

# Life-cycle management of PERCO workplace pension savings schemes

– Best Practice Guide –

April 2014



**The French Asset Management Association (AFG)** represents and defends the interests of asset management professionals. In France, the industry manages some €3 trillion, including more than €1.6 trillion in collective investment schemes, for which it ranks first in Europe and second worldwide behind the United States.

The sector is organised into standardised entities, asset management companies, which are subject to stringent rules in terms of organisation and oversight, and answer to the French securities regulator, Autorité des Marchés Financiers. Financial institutions with multiple businesses, notably banks and insurance companies, have hived off their asset management activities, while a growing number of boutique investment houses are performing with proven excellence.

The AFG role is to inform, assist and train its members, providing constant support on legal, tax, accounting and technical issues. It stimulates industry debate on future developments in management techniques, performance measurement, investor protection, corporate governance, research and training.

By interfacing with the French, European and international authorities, the AFG contributes actively to shaping the regulatory framework. It plays a key role in setting ethical rules and draws up codes of conduct for professionals. And it helps promote and strengthen the influence of the French asset management industry – one of the world leaders – among investors, listed companies, politicians and the media, both in France and internationally.

From the outset the AFG has contributed to developing workplace savings schemes, especially PERCOs, and promoting them to regulatory authorities at domestic and European level.

The PERCO is a workplace pension savings plan open to all members of staff to help them prepare financially for retirement. It offers at least three investment vehicles and the choice of a lump sum or an annuity at maturity. Any firm that has operated a savings scheme for at least three years is required to negotiate the introduction of at least one retirement savings vehicle. For 2014, the upper limit on employers' matching payments into PERCOs was set at €6,007, compared with €5,925 in 2013. At 30 December 2013 assets under management in these schemes amounted to €8.6 billion, up 28 per cent on the previous year. Nearly 121,000 companies now offer a PERCO – 20 per cent more than a year earlier – and more than 1,536,000 employees have already enrolled in one, a 23 per cent rise year on year.

*\*16% of the annual upper limit for social security contributions, i.e. €37,548 for 2014.*

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# **Life-cycle management of PERCO company pension savings schemes**

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Prepared by the special working group  
of the Employee Savings / Retirement Savings Committee  
and the Asset Management Techniques Committee

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## Foreword

### 1. What is a PERCO?

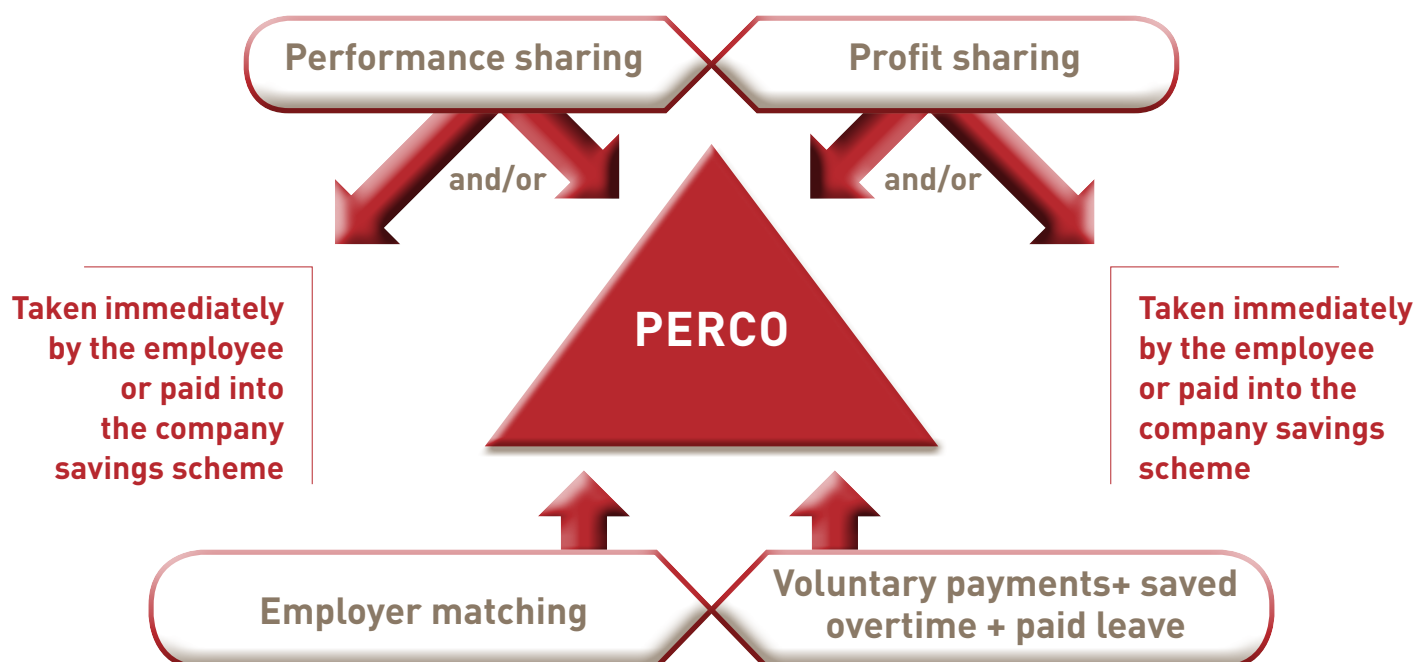
A PERCO (*plan d'épargne retraite collectif*) is a defined-contribution pension savings scheme that allows beneficiaries to build up a lump sum or an annuity, which is locked in until retirement. Exceptionally, entitlements can be paid out early in five cases: acquisition of a main residence, disability, death, debt overload, and expiry of unemployment benefits.

