions, they typically end up with one or more additional pension plans. In the past, there was little reason to harmonise these plans from either a finance or human resources perspective. As a result, many companies now find themselves with an international patchwork of pensions. But times – and regulations – have changed and companies require more knowledge and control over their pensions. A multitude of different pension plans increases complexity and reduces transparency, leading to hidden risks, inconsistencies and inefficiencies. Companies are now actively searching to reduce these risks and costs. At the same time, as companies look to address their pensions from a risk and financing perspective, many are also taking the opportunity to re-examine their overall pensions policy, seeking to define a single company-wide pensions philosophy and to align their pensions across their businesses.

Redefining benefits

Given the increased sensitivity of company balance sheets to pension liabilities, it is not surprising that companies have looked carefully at how they fund their pensions. All companies interviewed had carried out a review of their pensions in the past few years, and it is clear that the shift from Defined Benefit (DB) to Defined Contribution (DC) pensions has been given increased impetus by the economic crisis. The overwhelming majority of respondents indicated that they now had either an implicit or explicit policy to move to DC pensions. Companies pointed to the predictability and low cost of DC pensions, and the fact that DC pensions were becoming an accepted norm in many markets, making it easier to move from DB to DC. Despite this clear trend, several respondents indicated that they preferred DB pensions in principle and considered them to be both more cost-effective for companies over the

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1 See http://www.ifrs.org/NR/rdonlyres/28918713-A8B8-43F9-B344-6545BAF0D368/0/IFRICD19.pdf. Before 2006, companies were able to ‘smooth out’ any shortfalls through changing their assumptions. On this, see Bergstrasser, Desai, Rauh 2003.
2 See Bogers, J.J.J. 2011.
3 This is supported by similar findings in the Mercer Global Benefits Governance Survey 2009/2010 published in July 2011.
long term and better for their employees. However, they indicated that the pressure on company balance sheets from tightened regulation was driving them towards DC solutions. This strong shift to DC pensions has considerable consequences for all stakeholders, as many companies pointed out, and will clearly affect the European pensions environment for the years to come.

‘We require sustainable pensions – and that means pensions where we are not required to make additional payments.’

The AEGON Global Pensions European Pensions survey
Over the course of one year between November 2010 and July 2011, AEGON Global Pensions interviewed representatives from 15 multinational companies and two industry organisations. In addition, we interviewed six international pension consultants, three representatives of the European Commission and two representatives of national supervisory bodies.

For the purposes of the white paper, the interviewees, companies and other organisations are referred to anonymously. We are very grateful to all interviewees for their generous cooperation.

Multinational companies and organisations surveyed
With the shift to DC pensions, ‘legacy’ DB pensions are clearly a very important part of the challenge that many companies face. How can companies best manage their DB pension plans, and what possibilities are there to make these plans more efficient and less risky to the sponsoring company? In addition, how can companies best manage their DC pensions in order to provide the best solution for their employees? For companies operating across Europe, the European environment offers the hope of cross-border efficiencies, but at the same time it can represent an enormous challenge.

**The challenge of Europe**

Within Europe, no two countries have the same pension system and the nature and importance of company pensions is different in each country, depending at least in part on the present perceived strength of the state pension system. Not only is there a difference between DB and DC plans within countries but there are different interpretations (and, once again, regulations) of these different systems in each country. In addition, the pensions landscape across Europe is rapidly changing as countries reform their pension systems.

For multinational companies operating in Europe, the differences between the country pension systems make it difficult to create even a uniform overview of the funding levels of the different company pension funds. There is presently no single way to value pension liabilities in Europe, as pension plan funding regulations are still a national concern. This difference between national pension fund reporting and international corporate accounting may result in misalignment between the corporate view of pension funds and the local view of the same funds. In addition, it means that a national regulator may call for action to be taken to resolve a funding issue that is not perceived as such at a corporate level. This interplay between different accounting rules and national pensions legislation makes balance sheet forecasting and control difficult. In such a complex environment, reducing complexity can itself be a very complex process. This does not mean that it is not worth the effort, but it helps explain why some companies are reluctant to embark on cross-border pension activities.

“We are not in the business of trying to claim dual relief because we have got a Dutch person in Germany who might move to Spain ... We don’t bother to claim any of that because it is just too complicated. It has just got too complex.”

Given this complex web of rules and obligations, it is not surprising that companies are looking for ways to reduce complexity, along with cost and risk. As the pressure to improve pensions governance has increased, companies have moved to implement a number of solutions to make their pension offerings more transparent, consistent, uniform and - where possible - efficient.

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Pooling pensions – an overview of solutions

Information pooling
Several multinational companies have implemented data and administrative pooling solutions (also referred to as investment or portfolio accounting). Pension assets remain invested within their present legal vehicles and pooling is only carried out at an administrative level. The company has a unified source of information on its pensions, but may not have the ability to process or act upon the information available. It is also essential that the information received is consistent.

Asset pooling
Asset pooling enables companies to pool their pension assets and to receive consolidated reporting. It can help companies to improve the management of their pension investments, generates efficiencies and makes it easier for companies to control their pension plans. Asset pooling was initially only of benefit to the largest multinationals (with more than five billion euro in assets) but the arrival of ‘off the shelf’ multi-client asset pooling now means that companies of all sizes can benefit by participating in pre-existing asset pools.

Captives
Captive insurance companies (or captives, as they are called) are insurance companies owned by non-insurers, such as companies. First developed to cover employee benefits such as medical and life cover, they have more recently been adopted to finance Defined Benefit pension plans. Captives enable capital-rich company sponsors to gain more control over their assets. It also enables assets to be pooled, and surpluses from one country to be used to cover deficits in another country. Captives provide cost efficiencies over traditional insurance contracts, as the captive itself is not required to be profitable, and risk is born by the sponsoring company. The use of a captive requires more capital than alternative solutions, such as cross-border IORPs.⁵

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⁵ These advantages were highlighted by Coca-Cola upon the foundation of its Ireland-based captive in early 2011. See http://www.businessinsurance.com/apps/pbcs.dll/article?AID=/20110320/ISSUE01/303209983
Pension pooling and cross-border IORPs

Cross-border Institutions for Occupational Retirement Provision (or IORPs) offer the potential for cross-border European pension provision by providing companies with the ability to pool their European pension assets and liabilities. Although the benefits of pan-European pension pooling are clear, pension benefit systems within the European Union are not harmonised, which has a significant impact on attempts to consolidate pensions. Some of the largest multinational companies are making use of cross-border IORPs to pool DB pension plans from a number of countries and DC cross-border pension pooling vehicles are also increasingly being investigated. The use of a cross-border IORP does not necessarily imply that the pension plans within the IORP are ‘pooled,’ as they can be kept separate or be ‘ring-fenced’ within the IORP.

