THE CHICAGO COUNCIL ON GLOBAL AFFAIRS

EMERGING LEADERS PERSPECTIVES

Reaching Across Borders: The Use of Global Savings Accounts to Enhance Retirement Security Worldwide

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"If you are self-motivated, wow, this world is tailored for you. The boundaries are all gone. But if you're not self-motivated, this world will be a challenge because the walls, ceilings, and floors that protected people are also disappearing… Government will do less for you. Companies will do less for you. Unions can do less for you. There will be fewer limits, but also fewer guarantees."

- Thomas Friedman, *The New York Times*[1]

Executive Summary

Over the past 50 years, trends in employer-sponsored benefits, personal savings rates, and robustness of government retirement benefits have changed the outlook on retirement for millions of people around the globe. Given today's typically shorter periods of employment with any one employer, and the corresponding patchwork of benefits attendant to such movement within the workforce, the standard of living for the next wave of retirees could be dramatically different from the lifestyle enjoyed by previous generations.

The traditional model of retirement security must evolve to meet the ever-increasing demands of the modern world, as well as the needs of a constantly changing workforce. Significantly greater employee mobility, longer lifespans, and increased financial flexibility all require a more nimble retirement security framework.

Such a new model of retirement security must include tools to ensure adequate savings and access to financial resources worldwide. This paper calls for a new, global retirement account to achieve these and other goals. Such an account, specifically tailored to bolster retirement security for today's global workforce, could reach across borders to enhance quality of life on an international scale.

Note: A glossary of terms can be found on page 8.

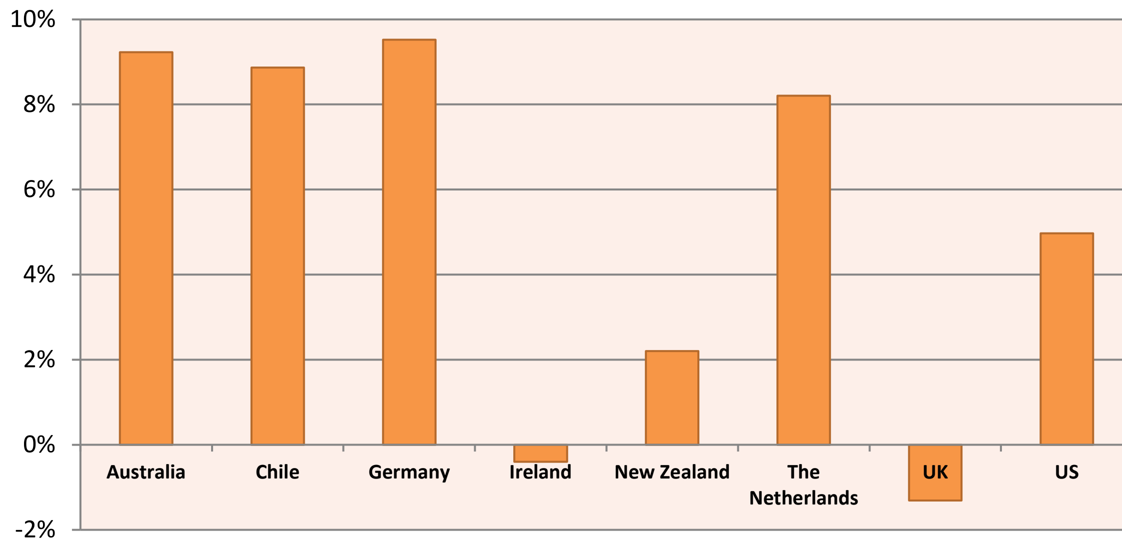
Introduction

Traditionally, funding for retirement has been based on a three-legged stool model, which historically has provided a solid platform for stable income in post-working years:

- Government benefits (including public pension plans and Social Security)
- Employer retiree benefit programs (e.g., corporate sponsored retirement plans, Taft-Hartley retirement funds), and
- Personal savings

Today, government and employer benefits are generally decreasing—due to the closure of generous defined benefit plans and/or benefit design changes (e.g. reductions in benefit accruals or increases in the retirement age). This changing landscape has resulted in the growth of defined contribution plans (such as 401(k) plans), which shift greater financial responsibility for retirement on to individuals, who are often not equipped to assume the investment risk associated with to such plans.[2]

Figure 1: Household Savings Rate (2015)



This research relies heavily on the efforts of the Organisation for Economic Co-operation and Development (OECD), a group of 34 developed countries which seeks to compare policy experiences, find answers to common problems, identify best practices, and coordinate the domestic and international policies of its members.[1]

Net household saving is defined as the subtraction of household consumption expenditure from household disposable income, plus the change in net equity of households in pension funds. Household saving is the main domestic source of funds to finance capital investment, a major impetus for long-term economic growth.