In consequence, the PERCO has a long-term investment horizon.

The operating procedures are set forth in the scheme's bylaws; they can be company-specific or apply to several companies.

Membership is optional. Employees can pay their profit sharing money or bonuses into the PERCO and also make additional payments on a regular or periodic basis. The company can then top up these payments with matching contributions.

In accordance with the Pension Reform Act adopted on 9 November 2010, at least one-half of profit sharing money must be paid into the scheme by default.



Employees enrolling in a PERCO must be offered at least three investment vehicles with different profiles. These are generally Employee Investment Funds (FCPEs), and one of them must be an Social impact fund<sup>1</sup>. Employees are free to choose their investment; if they do not express a specific preference, the scheme must have a default option.

Since launching in 2003, most PERCOs have offered a choice between self-directed management and a life-cycle approach, which depends on the employee's time horizon for retiring. The Pension Reform Act went a stage further by making the life-cycle approach systematic. It brought in rules for protecting savings, meaning that every PERCO now has to allocate savings in such a way as to "gradually reduce financial risks"<sup>2</sup>. With the life-cycle option, the employee's savings have to be invested in riskless or low-risk assets when he or she reaches retirement age or at the end of the chosen investment horizon. Life-cycle management can be the PERCO's default option<sup>3</sup>.

The regulatory section of France's Labour Code clarifies the objective sought by the legislature:

**“Art. R. 3334-1-2.** – Pursuant to the second paragraph of Article L. 3334-11, the bylaws of a [PERCO] scheme shall establish the conditions under which each participant is offered a savings allocation option intended gradually to reduce the financial risks affecting the value of the assets in the scheme's collective investment undertaking.

“Where this option has been chosen by the participant, it shall be organised as follows:

“1. The savings allocation shall gradually increase the share of monies invested in one or more collective investment undertakings with a low-risk profile, as determined in the authorisation provided for in Article L. 214-3 of the Monetary and Financial Code;

“2. No later than two years before the PERCO exit date, the participant's portfolio of units shall be composed of units of collective investment undertakings with a low-risk profile, for at least 50% of the amounts invested.

“The scheme bylaws shall establish the arrangements in which the amounts and units invested by the participant are gradually transferred to investment media meeting the requirements of this article, taking into account the chosen investment horizon or, failing this, the scheme exit date.

1) Funds with between 5% and 10% invested in the securities of social undertakings, within the meaning of Article L. 3332-17-1 of the Labour Code.

2) Article L. 3334-11 of the Labour Code.

3) Investment option adopted for the PERCO's bylaws if an employee does not express a specific preference.

This guide describes the principles and best practices for life-cycle management on the basis of the employee's retirement age or investment horizon. It does not have legal weight, however. It is the product of an AFG working group chaired by Luc Peyronel, Deputy Chief Executive of CM-CIC AM, and Pierre Schereck, Head of Employee Savings Schemes and SRI at Amundi and chairman of AFG's Retirement Savings Committee. The group was facilitated by Laure Delahousse and Jean-Marc Fournié, rapporteurs for the Retirement Savings Committee, with the participation of Adina Gurau-Audibert, rapporteur for the Asset Management Techniques Committee.

## 2. Key participants

Like any employee savings scheme, the PERCO relies on the expertise of several key participants.

These are:

- the *custody account keeper*, authorised by the Autorité de Contrôle Prudentiel et de Résolution after consultation with the Autorité des Marchés Financiers (AMF), is responsible for safekeeping the assets (generally FCPE units) held by all the company's employees, and for recording their subscription and redemption orders;
- the *management company*, authorised by the AMF, manages the FCPEs designated in the PERCO's bylaws;
- the *depository* is responsible for safekeeping the FCPEs' assets and ensuring they are managed in accordance with the applicable laws and regulations.

*Some of the examples and charts used in this guide have been taken from various sources. Neither the AFG nor its representatives may be held liable for them.*

## Self-directed or lifecycle management?

Employees can generally choose between two methods of management for their PERCO:

- self-directed management,
- lifecycle management.

In many cases, the two are not mutually exclusive, and employees can spread their savings across both.

### 1 Self-directed management

Employees themselves take responsibility for determining how their payments are allocated to the funds proposed by the PERCO. To meet their needs, the service provider offers a diversified range of funds invested in different asset classes, such as equities, bonds and cash.

With the self-directed option, employees freely determine how their savings are allocated among the various funds, thus building their own PERCO portfolio. They are not subject to any constraints on the amount or frequency of payments and may adjust their savings allocation by switching between funds.

### 2 Life-cycle management

The custody account keeper invests the employee's savings on the basis of the asset allocation schedule set out in the PERCO's bylaws. The basic principle is simple: as employees near their planned retirement date, the share of their savings invested in risk assets – particularly equities – is scaled back, while a larger proportion is put into fixed income products (bonds, money market instruments).