With so many potential solutions on offer, it is not always obvious which path companies should take. Asset pooling is perhaps a case in point. Although the majority of companies interviewed thought asset pooling could be of interest to their company, only a few were using it. A recurring theme from the interviews is that companies like to see what their peers and providers are doing, what is successful and what is not. How companies approach the changing pension environment and the shift to DC varies by company, and these differences in approach can largely be traced back to the different structures and cultures of companies.
Chapter 2
Company culture and pensions
The companies interviewed for this survey are all looking to be able to provide manageable and competitive pensions at a predictable cost. Despite this common aim, however, the different companies - all leading companies in their fields - approach their pensions in sometimes very different ways. There is clearly no such thing as a ‘one size fits all’ solution for every kind of company. The way a company goes about achieving its goals is highly dependent upon the type and structure of the company itself, the present state of its pensions and what it wants to achieve with its pensions. Company culture plays a crucial role.

How to manage your pensions – four archetypes

Although the companies interviewed by AEGON Global Pensions were all affected by similar issues, it was clear that they adopted different approaches in trying to achieve better control over their pensions. In order to clarify the differences between the companies interviewed, we recorded how the companies were managed in general and how they manage their pensions in particular. The companies were then mapped onto a chart that recorded the degree to which the company and its pensions were centralised. When combined with the views expressed in the interviews, we were able to identify four groups of companies with distinct characteristics and approaches to pensions, which we have labelled the Pragmatists, Trailblazers, Visionaries, and Transformers.

Pension management company archetypes

<table>
<thead>
<tr>
<th>Organisation</th>
<th>Decentralised</th>
<th>Centralised</th>
</tr>
</thead>
<tbody>
<tr>
<td>Thought leaders</td>
<td>Visionary</td>
<td>Trailblazer</td>
</tr>
<tr>
<td>No-nonsense</td>
<td>Transformer</td>
<td>Pragmatists</td>
</tr>
</tbody>
</table>

Pragmatists

The first group of companies identified are the Pragmatists. These are centrally-led companies with a strong focus on their core business and a ‘no-nonsense’ approach to pensions. Their local businesses have a considerable degree of autonomy, and of all companies interviewed, they placed the least value on pensions as part of the benefits package. They were typically the least interested in cross-border European solutions, and the most wary of potential disruption to their businesses from legislation in the EU. These companies did however state that if a proven, simple pan-European DC solution were to be introduced – a 401(k) for Europe - then they would be interested.

Trailblazers

The next group of companies identified are the Trailblazers. These companies are centrally-led, capital-rich and well established. They have a strong pensions tradition and large Defined Benefit plans. They consider pensions to be important, and these companies have substantial in-house pensions expertise. Trailblazers are prepared to move into uncharted territory, and have the knowledge and determination to succeed. They are first movers in asset pooling for pensions and in the exploration and adoption of cross-border pension vehicles.

6 The companies were analysed using AEGON Global Pensions’ pension scan methodology, which provides a tool for judging how centralised a company is, how its pensions are managed and which pension solutions may suit it best.
Visionaries
The third group of companies are the Visionaries. These are companies that have generally experienced a period of impressive growth, and the creation of an international centralised pensions framework has typically lagged development of other business structures. These companies have been looking again at their pensions governance and indeed at their entire pensions policy. They realise that retaining and attracting staff is of vital importance, and are interested in efficient and effective solutions that will help them achieve their ambitious goals. They are interested in cross-border and pan-European pensions but are reluctant to be first movers. They are often in contact with the Trailblazers to share ideas and experiences.

Transformers
The final group of companies are the Transformers. These are established companies operating in highly competitive environments. They need to adapt themselves to continue their past success and their pension structures also need to change. These companies need to balance the requirements of their legacy pension structures with their needs for the future. As these are companies that are often reshaping themselves through mergers, acquisitions and divestments, although they are looking at their pension structures and policies across the company, they are often looking for shorter term solutions and de-risking solutions. They typically have a ‘wait and see’ approach to cross-border and pan-European pensions.

Profiling companies - coordinating and centralising pensions management
When addressing how best to manage pensions in different countries, the first question a company needs to ask is how pension benefits management fits within its organisational structure and culture.

By identifying how a company is currently positioned and where it wants to be in terms of governance and centralisation, both from a company perspective and a pension benefit management perspective, it is possible to identify which solutions may help the company to gain more control over its pensions. If a company is decentralised, then centralised pension solutions are more difficult to implement.
All companies interviewed had taken actions over the past few years to improve the control and governance of their pensions. However, the term governance conceals many levels of control – strategic, operational, reporting and compliance – and the degree to which these elements are centralised depends largely on the culture and management style of the company.

**Controlling complexity**

‘With our pensions, we are looking to increase our governance and our efficiency – we want better transparency, more harmonisation and to work more across borders.’

When trying to gain control over company pensions, the solutions chosen depend very much on the type of company in question. For example, there is a clear difference in approach visible between the Pragmatists, on the one hand, and the Trailblazers, on the other. The type of approach chosen appears to be partly due to national/cultural differences and partly due to company management styles – as decentralised companies that are starting to centralise their functions are less likely to be able to impose (and monitor) a company-wide set of rules if the company as a whole is not run in this way.

‘We are much more directive than we used to be. It used to be a matter of persuading people to do the right thing. We haven’t always got the time to do that.’