Source: OECD, "Pensions at a Glance 2015: OECD and G20 indicators," 2015.

Why Do We Need a New Approach to Retirement?

Global Worker Mobility

Today's information-based economy has led to a more mobile society, no longer limited by the historical limitations of one's domicile. As the geographical location of employers is less and less significant to today's employees, the role of a particular national retirement plan becomes less and less relevant. It is not uncommon today for many employees to have lived and/or worked in multiple countries, with notable movement of workers from Eastern Europe, various parts of Asia, the Middle East, and Latin America.[3] Trends suggest that people working abroad tend to retire in their home country. More often than not, these "global nomads" find themselves in jurisdictions without any suitable retirement plans or, as a result of changing work locations frequently, have fragmented benefits that do not reflect the true measure of their service. Additionally teleworking, combined with phased-retirement policies, have created an increasingly common phenomenon known as the "snowbird" lifestyle: partially retired workers who retreat to warm climates for a portion of the year while continuing to work. One related example of worker mobility is the free movement of people across the European Union (EU) adopted in the Schengen Agreement in 1985. Today, many workers are able to earn wages from various countries, yet national-retirement plans often place country-specific rules and regulations on savings mechanisms available to employees during their working years. Such limitations often cause difficulties for retirees trying to access their savings, irrespective of where the savings were earned or one's chosen domicile in retirement.

Entrepreneurship, the "Gig" Economy, and Career Mobility

Today's workers are expected to have more than 12 employers over the span of their working years, and their tenure at each assignment is expected to be shorter than in the past.[4] These trends affect the retirement savings of the contemporary workforce, often resulting in employees filling many small pots of pensions with different employers, which are often forgotten or incur high fees for administrative expenses to service the accounts which diminish the return on investment. Such employees are not benefiting from the economies of scale and cost savings that could be achieved from combining multiple pension pots into a single plan.

Further, increasing numbers of people today embrace the independence of today's "gig" economy. These workers provide services to support on-demand commerce and are classified as independent contractors, rather than full-time employees working for a specific company. This means that they cannot access an employer-sponsored benefit plan, including retirement savings vehicles.[5]

This fluid job market highlights the role of personal savings in the retirement equation. The changes mentioned above often result in inadequate retirement savings for many workers, notably those under 35, in mid-low income jobs, and working in part-time or temporary positions.[6]

Aging

The world's average population age is rising faster than ever due to falling fertility rates and increased life expectancy. This trend is most evident in developed countries, where adults aged 60 and older account for 22 percent of the population versus 4 to 5 percent historically, and they are expected to increase to 31 percent of the population by 2040.[7] Longer life spans typically translate into more post-working years, increasing the demand for retirement funds.

Macroeconomic Factors Impacting Government-Sponsored Benefits

Finally, the need for personal retirement savings is heightened because of macroeconomic factors affecting government-sponsored benefits. The aging populations of Europe[8] and the US[9] mean that soon there *will be more retired people than actively working people paying into government-sponsored retirement programs*. The richness of publicly sponsored retirement benefits will most likely be diminished for future retirees, due to declining tax revenues, government debt obligations, possible inflation, and fiscal policies (See Figure 2). Furthermore, monetary policies that have resulted in negative interest rates could discourage savers. These trends are increasing pressure on income stability and financial security for retirees.[10]

A worldwide crisis in retirement funding looms on the horizon, underscoring the need for more diverse and stable funding sources, including personal savings and investments.[11] While politically unpopular to discuss, actuarial analysis of the US Social Security program and its equivalents in the EU shows that they will experience increased strain, especially those financed on a Pay-As-You-Go basis. Program changes are inevitable as the retiree/worker dependency ratio increases. Some countries have changed their government retirement systems to direct contribution/personal account systems, where contributions are used to provide a pension at retirement. The decline in government- and employer-sponsored pension plans highlights the significance of personal retirement savings by today's workers.

Comparison of Current Best Practices in Key OECD Countries

To develop a new approach to retirement savings, we must examine current best practices at the country level.

Figure 2: National Budget Deficit % (2015)

Source: OECD, "Pensions at a Glance 2015: OECD and G20 indicators," 2015.