Employees decide on the amount and frequency of payments.

Payments are invested automatically in the FCPEs covered by the PERCO bylaws according to a pre-determined allocation schedule based on the employee's:

- age and likely retirement date, or
- investment horizon as stipulated when enrolling in the scheme (for example, the employee may be investing with a view to purchasing a home).

The bylaws and allocation schedule are provided to employees before they enrol in the scheme. Changes to the mix are planned for each employee and carried out automatically.

The idea is to maximise the return on employees' investments as a function of their investment horizon and to progressively limit risk-taking based on risk/reward assumptions for each asset class.



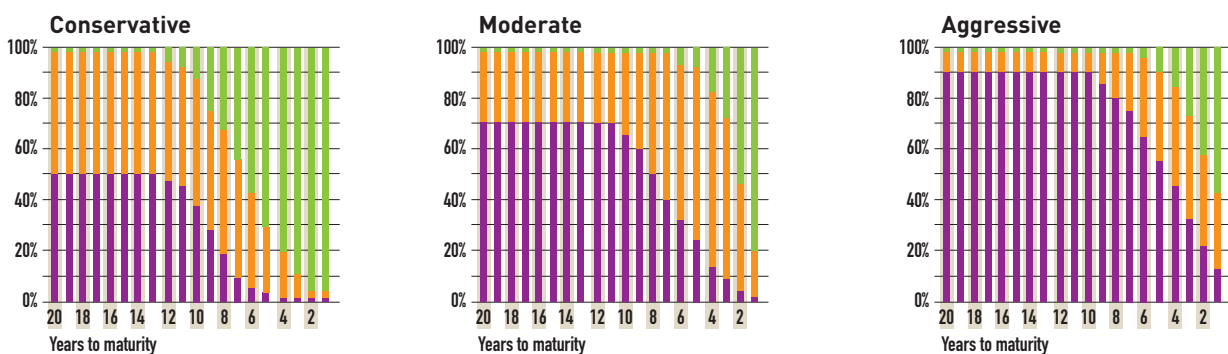
This framework draws on the standard approach to financial management of different asset classes. The longer the investment horizon, the larger the portion invested in equity-type vehicles. Conversely, as the horizon shortens, the proportion allocated to the riskiest products is lowered to make room for fixed income products (bonds and/or money market instruments).

Under the life-cycle approach, an employee enrolled in a PERCO may have a choice between several allocation profiles (or schedules), offering conservative, moderate or aggressive risk/reward profiles depending on the size of the respective equity and fixed income components.

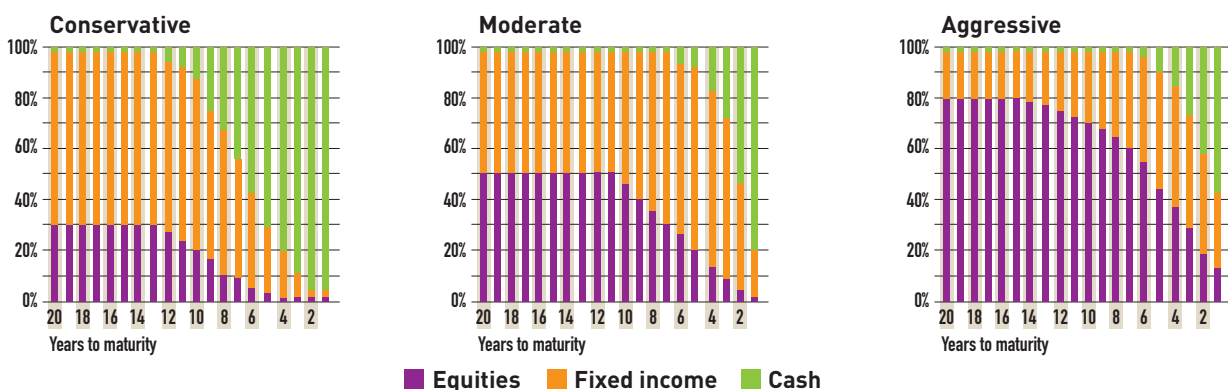
Each management company will offer its own schedules and profiles. While management companies generally apply the principle of spreading allocations across different asset classes (equities, bonds, cash), the initial mix and the speed with which sensitivity is reduced is specific to each company.

**Sample allocation schedules showing distributions across asset classes for a 20-year horizon according to three risk/reward profiles:**

**Example 1**



**Example 2**



**Life-cycle management of PERCO company pension savings schemes**

Self-directed or lifecycle management?