**The value of pensions**

‘We believe that pensions are a very important part of the benefits package and are even becoming more important.’

Pensions in many countries are a very important benefit, and, in an ageing world, their importance is only likely to increase. Nevertheless, companies have different cultures and operating environments and their pension needs may differ considerably. Of the companies interviewed, the Pragmatists were least convinced of the importance of pensions in relation to other benefits, while the Visionaries and the Trailblazers were most convinced of the importance of company pensions.

**Centralising pensions**

Historically, pensions have been managed decentrally. Until recently, therefore, it was usual for companies to have no single company-wide pensions policy (or strategy). Decentralised companies may wish for more decisions to be made by the separate businesses involved; more centralised companies may wish all or most decisions to be taken centrally.

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7 See Madsen, C. and Tans, M. 2010, p. 4-5.
All the companies interviewed regarded some degree of centralised control of pensions as important (and agreed that such control had become more important over the past few years as a result of regulations and the crisis). Two thirds of the companies already had a significant level of strategic control (through a Global Pensions Board) and one third a lesser degree. 80% of the companies interviewed had implemented either pension guidelines or a pension policy, with the remaining 20% still developing a full set of guidelines. All companies regarded centralised reporting as important, although seven of the fifteen companies interviewed have yet to implement it fully. One of the Pragmatists companies had achieved full centralised reporting of all its pension plans only to abandon this as surplus to requirements. The question is clearly not simply whether centralised pensions management is useful or necessary, but how much centralisation is necessary or beneficial. The answer depends very much on the type of company and what it is looking to achieve with its pensions.

‘For pensions risks, we have the pension board. As part of our governance processes we look at the risk for all of our pension funds which covers 95% of our liabilities on a regular basis. We carry out risk assessments and have consultants look at our pension plans every three years.’

Degrees of centralisation

All the companies interviewed had drawn up some form of pension guidelines over the past few years, ranging from more general statements of intent (typically Pragmatists and Transformers) to stricter policies that have to be followed to the letter (more often Trailblazers and Visionaries). The underlying aim for all companies was to gain insight into the company’s pension liabilities around the world, to maximise transparency and to establish clear lines of responsibility.

‘Our pensions are centralised from a monitoring point of view but certainly not from an administrative point of view. Administration is still absolutely carried out in the countries. Other benefits are not so centralised.’

Despite the move to centralise, there are still significant differences between the degree to which pensions at many companies can truly be said to be centralised. While the Trailblazers and Visionaries tend to opt for formal Pension Boards with a high degree of control over the day-to-day management of the company pension plans, the Pragmatists and Transformers seem to prefer a less rigid structure – but still retaining an element of central oversight and control.

‘Our company is more informal and less bureaucratic – pension committees and reports just create more work. We have very short lines of approval. We have no pensions board. Our model is based on collaboration, not structure.’
The interviews made clear that while many companies wished to have a complete overview of their pension plans and liabilities around the world, companies are still dependent upon their local management for the daily operation of most of their pension plans and fulfilling local legislative requirements. Naturally, it is the larger Defined Benefit pension plans that receive the most attention. Indeed, the companies with the largest Defined Benefit pension plans had gone the furthest in centralising their pension management at all levels and it was these companies – the Trailblazers – who were looking to leverage their considerable resources and in-house expertise. However, even with the most centralised of organisations, the smaller pension funds still tend to be run more locally. As one respondent pointed out, this is not always the ideal solution, as a lot of small plans can add up to a significant liability.

“We strive for perfection but we live in the real world. So, although we would like to have control of the very small pension plans, we cannot. We cannot do everything from the centre, so, if it is too small, we let them do it locally.”

“A few years ago, we started with international accounting, and, at first, we got a lot of information on the larger plans but not the smaller plans. Our accounting is not interested in the smaller plans, but if you have a lot of small plans, you still have a large liability.”

“If we make a new policy, then we drive it from the top. So then we say to New Zealand or the US or Germany, you have to change your plan. That is the only time when we go to the countries and tell them they have to change something. We did this with defined contribution plans. On the defined benefit side, there will never be a new plan set up again, unless we change our global policy, which I don’t expect. That job is done.”

Cross-border pensions

As pensions governance and management becomes more centralised, the opportunity to provide pensions across borders becomes more viable and attractive. Although 80% of the multinational companies interviewed were interested, in principle, in some form of cross-border European pension, more than half had deep reservations about the likelihood of actually being able to make use of such a pension in the near future. Unsurprisingly, the Trailblazers – the companies with the most centralised pensions management and in-depth expertise – were most positive about cross-border European pensions (and were actively working on them) and the Pragmatists were the least positive.

This strong difference in viewpoints reflects several key differences. First, companies with significant DB pensions are typically more interested in cross-border pension solutions in general – and not only for their DB pensions. For DB pensions, cross-border pooling offers the possibility of regulatory arbitrage as well as potential governance and efficiency benefits, including operational efficiencies (dealing with a single pensions vehicle and board of management, consolidating small or ‘orphan’ pension funds, economies of scale in asset management, and dealing
with a single supervisor and supervisory regime). For DC pensions, cross-border pooling also offers governance and operational efficiency gains, but many of these gains are to the benefit of the employees directly. Pooling DC pensions is not about harmonising benefits but rather about improving the management and governance of the services being provided. The Trailblazer companies, who have a strong tradition of DB provision are looking to provide their employees with high quality, DC pensions and cross-border pension pooling is one way to ensure that they are providing high quality and efficient pensions to their employees.

‘From a governance perspective, there is every advantage to managing our Defined Contribution pension assets properly for everybody with a central team, rather than having lots of part-time managers trying to deal with these things.’

Secondly, if pensions are primarily seen as being the responsibility of HR, and Finance has less control over pensions, then a company is less likely to explore cross-border solutions, as the drivers are primarily concerned with finance and risk. In addition, unlike Finance, HR tends to be less centralised, so is less likely to look for centralised solutions. This is perhaps most evident with looking at the cross-border provision of DC pensions, where from a pure HR perspective the benefits of adopting a cross-border approach may not appear convincing, whereas from a treasury or finance perspective the case is easier to make.