According to the OECD, the following comparison illustrates the techniques in use across countries with significant rates of replacement income at retirement and/or unique element of national retirement schemes. (The “replacement rate” is the percent of pre-retirement earnings achieved in post-working years, through various sources including public and private pensions.) OECD has done studies to suggest that 60 percent is a reasonable rate of replacement income for retirees to continue their standard of living in their post-work years.[12]

Some countries have made occupational and/or private pensions mandatory (Australia, Chile, Singapore, Japan, UK, New Zealand, Norway) or quasi-mandatory (the Netherlands, Sweden) to ensure that most workers are eligible for, and have access to, a pension at retirement. In many countries personal retirement savings are fully voluntary but pension plans are routinely provided by employers (e.g., Denmark, Ireland, South Africa, and United States). Other countries are considering making pensions mandatory (e.g., India, Germany). The low level of funding for private pensions is a major concern for policy makers across the globe.[13]

Australia

Australia’s retirement income system has three components: a means-tested age pension funded through general taxation revenue; the superannuation guarantee a compulsory employer contribution to private superannuation contributions, and other private savings. Superannuation saving is encouraged through taxation concessions.[14]

Other notable elements of the Australian system include:

- The development of large multi-employer superannuation funds (and related closure of small funds)
- The ability to take benefits as a lump sum at retirement

Chile

The Chilean pension system has three components: a redistributive first tier, a second tier of mandatory individual accounts, and a voluntary third tier. The individual accounts system was introduced in 1981 and is a defined contribution system.[15]

Notably, the Chilean system is a prime example of privatization of a public retirement plan. In the 1980s, the Chileans introduced:

- Mandatory individual retirement accounts
- No deduction for individual contributions
- A revised hybrid system that includes incentives to diversify
- No means testing (i.e. universal basic pension)
- A lowered withdrawal rate to 30 percent
- A more industry-focused foundation, so the scheme operates similar to a co-op
- Sophisticated risk-based solvency

New Zealand

The public pension is a flat-rate based on a residency test. Coverage of occupational pension plans continues to diminish while coverage of the KiwiSaver voluntary workplace savings scheme continues to grow.[16]

Other notable elements of the program in New Zealand are:

- KiwiSaver-flat subsidy with matching contributions from the government and employer
- Adopted superannuation funds
- Universal pension
- Auto enrollment
- Pre-set auto default settings
- No tax-exempt employer sponsored plans
- No tax incentives
- Means test for basic public pension

The Netherlands

The pension system of the Netherlands has three main pillars: a flat-rate state pension related to minimum wages and financed via payroll taxes; funded occupational pension schemes, and individual savings schemes. Although there is no statutory obligation for employers to offer a pension plan to their employees, industrial-relation agreements result in 91 percent of employee coverage. Accordingly, these schemes are therefore best thought of as quasi-mandatory.[17]

The Dutch system is also notable in that it includes:

- Universal pensions (no means testing for public pensions, universal flat rate pensions based on age and residency)
- Moving retirement age to 67 or 68, occupational based system: retirees receive a set amount from employer
- Workforce issue as defined benefit plans transition and companies are subject to trends in the defined contribution marketplace
- More plans struggling with solvency
- Highest rate of pension coverage in the world—mostly defined benefit plans

Furthermore, the Dutch system allows benefits to be cut and pension increases to be stopped if pension funds have insufficient assets. Many Dutch pension fund members have been impacted by benefit reductions.

United Kingdom

The public scheme has two tiers—a flat-rate basic pension and an earnings-related additional pension—which are complemented by a large voluntary private pension sector. The public scheme has been reformed into a flat-rate basic pension for those reaching state/public pension age after April 2016. An income-related, non-taxable benefit (pension credit) targets extra spending on the poorest pensioners.[18]

Other elements of the UK pension plans include:

- Created National Employment Savings Trust Plans (NEST) as a default provider for employers that do not want to make an active provider choice in offering mandatory defined contribution plans (NEST plans are government sponsored defined contribution savings vehicles that are accessible to employers and workers to help meet required savings thresholds).
- Eliminated means testing to universal basic pension
- Linked public pension eligibility age to life expectancy and correlation is now indexed
- Reformed system to move to a flat rate pension rather than percent of salary
- Minimum required contribution by all employees and employers into an account (a central trust, individual plan, or company vehicle)
- Minimum contributions are currently 3%, being phased up to 8% by 2019 with at least 1% (to increase to 3%) from employers
- Utilizes auto enrollment but participants can opt-out of the program with re-enrollment happening at three-year intervals