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# The two main approaches to life-cycle management

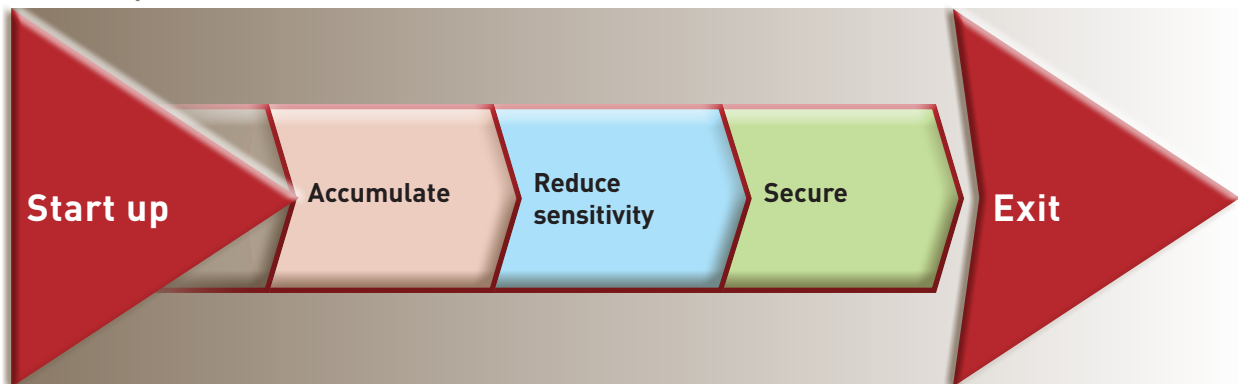
Approaches to life-cycle management can be split into two main groups:

- life-cycle management based on fund switching,
- target-date (or “generation”) funds.

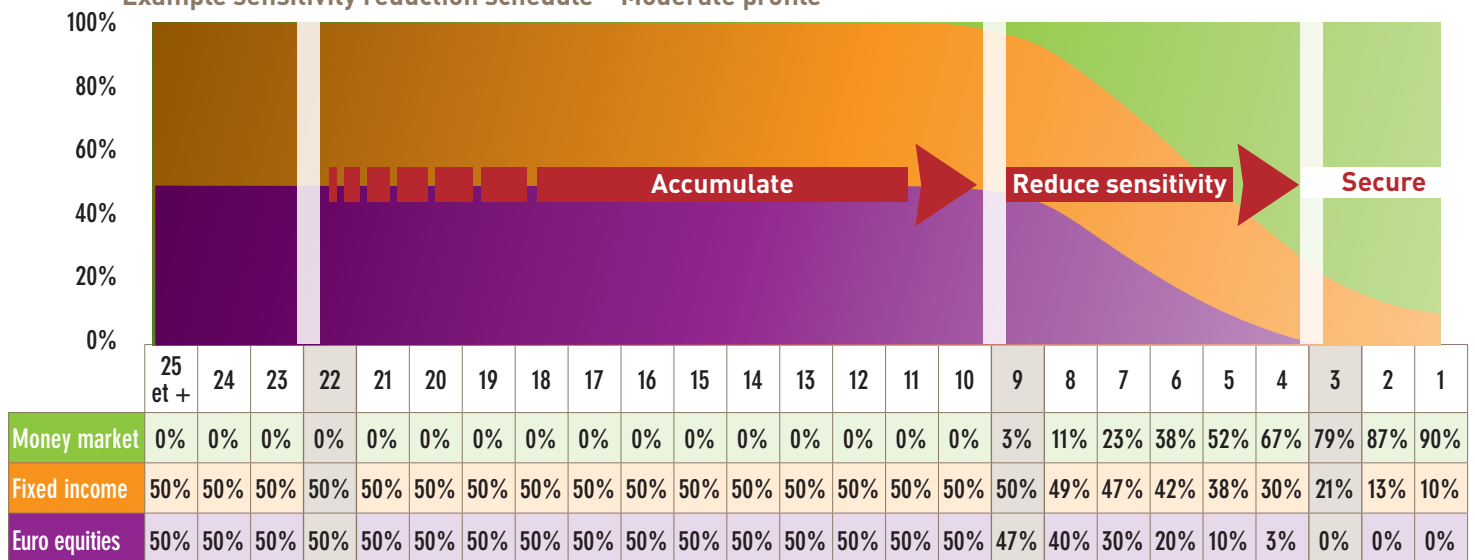
Although these two groups use different techniques, they both establish one (or several) asset allocation schedules that all feature an accumulation phase in which the investment is built up, principally in equities and bonds, followed by a phase in which risk sensitivity is gradually scaled back, and a final phase in which the accumulated wealth is stabilised by increasing the cash position.

These models, in which regular annual, quarterly or monthly payments and any accumulated wealth are automatically allocated, include a regular rebalancing mechanism reflecting the predetermined schedule or profile selected by the employee.

## The three phases of a PERCO



## Example sensitivity reduction schedule – Moderate profile



## Life-cycle management of PERCO company pension savings schemes

The two main approaches to life-cycle management

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# 1 Life-cycle management based on fund switching

The custody account keeper applies the risk sensitivity reduction schedule to employee portfolios.

## 1.1 Life-cycle management based on switching between “pure” funds

One or more allocation schedules covering several funds are drawn up for each beneficiary according to risk appetite and target returns.

This method uses “pure” funds, which generally represent three main asset classes, i.e. one equity fund, one fixed income fund and one money market fund.

The mix is managed according to a pre-arranged schedule (typically annual) to gradually reduce risk. A percentage of savings is moved yearly from the equity fund into the fixed income fund and then into the money market fund.

To avoid allocation discrepancies relative to the schedule, caused by fluctuations on financial markets, the mix is corrected during the year by rebalancing assets between the funds on a monthly or quarterly basis.