**Wait and see?**

Presently, it appears to be the Trailblazers alone who are adopting cross-border pensions, with the other companies - and to a large extent providers also - are looking to see what the Trailblazers are doing and how they are faring. Although a few of the Pragmatist companies saw cross-border IORPs as ‘consultancy-driven,’ most companies are waiting to see what obstacles the early adopters of such IORPs are having to overcome and what benefits they gain. In addition, many are looking to providers to see what they are doing. So, why are other companies not following the Trailblazers and can the EU do something to assist these multinational companies to streamline their pension provision and to help them be more competitive?
Chapter 3
The European regulatory environment
\textit{We wish to develop a European Pension Fund.}'

The idea of cross-border pensions has stimulated considerable interest over the past few years, and our survey revealed that the concept of cross-border pensions is attractive to most of the companies interviewed. However, developments in this area have been slow, which is why the European Commission is looking again at how it can stimulate and facilitate the provision of pensions across borders. Although the role of the European Commission in this area is difficult, and sometimes contentious, it is also crucial to the further development of both single-country and cross-border pension provision in Europe. On the basis of our interviews, we have analysed the main issues companies face in managing their pensions in Europe and how the activities of the European Commission will shape the progress of cross-border pension provision.

The reason for the significant gap between most companies' interests in cross-border pensions and their actions is easy to identify. No European country has the same pension system as its neighbours and it is unlikely that this situation will change any time soon, if at all. Across Europe, different multi-pillar pension systems have been constructed over time, each the result of particular choices and cultures. A pan-European occupational pension has to be able to operate efficiently in this complex and fragmented environment.

\textit{Europe is pretty complicated. It's just not as easy as you think.'}

Nation states, the EU and pensions

To date, fewer than 80 cross-border institutions for occupational retirement provision (IORPs) have been set up.\footnote{If the clarified definition of 'cross-border' is adopted in the proposed updated IORP directive, this number will probably be more than halved. The European Commission has issued a Call for Advice on the IORP directive which (among other things) clarifies that the purpose of the IORP Directive is to enable an employer in one Member State to sponsor an IORP located in another Member State. IORP and sponsor location (not employee location, retiree location or scheme nationality) determine if activity is 'cross-border.' The Call for Advice can be found at http://ec.europa.eu/internal_market/pensions/docs/calls/042011_call_en.pdf. For the latest EIOPA/CEIOPS report on cross-border IORPS, the 2011Report on Market Developments, see https://eiopa.europa.eu/fileadmin/tx_dam/files/publications/reports/IORP-Market-Development-Report-2011.pdf.} The reason for this limited uptake is partly historical - pensions have typically been the responsibility of local HR departments and most companies have only recently started to centralise their pension management - but it partly reflects the position of pensions themselves in European law. Pensions sit in a grey area straddling various areas of national and European laws and regulations.

Although the European Union has considerable power over elements within the national systems (and not just cross-border elements), European Member States are responsible for the structure and management of their own pensions systems (through Social and Labour law). Despite this, the EU internal market for financial services, which is intended to ensure fair competition across the EU, applies at least in part to the provision of pensions. In addition, the European Stability and Growth Pact is increasingly having an effect on pensions systems. Central and Eastern European countries in particular have been affected by the Stability and Growth Pact, as demonstrated by the reversal of Hungary's funded second-pillar system. The EU therefore has considerable power over the way in which the Member States construct and fund their pension systems, and the European sovereign debt crisis may lead to an increase in this power.\footnote{For example, reform of the state pension system was one of the conditions of financial support to Greece. See, for example, the March 2011 IMF country report no. 11/68 on Greece, http://www.imf.org/external/pubs/ft/scr/2011/cr1168.pdf.}
The legislation coming out of Brussels gives us some headaches with regard to financial risk management. Europe wants to take more control over all financial activities, including pension funds and plans. I think this raises more questions than answers.

Enabling cross-border activities

Against this complex background, multinational companies are eager to find a solution that will enable them to simplify their pensions management across Europe, looking to cross-border European pensions to help them to remove complexity and increase control. They are looking for the means to manage and provide pensions across borders in what is – and will probably remain – a complex regulatory environment. The European Commission is looking to assist companies in achieving this.

The position of occupational pensions in European law

Individual EU Member States are presently responsible for the regulation and supervision of occupational pensions in their own countries. At the same time, the EU facilitates and supports the liberalisation of financial services providers across the EU, including pension providers. The 2001 Treaty of Nice (article 51) established the principle of the liberalisation of financial markets. However, pensions are more than just financial products, and are also covered by EU and local regulations on consumer protection and by national social and labour law. The European Stability and Growth Pact is also likely to play an increasingly important role in driving reform of individual country pension systems, as is already visible in pension clauses included in the bailout agreements of Ireland, Greece and Portugal.

The legislator’s dilemma – red tape and pensions

What we do in the internal market is legislate and what we can’t do is to legislate the mandatory use of occupational pensions.

The EU is often criticised for producing ‘red tape’, increasing the burden on businesses and hindering competition. In part, this reflects what may be called ‘the legislator’s burden’ – legislators have a single tool which is the ability to pass laws, and laws may not always be the best way to achieve a goal. Bearing this in mind, the actions of the
European Commission in its present review of pensions (the forthcoming White Paper on Pensions) are laudable. The European Commission has explicitly asked for input from all stakeholders, and has engaged in an open and transparent process of review.