United States

The publicly provided pension benefit, known as Social Security, has a progressive benefit formula. There is also a means-tested top-up payment available for low-income pensioners.[19]

The US system is also notable in that it includes:

- SEPs (Simplified Employee Pensions)
- Defined contribution plans administered by financial institutions create a framework for a simpler type of pension arrangement
- Quick enrollment formula directs a pre-set contribution rate and asset allocation which has increased participation rates threefold
- Auto enrollment
- Auto escalation
- Auto rebalancing

Based on current pension rules, the average individual in at least two-thirds of the OECD countries needs to complement public pension benefits with funded, private pensions in order to maintain the standard of living at retirement: approximately 60 percent of the final worker’s final salary.[20]

	Retirement Age	Life Expectancy at Birth	Life Expectancy at Age 65	Birth Rate	Replacement Income in Retirement
OECD Composite	64	80.0	19.3	1.67	63.0%
Australia	65	82.4	20.8	1.88	58.0%
Chile	65	79.8	19.6	1.80	37.7%
Germany	65	80.7	19.4	1.41	50.0%
Ireland	66	80.6	19.2	1.96	42.2%
New Zealand	65	81.0	19.9	2.01	43.0%
Netherlands	65	80.9	19.3	1.68	95.7%
UK	65	80.4	19.4	1.83	38.3%
US	66	78.9	19.3	1.86	44.8%

Source: OECD, "Pensions at a Glance 2015: OECD and G20 indicators," 2015.

Regardless of the specific methodologies and incentives implemented, it is clear that retirement readiness must be enhanced with new tools and approaches. Should national governments choose to consider ways of increasing access to retirement benefits for non-traditional employees, new mechanisms, such as portable benefits or risk-pooling, could serve to provide benefits to workers in the 'gig' economy.[21] The consensus seems to be clear: no matter what country they come from, individuals will need to take on a greater share of the burden in funding retirement.[22]

Tools to Empower International Retirement Savings

Reviewing the best retirement schemes, it becomes apparent that a new vehicle for enhanced personal savings would enable workers to better prepare financially for retirement. The goal would be to broaden coverage and increase contribution levels so as to enhance the retirement readiness of future generations. The multitude of country-specific tools complicate rather than encourage personal savings for retirement. A global retirement account would simplify national restrictions on savings and access to funds in an individual's post-working years, and would put in place standardized design options and rules for the equitable treatment of retirement savings and investments. It should be noted that such a pension program is currently under consideration by the European Union.[23]

Catherine McKenna, Global Head of Pensions for the international law firm of Squire Patton Boggs, enthusiastically supports the establishment of global accounts: "For any saver, choosing how best to save for retirement is already a challenge, and for a global worker, is highly complicated. Such complexity disincentives saving and makes a meaningful comparison between differing products almost impossible for any consumer. The creation of global accounts will go a long way towards simplifying the process of saving for today's world-wide workforce, thereby significantly increasing the odds of achieving retirement security on an international scale."

Global retirement accounts would be designed as after-tax savings vehicles, unlinked from any employer. The funds in the account could be invested at the discretion of the individual account holder and would be tax-free on withdrawal. This approach would minimize taxing implications for nations as the wages are earned, and prevent double taxation for savers on accessing their money. To the extent that as the global account is not tax-preferred, there would be no limits to the amount of money saved in the accounts.

In terms of tax treatment, governments would not provide tax breaks for contributions, but earnings and withdrawals would be accessible tax-free. Essentially, savers would pay taxes on money when funds are invested and avoid taxes when withdrawing funds in retirement.

Private financial institutions would administer the funds and investment options for minimal administrative charges and competitive market pressures and the attractive volume of plan participants would ensure reasonable fees.

Other elements critical to the success of the global retirement account would include incorporation of proven design techniques, such as auto-enrollment, financial

education, and simple investment choices. (Evidence from UK and Australia shows that auto-enrollment/compulsion is needed if the goal is for employers to help employees set up retirement plans.) Further communication efforts should be coupled with the creation of the new global retirement accounts to promote participation rates.

The regulatory framework for global retirement accounts would be created in a collaborative effort led by: the US Departments of Labor and Treasury, and the European Insurance and Occupational Pensions Authority, the European Banking Authority, and the European Securities and Markets Authority. Periodic review and guidance for the framework would be issued by the OECD to ensure checks and balances to this collaborative system of regulatory oversight.