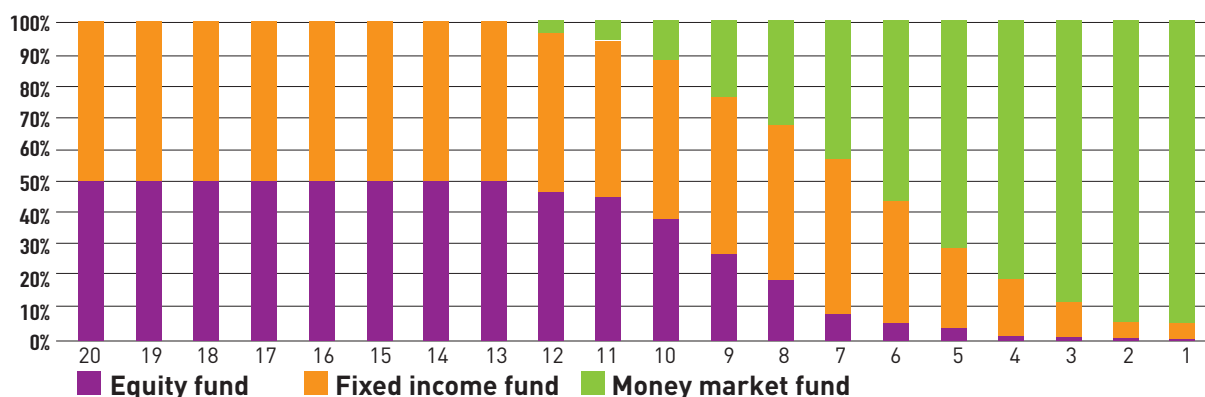
Depending on the contract signed for the PERCO, the schedule may be reviewed regularly, for example every three or four years, if long-term return assumptions are changed. In this case, PERCO signatories must give their agreement.

### Sample allocation schedules

#### Example A :

*In this example, savings are distributed between cash, fixed income and equity assets over a 20-year horizon. There is an equal mix of equities and bonds from the start of the period and up to 13 years before retirement.*

*Twelve years before retirement, sensitivity is reduced by increasing the money market fund's share while reducing the share of the equity fund. The fixed income component begins to be reduced seven years before retirement, while the money market fund's share goes up.*



*In this example, we see that as the retirement date approaches, the shares of the fixed income and equity funds shrink but do not disappear completely. These classes continue to make up a small share of the mix in order to boost returns slightly at the end of the period.*

### Life-cycle management of PERCO company pension savings schemes

The two main approaches to life-cycle management

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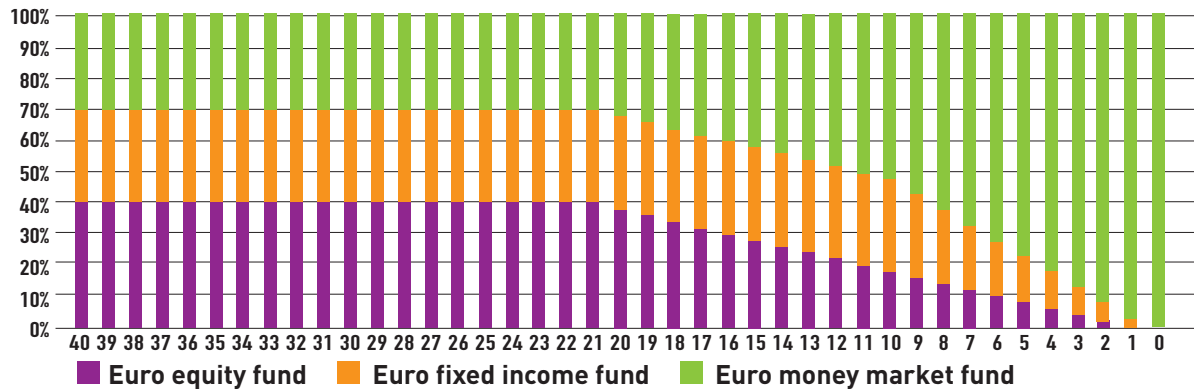
### Example B

*In this second example, savings are distributed between cash, fixed income and equity assets over a 40-year horizon. Under the proposed allocation, between 40 and 20 years prior to retirement, a significant proportion (one-third of the mix) is invested in money market products to reduce the overall volatility of the proposed allocation and provide security.*

*The proportion allocated to the cash component goes up approximately 20 years prior to retirement, first by reducing the equity fund's share, followed later – eight years before retirement – by the fixed income fund.*

*Here, the accumulation and sensitivity reduction phases follow a different path compared with the previous example, and the mix is 100% cash by the end of the PERCO lock-up period.*

### Conservative profile



In the two examples above, assets are heavily invested in money market products in the last three or even five years, so that, in the years leading up to retirement, the employee's investment is less and less sensitive to movements on at-risk markets (equities and long-term bonds). Thus, as the forecast retirement date approaches, the employee gains a more accurate idea of the lump sum or annuity he or she can expect.

## 1.2 Life-cycle management based on switching between balanced funds

An allocation schedule covering a range of three or four balanced funds, each offering a pre-defined risk/reward profile, is drawn up for each beneficiary. Funds are combined over time to mitigate risk, based on the principle of successively switching out of the riskiest fund and into the safest one as the retirement date nears.