In calling for input for its forthcoming White Paper on Pensions, the European Commission laid out in its Green Paper five issues concerning pensions and providers:

- to ensure adequate and sustainable pensions;
- to address the appropriate retirement age;
- to enable portable and cross-border pensions, removing obstacles to people who work in different EU countries and improving the conditions for pan-European pension plans;
- to make pensions safer, possibly by improving the solvency regime; and
- to make pensions more transparent, enabling people to have a clear idea of the status of their pensions and for DC participants to take informed decisions on their investments.\(^\text{10}\)

Pensions are presently receiving considerable attention and it is up to the various stakeholders to make sure that their hopes and concerns are heard. On the part of multinational companies, it is clear that they would welcome a simplified system of cross-border European pension provision and that the present system is proving difficult to negotiate. The European Commission is looking now to find a way to remove some of the roadblocks and is actively engaged in challenging all and any unfair barriers to competition as a result of discriminatory tax treatment in different countries. It remains to be seen how effectively the Commission can avoid the legislator’s dilemma when the time comes to legislate.\(^\text{11}\)

\[\text{‘What we want to do is to create a legal framework for the internal market in order to create a possibility.’}\]

The IORP Directive – harmonising pensions?

\[\text{‘With cross-border IORPs, it’s not that companies aren’t interested but there is a gap between theory and practice.’}\]

On 3 June 2003, the European Parliament and Council adopted Directive 2003/41/EC on the activities and supervision of institutions for occupational retirement provision (IORPs).\(^\text{12}\) This directive, commonly known as the IORP directive, is perceived as lying at the heart of cross-border European pensions.\(^\text{13}\) The directive itself declares that it ‘represents a first step on the way to an internal market for occupational retirement provision organised on

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\(^{11}\) The UK DB system is perhaps a case in point, where legislation intended to protect people with a DB pension has made DB plans increasingly costly and difficult for companies to maintain.

\(^{12}\) IORPs should be understood as funded pension providers with a workplace link. There are presently approximately 140,000 IORPs in Europe.

\(^{13}\) Pan-European pensions can be provided in other ways, for example, via a trust or by an insurance company.
a European scale." The IORP Directive was created to help funded pension providers benefit from the EU’s internal market in financial services. It allows pension funds in one European country to manage the pensions of a company operating in another Member State and also enables companies to create a single pension fund for all their operations in Europe. The IORP Directive has been implemented by almost all Member States, and the EU is presently taking action against the remaining states, Poland and Estonia, who have yet to implement the Directive.

‘The idea of a European Pension Fund is good, but the situation has to improve – the hurdles are presently too high, tax-wise and social-security wise.’

It should be noted that the IORP Directive states that it is a ‘first step’ towards an internal market for pensions: it is a ‘minimum harmonisation Directive’ which means that it sets a minimum level of required harmonisation. It is this minimum level that makes it more difficult to implement cross-border pension vehicles effectively. Prudential rules within member states continue to differ, and many of the companies interviewed – in particular but not exclusively the Pragmatists – perceived different national and social labour laws and tax treaties as obstacles to creating a cross-border IORP.

Taking a new approach – IORP Directive II

‘We want to create choices rather than restrict choices.’

Due to the low uptake of cross-border pension vehicles, the European Commission issued a Call for Advice on 7 April 2011 to the European Insurance and Occupational Pensions Authority (EIOPA) on the reform of the IORP Directive. The Call for Advice states that ‘the Commission intends to propose measures that simplify the legal, regulatory and administrative requirements for setting-up cross-border pension schemes. Employers, IORPs and employees should be able to reap the full benefits of the Single Market.’

‘You shouldn’t look to the EU to design products, but if, for example, you wish to develop a hybrid DB/DC product, you should be able to do so, providing it is properly supervised. We are looking to companies and the industry to develop solutions and if there are legal bottlenecks then we will need to take action.’

The Call for Advice lays out a number of areas for improvement including providing a stimulus to cross-border activity, introducing common standards for the risk-based supervision of IORPs across Europe and the need to address the issues raised by the increasing use of Defined Contribution pensions. The European Commission is expected to present its proposal to amend the IORP Directive in 2012.

15 See http://ec.europa.eu/internal_market/pensions/docs/calls/042011_call_en.pdf for the full text of the Call for Advice.
16 Paragraph 1.2 of the Call for Advice.
In addition to improved governance, the benefits of a cross-border IORP for funding levels makes them interesting. If you can combine your assets and liabilities in a cross-border IORP in a country with a more liberal regulatory regime then you can gain extra benefits. The regulatory regimes in the UK, Ireland and the Netherlands are quite stringent compared with some other countries.

The common standards for risk-based supervision proposed by the European Commission should, if adopted, help harmonise pensions across Europe, making it easier and more transparent for companies looking to operate cross-border European pension plans. However, the devil lies in the detail, and there is already considerable debate on what is desirable or achievable in this area.

One reason why companies are interested in cross-border European pensions is that potentially this enables them to work with a single national supervisor, instead of having to meet the different requirements of multiple supervisors. Some companies may naturally be drawn towards a regulatory regime that is seen as lighter or which provides more flexibility when drawing up recovery plans. Some fear that a new IORP directive would remove the option of selecting a more flexible regulatory regime for an IORP.

We would like to see the use of common terminology – and once we have that, common principles.

While it may be a matter for debate on whether the same requirements should be made of all IORPs, a common European methodology for measuring risk would help improve transparency and may in itself provide benefits to multinational companies looking to better manage their pensions across Europe. A common methodology would enable all stakeholders to be able to judge and compare the value and security of the benefits upon offer – something that is essential if competition is to be fair.

**Changing legislation**

How do you effectively marry the several pillars of a pensions approach – the state pillar, the company pillar and individual personal investment?

Although cross-border IORPs may not yet be able to provide the single pan-European company pension that many companies may hope for, this does not mean that they are not useful in their present form – indeed the Trailblazers are presently working on using cross-border IORPs for smaller DB plans and also to enable the more efficient management and provision of their European DC plans. Despite this fact, 20% of respondents had looked at cross-border IORPs (as they presently stand) and rejected their use in all circumstances, while most of the other respondents have adopted a wait and see approach.

17 For example, different solvency requirements are presently made of insurance companies and pension funds. It is important that all parties are aware of these differences and their implications.
One of the issues currently slowing down companies in trying to build a cross-border IORP is that it is not always clear in advance to what extent the benefits being provided can be harmonised. For example, for the operation of a cross-border Defined Contribution plan between the UK and the Netherlands, a recent Holland Financial Centre study showed that more than 100 articles of UK social and labour law would have to be adhered to by the Dutch-based DC plan.\(^{18}\) However, it is important to remember that the main benefit of cross-border IORPs as they are presently possible is not concerned with the harmonisation of benefits. Rather, they are concerned with improving governance, reducing risk and providing cost efficiencies. The continued need to follow national social and labour law for the pension plans should not be seen as insurmountable. A company should already be adhering to local social and labour laws with its pension plans, so the requirement to continue to do so should not in itself pose a problem.