Conclusion

Initial reactions from leading pension policy authorities suggest interest in how global retirement accounts could function in the real world.

Matti Leppälä, CEO and Secretary General of PensionsEurope, a retirement think tank based in Brussels said, "PensionsEurope believes that social security and workplace pensions do and should continue to provide the bulk of the retirement income. However, voluntary personal pensions can be needed and useful, especially to provide pensions for those who don't have access to adequate workplace pensions.

PensionsEurope believes that the creation of a standardised pan-European Personal Pension Product (PEPP) [PEPP is a concept similar to the global retirement account except designed for administration in the European Union only; it is now under consideration by the EU government] may improve supplementary retirement savings, particularly in Member States where there is no or not a well-developed personal pension system or there is limited workplace pension coverage. A PEPP can also prove to be useful when there is poor security for existing personal pension products or when existing products are not attractive enough."

Aliya Wong, ERISA attorney, said, "As we move to a global economy, it makes sense to think of a global retirement vehicle. In addition, pooling the saving expertise of various nations could be beneficial in increasing efficiencies and individual savings."

David John, senior strategic policy advisor at the AARP Public Policy Institute, said, "In an ever more global workforce, a portable universal retirement savings plan that employees can carry with them from place to place is essential. Such a plan could plug into the national system wherever the individual locates and take on the characteristics of it while he or she is there. Probably the most complex aspect will be coordinating regulation so that local standards are met, but this is an essential element."

While this concept is complex, further consideration is warranted. Ideas for implementing the global participant account, originally conceived in this paper, will be explored more fully with stakeholders at an upcoming Savings & Retirement Foundation forum in Washington, D.C. in summer 2016.

Glossary

Source: Rob Austin, Director of Retirement Research, Aon Hewitt, unless otherwise noted.

Administrative fees: The charge for the basic services needed for the operation of the plan such as plan recordkeeping, accounting, legal, and trustee services.

Auto-enrollment: Feature where workers must take an action to elect out of participating in the plan.

Auto-escalation: Feature where participants will have their contribution rates increase at a specified rate (usually one percentage point) on a periodic basis (often annually).

Defined benefit: Retirement plan where the plan sponsor promises a specified monthly benefit in retirement according to a formula based on factors such as age, tenure, and employee earnings.

Defined contribution: Retirement plan where the plan sponsor, the employee or both make contributions to the plan on a regular basis. The amount of retirement benefits depends on the frequency and amount of contributions along with the investment earnings they produce.

Help/advice in financial goal setting: The assistance from a professional investor on what portfolio to use to best balance risk and reward to meet financial goals. Help can also encompass robust solutions such as target-date funds and managed accounts.

Investment selection: The choice of investment funds or securities for a portfolio.

Labor force: Workers age 15-64 (employed and unemployed).

Means testing: A determination of whether an individual or family is eligible for government assistance, based upon whether the individual or family possesses the means to do without that help.

Old-age dependency ratio: The ratio of older dependents--people older than 64--to the working-age population--those ages 15-64. (Source: World Bank)

Pension Gap Index: A comprehensive assessment of the progress that countries are making in preparing for global aging, and particularly the “old-age dependency” dimension of the challenge. (Source: CSIS)

Private pension: A pension plan administered by an institution other than general government. Private pension plans may be administered directly by a private sector employer acting as the plan sponsor, a private pension fund or a private sector provider. Private pension plans may complement or substitute for public pension plans. In some countries, these may include plans for public sector workers. (Source: OECD)

Replacement rate: A person's gross income after retirement, divided by his or her gross income before retirement.

Target-date funds: A combination of investment funds that automatically resets the mix of holdings in its portfolio according to a time frame that is appropriate for a particular investor. Usually, the timeframe is based on a retirement date.

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Kathryn connects the worlds of commerce and public policy, shapes business-related public policy, and creates impactful communication campaigns. With more than 15 years of corporate experience, Kathryn has led public affairs efforts at two multinational manufacturing and services enterprises. While on assignment in Washington, DC, with Caterpillar Inc., Kathryn played leadership roles in significant legislative activities including the Affordable Care Act and the Pension Protection Act. She currently leads engagement on public policy issues for Aon—the world leading insurance brokerage and human capital consulting firm—at the state, federal and international levels. In addition to degrees in communication studies from Eastern Illinois University, Kathryn earned an MBA from Georgetown University. Kathryn resides in Chicago.

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