According to a set frequency, the employee's savings are gradually moved from one fund into another whose strategic allocation is appropriate for the remaining duration. In some cases, a percentage of the payments or capital is invested annually in the lowest-risk fund. In other cases, all the savings may be switched at a pre-arranged date out of one fund and into the fund with the least risky profile. However, the more gradual the switching process is, the more that market effects are smoothed out.

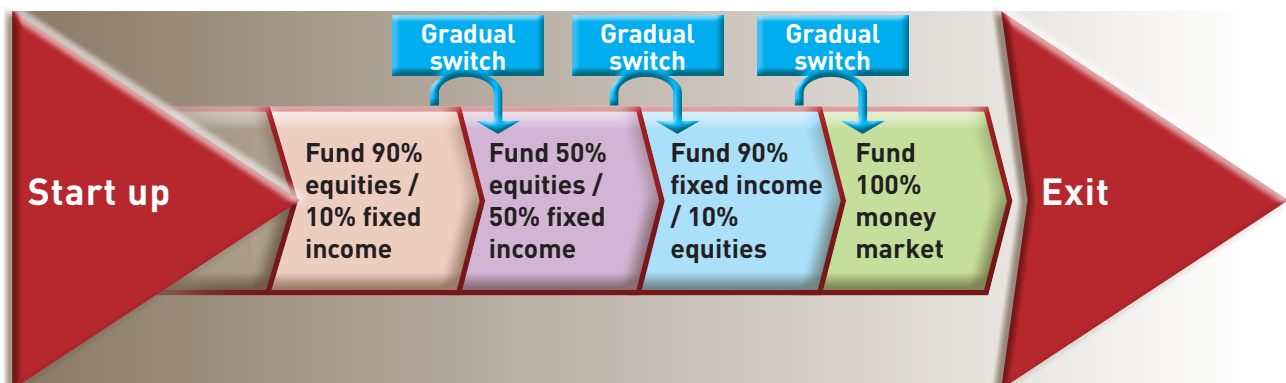
### Example of management based on switching between balanced funds:

*Example of management based on switching between balanced funds:*

- *aggressive – 90% equities / 10% fixed income,*
- *moderate – 50% equities / 50% fixed income,*
- *conservative – 90% fixed income / 10% equities,*
- *100 % money market.*

*Based on the employee's age when the PERCO is opened, savings are allocated to one or two funds and then gradually switched to the less risky fund.*

**Example of a PERCO managed by switching between funds with different profiles**



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### Life-cycle management of PERCO company pension savings schemes

The two main approaches to life-cycle management

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## 2 Target-date (or “generation”) funds

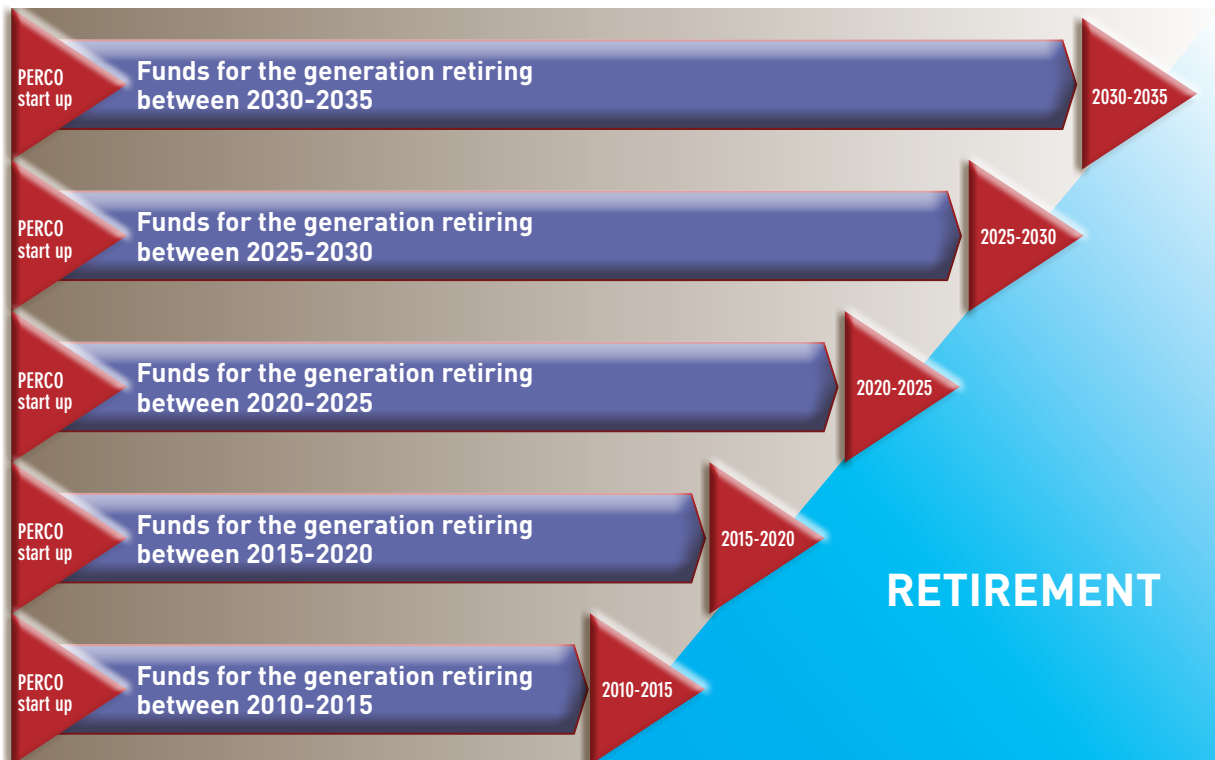
Employees invest in just one fund with a set horizon, with management tailored to that generation of investors. Each “generation” invests in “its” fund. This is the fund that will stay with the employees in that age bracket until they retire. Maturities for target-date funds may be spread over time, usually at three- to five-year intervals.