The new EU White Paper on Pensions and the proposed IORP II Directive may temporarily have caused some companies to pause in order to see what changes the EU intends to make, thus ironically leading to further delays in the development of cross-border IORPs. Nevertheless, the European Commission is aiming to simplify and stimulate cross-border pension provision and it is to be hoped that the new IORP directive will do just that. In this respect, it should be added that, although much can be done by the EU to clarify terminology by establishing a common language and methodology for pensions, cross-border activity can only truly be made simpler if the Member States themselves move to harmonise more of the different national laws affecting pensions. If the Member States wish to facilitate multinational companies and to enable greater mobility of labour, they themselves could take the opportunity provided by pension reforms to align their occupational pension systems with their neighbours.

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18 Meerten, van H 2011.
Chapter 4
The road ahead
'We are convinced that with the ageing population worldwide it will become more and more difficult to find and keep the people we need. We have established our new pension policy precisely to enable us to attract and retain employees.'

With the legislative road ahead at present concealed, it is not clear what the European White Paper on Pensions and the new IORP directive will ultimately contain. This on its own may give companies pause for thought, and indeed several companies interviewed clearly state that they will adopt a ‘wait and see’ attitude for just this reason. Indeed some interviewees suggested that the new IORP directive should be abandoned as it is potentially stifling the activities it is trying to stimulate. However, our interviews also revealed that the gridlock in European pensions appears to be loosening. For those companies looking to align their pensions across Europe - where possible - and to gain a clearer view and better grip of their pensions in Europe (and elsewhere), there are steps that can be taken now, which will help prepare the ground for further developments, as they arise.

**Defined Contribution is the future**

'Increasing legislation made DB pension plans more and more of a pain... the volatility on the balance sheets, the funding, it creates too much hazard for companies.'

Much has been written about the decline of DB pensions. This is perhaps nowhere more apparent than in the debate in the UK about ‘gold-plated’ public pensions for civil servants. These ‘gold-plated’ pensions are DB pensions, and the tone of the debate makes it clear that these are now perceived as an unaffordable luxury. This view is strongly supported by the respondents to our survey. The overwhelming majority of respondents have either an explicit or implicit policy to move to Defined Contribution pensions and to close all existing Defined Benefit plans. Despite this strong move, respondents were aware of potential shortcomings in the Defined Contribution system and made it clear that companies will continue to have a role to play in ensuring that their employees are assisted to build adequate pensions. As one respondent made clear, the shift to DC pensions is helping companies to remove a significant risk from their balance sheet but it is not removing risk entirely from the company. The company still retains responsibility for looking after its employees - and, as several respondents pointed out, in an ageing world, the importance of pensions is likely to rise.

'With DC pensions, I am concerned that in the future employees may feel that they do not have sufficient savings and will look to the company to compensate them for this. The issue is about delivering DC more intelligently. There is much more to be done. DC is going to change enormously over the next few years.'

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19 For more on the subject of the shortcomings of DC and suggested improvements for the future, see Tans, M. 2009 and Bovenberg, L. 2011.
Improving governance

‘As of last year, we introduced a policy for pensions that clearly lays out what kind of pensions we wish to provide as a company and which criteria they need to satisfy.’

Almost all companies interviewed had carried out a review of pension policies in the past 5 years, and all perceived pensions governance as being very important. Looking to solutions that assist with the coordination and efficient management of pensions the majority of companies interviewed expressed an interest in asset pooling. Asset pooling can help improve governance – by creating a shorter chain of command, and offering improved knowledge of and control over investment decisions. Although risk pooling is sometimes thought of as a natural precursor to asset pooling or even pan-European pensions, few companies seem to consider it to be a similar type of solution. Risk pooling is a well-used and relatively simple insurance solution that does not touch upon pensions. However, the convenience of risk pooling may provide a good example of how asset pooling may function to the benefit of companies. Indeed, of those companies interviewed, nine expressed a positive view on asset pooling and the potential benefits that it may offer.

Pan-European pensions

‘It makes sense to adopt a phased approach to introducing pan-European pensions – but only if you know that it will eventually be possible to include all European countries.’

The path to cross-border IORPs is more complex and the ultimate benefits that can be realised are to many companies less clear, partly because IORPs can be used in different ways to achieve different ends. In an ideal world, most of the companies interviewed would appreciate the simplicity and efficiency of being able to run a single (preferably DC) pension plan for Europe. In addition, several companies were interested in the idea of being able to pool their DB pensions under the supervision of a single regulator. However, the practical constraints of still having to apply widely varying social and labour law and other non-harmonised national regulations has certainly impeded the development of cross-border pension plans. It is therefore important to repeat that cross-border IORPs are not only about harmonising benefits but about centralising control, maximising efficiencies and ensuring a consistent level of quality across a company’s pensions in Europe.

‘What we want to gain from cross-border pooling is to speed up the decision-making processes and to optimise everything as much as possible – to make it really cost-efficient and responsive, to have trustees we trust. For Defined Benefit plans, the answer would seem to be Captives.’

The Trailblazer companies who have set up cross-border IORPs are already highly centralised and have significant pension funds and pension management organisations. For these companies, it is already clearly worth investigating what they can achieve through a cross-border IORP. The Trailblazers have typically been at the forefront of pensions
development, being early adopters of bespoke asset pooling solutions, for example. For such companies, the potential benefits of a cross-border IORP outweigh the development costs. In any case, these are companies with dedicated teams of international pensions experts. They have both an appetite and the infrastructure to drive innovation. One Trailblazer company pointed to the use of Captives as an effective cross-border mechanism for derisking DB pensions, although Captives are more suited to the largest companies as they are capital intensive.

‘I think that the most important driver for a Pan-European pension plan is to gain more control. In addition, if you have combined your pensions into a single IORP, you only need to deal with a single supervisor, which is naturally simpler and more convenient.’

Centralised solutions

‘Asset pooling is not only about governance; it also provides cost-efficiencies and operational efficiencies – there is no way we are going to make this shift without getting some economic advantages.’

‘We like asset pooling for obvious reasons: economies of scale, economies of governance and so on. This is important to us and that makes it interesting for small pension funds to participate in the rich vehicles we can create.’

For those companies for whom centralised pension solutions are appropriate, administrative pooling and asset pooling represent practical first steps towards building a ‘shared service centre’ for pensions. Although creating a cross-border asset pooling solution for the first time is a difficult process and requires considerable international expertise, once such a solution has been built, it is straightforward and flexible to use. As cross-border asset pooling solutions are now available in the market ‘off the shelf,’ the difficulty of implementation has been considerably reduced. Given the changing pensions environment, however, it is very important that companies looking to implement asset pooling should select a flexible solution that can be tailored to suit their company as its needs change and develop. A modular solution should be able to service the different types of asset management models required by different pension systems.

‘Asset pooling is the first step towards cross-border pensions. We’ve had the ambition for a long time to move to true cross-border pensions.’

20 To find out more about the uses and benefits of cross-border asset pooling, see Ittersum, van W. A. 2010.
‘I think our first step would be asset pooling and then we need to see what kind of work the large multinationals do with cross-border IORPs before we make up our minds about whether they are worth the effort.’

A new model – the Shared Service Centre for Pensions

‘You can’t have a single pan-European pension fund. You have to build lots of separate rooms within one building, so to speak, and once companies discover that fact, a lot of them have second thoughts.’

‘I think that the most important driver for a Pan-European pension plan is to gain more control. In addition, if you have a single pension plan, you only need to deal with a single supervisor, which is naturally simpler and more convenient.’

Given the inability to harmonise pension benefits across Europe, it may help foster understanding of the role of cross-border IORPs to look at them not so much as a single pension plan, but rather as a Shared Service Centre for pensions. Their role can be seen to be much like that of Shared Service Centres for Finance and Accounting. Such Shared Service Centres also have to take into account local and international regulations but are nevertheless capable of providing governance and efficiency gains. The Trailblazers who presently have set up a working cross-border IORP appear to be approaching them in just such a way, taking smaller DB pension plans which by their nature are less efficient to run and combining them in a cross-border IORP. The next step to be taken (and which is being taken) is to coordinate and manage the provision of DC pensions across borders through a cross-border IORP. Indeed, cross-border DC plans are in principle the simplest kinds of plans to operate across borders – the issues raised by cross-border Defined Benefit plans are considerably greater.

‘We are moving from a Defined Benefit world towards a pure Defined Contribution world. Pure DB has shown its shortcomings but pure DC has shortcomings too. We need to have an open and factual discussion about this.’

‘We may look at pension pooling in the future; let’s say in three years at the earliest. We first want to see others being successful. I think it should first be the major European multinationals... and currently not even the major European companies are doing too much here except talking.’
We looked at Pan-European pensions about 4 years ago. There was nothing in the market and nothing we could take off the shelf.

For Pan-European Pensions, we would rather not be an early adopter. We would rather wait five years and then see how the market has developed. We prefer to be innovative in our products but not in our pensions!

What is the business case? You need a very solid business case. In the meantime, I think everyone will continue to de-risk and do everything to decrease their exposure.

In theory, cross-border IORPs have much to offer, but for many companies the practical business benefits still need to be demonstrated. Few companies presently are sufficiently centralised and focused on pensions management to be able to justify the cost and effort of exploring cross-border IORPs when the outcome of the project is unclear. As with Shared Service Centres, companies will wait to learn from the experiences and lessons of the front-running companies, the Trailblazers.

We don’t have pan-European pension plans - the tax hurdles are enormous and what are we actually going to get out of it? It seems to be a consultancy-driven thing.

For Defined Contribution plans, we are looking for low cost solutions. Low cost is essential for DC.

Harmonising pensions – a 401(k) for Europe?

As the European Commission itself has declared, there is still work to be done if Pan-European pensions are to become a reality. Although cross-border IORPs can provide a useful tool to centralise the management of pensions across Europe, 80% of companies surveyed (including companies from all categories) expressed an interest in a harmonised pan-European company-supported DC plan for employees – a 401(k) type plan for Europe. Although it is highly unlikely (although not impossible) that the countries of the European Union will agree to harmonise their social and labour law on pensions, it may be that the EU can create the legislation to allow for the creation of a simple, transparent, pan-European DC plan which member states can freely adopt.

In the call for advice on the new IORP directive, the European Commission clearly states that it wishes to increase the security of those people with DC pensions. If DC is the future of the occupational pension system, then here perhaps is an opportunity for the EU to help sketch out the framework for a pan-European 401(k) plan. The demand from the multinational companies is there.
‘If Europe were to introduce the same system, whether it is the New Zealand Kiwisaver or the stakeholder pension, then the problem would be solved.’

In the meantime, we can see that a few front-runners are pushing the boundaries of what is possible, while other companies are looking to see what solutions the Trailblazers create. At the same time, we can see that the different EU countries are also launching more cross-border vehicles, with the PPI cross-border vehicle for DC pensions most recently having been launched in the Netherlands in January 2011. Over the coming year or two, we can expect to see further advances with more countries launching cross-border IORP vehicles (perhaps in Germany and the Central and Eastern European countries).

As Europe moves increasingly towards variants of DC pensions, we can also expect some amount of further harmonisation. Indeed, while the EU is examining how it can best approach DC pensions, the shift to DC for multinational companies is only likely to be accelerated.

The future of pension provision

‘I think the future will see more multi-employer solutions.’

As the respondents to the survey made clear, the world of pensions is still changing and this change will be felt throughout the pensions environment, including the providers. Among the respondents, there was a clear divide between the Pragmatists who have a strong preference for dealing with ‘best of breed’ local providers only and who presently have no interest in cross-border pensions activities (20% of those interviewed) and the other companies who are all open to exploring ways to exploit the potential benefits of cross-border pension solutions.