The fund’s asset mix changes based on the remaining investment horizon: when the horizon is far off, the allocation can be riskier; but as the horizon draws nearer, the fund invests more in safer assets.

Employees select the fund that corresponds to their age and planned retirement date. Each fund is designed to manage a risk/reward allocation based on its maturity. Therefore, throughout the life of the PERCO, employees should preferably stay with their initial choice of fund until it matures. That said, it is always possible to switch into other funds maturing earlier or later, depending on the terms and conditions of the agreement.

For example, a set of target-date FCPEs might comprise funds managed to the following horizons:

- 2010-2015
- 2015-2020
- 2020-2025
- 2025-2030
- and beyond.



### Life-cycle management of PERCO company pension savings schemes

The two main approaches to life-cycle management

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# Comparing different life-cycle management methods

## 1 Life-cycle management based on fund switching

### 1.1 Method 1: life-cycle management based on switching between pure funds

**Advantages:** the principle is simple; the provider uses pure funds to follow the allocation, switching, adjusting and rebalancing the employee's assets. Risk sensitivity is reduced regularly and gradually. The employee can choose between several types of schedule.

**Points to watch:** allocation schedules are pre-determined contractually and hard to change. The management company does not have much room to manoeuvre for tactical allocation.

### 1.2 Method 2: life-cycle management based on switching between balanced funds

**Avantages:** the same as for Method 1 but with greater flexibility in asset allocation.

**Points to watch:** the principle is harder to explain to employees because each individual's allocation has to be broken down between different balanced funds to recreate the mix of pure asset classes. The sensitivity reduction method may be smoothed to a greater or lesser extent.

## 2 Target-date funds

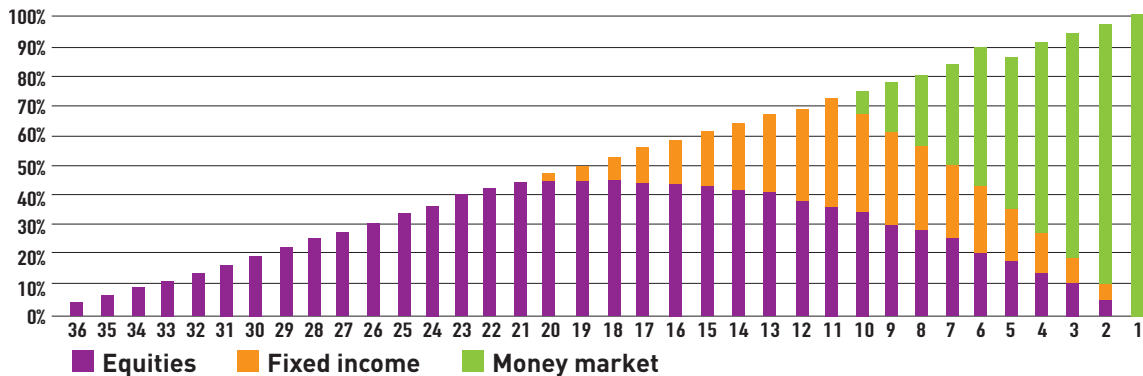
**Avantages :** the principle is easy to explain to employees, who theoretically do not have to change funds for the entire duration of the PERCO. The management company has more flexibility in fund management: allocation changes are provided for in the fund bylaws, not in the agreement governing the PERCO.

**Points to watch:** a fund has to be created for each "generation" in three- to five-year tranches, making it necessary to create a new fund regularly for each new generation. This technique thus requires a sufficient level of assets under management. The PERCO agreement has to be regularly updated based on the new funds created.

The employee is not usually able to choose between different risk profiles.

# PERCO accumulation effect

Example of asset distribution based on regular payments



Another way to demonstrate how capital is built up (not including market effects) is to decompose the payments accumulated over time according to the allocation of accumulated savings to each asset class. We see that, depending on the mix, a given allocation schedule will cause the position in each asset class to gradually accumulate and then reduce. Note also that certain periods feature maximum exposure to an asset class and may hinder proper wealth accumulation if they coincide with a disruptive market event.

Gradually reducing sensitivity is crucial to cope with market shocks. If the stock market crashes 20 years before the employee retires and if sensitivity is slashed after the crash, the employee’s capital will be severely and lastingly impaired. The same would be true if bond markets were to collapse ten years prior to retirement.

But to be effective, gradual sensitivity reduction relies on regular payments by the employee. Regular accumulation will pay off for employees over time, whether they opt for a self-directed or life-cycle solution.

So in the case of PERCOs, which are long-term investments where the time factor is hugely important, it is vital to urge employees to make regular payments.

By making small, regular payments, employees smooth out market fluctuations over time. If they make all their payments at one date, they might invest at the wrong time, when markets are peaking.

This recommendation is especially important because it is not always easy to maintain regular payments. The unpredictable nature of career paths can mean that employees find themselves unable to keep up regular payments into a long-term savings plan such as a PERCO. Also, profit-sharing and bonuses vary over time depending on company performance. Regular payments by direct debit, offered by all providers, can ensure that payments are made on a routine basis.

4) By the same token, when markets are rising, the employee’s capital will increase sharply in value



## Golden rules for saving in a PERCO

### → Determine your plans and set your goals

In most cases, savings accumulated in a PERCO are intended to be used as supplemental income when the employee retires. But since home ownership is a key consideration when preparing for retirement, PERCO funds can also be used to make a down-payment on a home. If the employee embarks on a clearly identified project, he or she will have to find the solution that fits best with their investment horizon and risk tolerance.

### → Take your investment horizon into account

Each financial instrument has a recommended investment horizon. The basic rule is to respect those recommendations. Employees who opt for self-directed management must take their own horizon into account. If they choose life-cycle management, the asset allocation schedule will automatically be calibrated on the investment horizon.

### → Assess your risk profile

Risk tolerance – the ability to put up with market fluctuations – varies from one saver to another. To accommodate that diversity, PERCOs generally offer several types of schedule, e.g. conservative, moderate and dynamic. Employees must make their choice based on their own degree of risk tolerance.

### → Stick to your initial goal

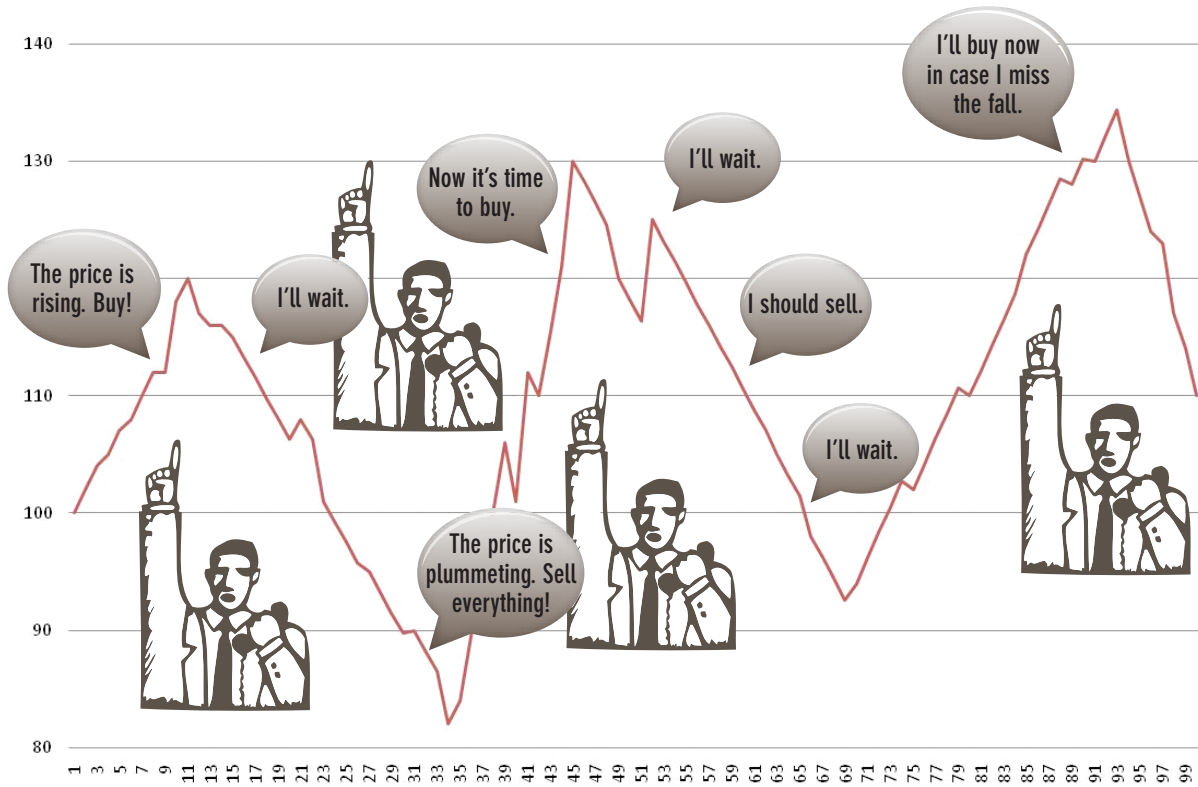
It is more efficient for long-term savers to adhere to their initial choices than to change investment vehicles too often. If those choices have been carefully thought out, and if the investment objective and horizon are unchanged, it is wise to stick with them rather than risk going against the market – in other words, buying or selling at the same time as everyone else.

Switching out of one investment into another that performs better over the short term can be counter-productive, since past performance is no guarantee of future returns.

### → Smooth your investments, specially during turbulent periods

Making regular payments is a way of smoothing the impact of market fluctuations. Some investments are made at the top of the cycle, others in the trough. All in all, these market effects are smoothed out.

Pitfalls to avoid:



The AFG thanks all the members of the working group who contributed to this guide, especially **Luc PEYRONEL** and **Pierre SCHERECK**, the co-chairs, and the facilitators:

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