‘If you have a company where the local plans are well run; they know what they’re doing and everything is going smoothly; then don’t touch it! But if you’re a company where your local plans don’t know which way to turn, then it’s a good moment to look at centralising your pensions – or consider going to an insurance company. Some people say insurance companies are more expensive but you’ve got to have the expertise available yourself if you want to run your pensions properly.’

The area in which most respondents could see immediate benefits to cross-border activity was in asset management. Although only 20% of those interviewed were actively working on establishing a cross-border IORP, a further 40%...
were interested in them. All of these companies missed the availability of a ready-made cross-border administration platform to service a cross-border pension plan. The challenge – to the EU, national regulators and the providers – is to create workable cross-border pension plans that will enable companies to provide their European employees with secure, sustainable and adequate pensions.

In the meantime, all eyes are on the few who have ventured to set up cross-border IORPs to see both what they are doing and whether they are receiving the benefits of their pioneering efforts.

‘There are a lot of companies who would love to go to one provider and have all their DC functions sorted out in the whole of Europe – but there is also no way that they will invest a lot of time and money to make it happen.’
Conclusion
Possible futures -
a very European dilemma
From the perspective of multinational companies, European pensions are at a crossroads. Globalisation, increasing governance requirements, a focus on derisking and the desire for predictability are all driving companies to reassess and redesign their pensions – and the global financial and economic crisis has acted as a catalyst. Although the crisis may initially have slowed down the development and adoption of some solutions, it seems ultimately to have increased the interest of companies in this type of solution. Similarly, although the crisis has made it more difficult for companies to derisk their DB pension plans, it seems also to have confirmed or even accelerated the shift to DC pensions.

In the area of cross-border pension solutions, if we look at how different companies are managing their pensions today, we can see that the Trailblazers are continuing to push ahead with cross-border integration of their pension plans while the Pragmatists have chosen to stick with single-country plans. The rest seem to be poised, assessing the available options but waiting to see which path will provide the best outcome. Although there appears to be something of an impasse, as the different players wait to see what actions others are taking, the European pensions environment is not static. Looking at developments taking place today, we can identify four potential drivers for the development and adoption of cross-border pensions in Europe on a broader scale.

Companies
The Trailblazers are strong companies, with long-term perspectives, deep pensions expertise and considerable resources. They are also companies who stand to gain the most from pan-European pensions. Trailblazers are already exploring cross-border solutions, including the use of captives to provide DB pensions and the use of Belgian OFP cross-border IORPs to manage problematic/legacy DB plans, and are exploring the development of cross-border IORPs for DC plans.

European Commission
The European Commission is presently preparing its holistic white paper on pensions and its new IORP directive, having engaged in a thorough consultation of market participants. The EU may lead the way by creating a coordinated legislative system and a level playing-field for pension provision, providing fertile ground for further developments. The idea of a 401(k) for Europe, a simple but effective pan-European DC savings vehicle that is accepted across Europe is perhaps the holy grail of pan-European pensions. It is possible that a single pension plan could be created as a 28th regime vehicle, but this would require unanimity among the EU member states. Alternatively, it may be possible for the outlines of such a plan to be described in the new IORP directive such that the EU member states could choose to implement it into their local social and labour law.

Providers
Specialised providers are starting to create distinct solutions to enable the efficient functioning of cross-border pensions, including multi-country administration, asset pooling, IT, and insurance solutions. For example, 60% of those companies interviewed expressed a positive view on asset pooling and the potential benefits that it may offer. By providing outsourced, cross-border facilities (‘shared service centres for pensions’), providers will enable companies to focus on their businesses.

Consultants
Many of the interviewees saw pan-European pensions presently as the domain of the Trailblazers and the international consultants. There is some truth to this: consultants are often at the forefront of pension developments, and they can highlight opportunities and play an important role in uniting providers, sponsors and regulators.
For the time being, companies will continue to build upon the foundations they have, using the tools at hand. It is clear that the Trailblazers are working not only on solutions for DB plans but are looking to cross-border solutions for DC plans also. The European Commission is focusing attention on pensions in Europe in all of their aspects, and providers and consultants are looking for effective solutions - not just IORPs but also multi-country insured solutions, captives and more. As more companies close and derisk their DB plans, we can expect to see an increased focus on improving DC plans, perhaps with an increased focus on asset pooling and further specialised cross-border solutions where these can be shown to be beneficial.

It is clear from our survey that different types of companies have markedly different aims and desires for their pensions, but equally they are unified by their desire for simplicity, clarity, sustainability and good governance. Much is going on in the world of pensions in Europe. The pensions landscape is changing and it is important that all the stakeholders: legislators, supervisors, providers and companies continue - and deepen - their dialogue.

Guidelines for pension plans

On the basis of the interviews and looking to the future of pensions in Europe, we have drawn up five brief guidelines for companies looking to improve their pensions management in Europe:

1) Know your pensions - a first step to improving control over your company pensions is to make a complete overview of all pension plans being provided by your company.

2) Prepare policy and guidelines - what does your company wish to achieve with pensions? Is your company culture centralised or decentralised (or transforming)? What are your drivers in improving pensions management?

3) Explore cross-border opportunities - cross-border pension solutions are not an end in themselves. However, like Shared Service Centres, they can provide efficiency gains and improve the control and management of your pensions. For companies with multiple, small Defined Benefit plans, a cross-border IORP can provide a useful resource for managing these pensions and simplifies regulatory issues. For companies with Defined Contribution plans, a cross-border IORP may provide the means to centralise and improve control and to realise efficiency gains for both the company and employees.

4) Identify all internal stakeholders at a local, regional and central level - finance, treasury, human resources, and employees - and evaluate pension solutions according to benefits offered to each group. It is important to maintain a dialogue with all stakeholders in order to ensure the success of any changes.

5) Select experienced international consultants and providers who can help you to design and implement your solutions with an eye to future developments.
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