

Tolley's Pensions Administrator's & Trustee's Newsletter

contents

News 1
In-house or Outsourced?
Weighing the Benefits 2-3
Latest Developments 4

The News and Latest Developments featured in this newsletter are supported by Current Awareness from Lexis®Library

News in Brief

- Liberal Democrat MP Steve Webb has been appointed as Pensions Minister. Mr Webb was the Liberal Democrat spokesman on work and pensions between June 2001 and May 2005, and returned to the role in January 2009. His appointment as Pensions Minister follows that of Conservative MP Iain Duncan Smith as Secretary of State for Work and Pensions in the new Coalition Government. Mr Duncan Smith served as Leader of the Conservative Party between September 2001 and November 2003.

- HMRC has published new versions of four contracted-out pensions guidance booklets: CA14C, CA15D, CA14E and CA16A. The first three cover the following contracted-out schemes: salary related; money purchase; mixed benefit and the overseas elements of these three. The fourth updated booklet is for Appropriate Personal Pension Schemes.

Coalition's Programme for Pensions

The new Coalition Government between the Conservative Party and the Liberal Democrats has published a document setting out its future programme.

Entitled *The Coalition: Our Programme for Government*, it contains a section on pension issues, which gives the following details:

- 'We will restore the earnings link for the basic state pension from April 2011, with a "triple guarantee" that pensions are raised by the higher of earnings, prices or 2.5%.

- We will commit to establishing an independent commission to review the long-term affordability of public sector pensions, while protecting accrued rights.

- We will phase out the default retirement age and hold a review to set the date at which the state pension age starts to rise to 66, although it will not be sooner than 2016 for men and 2020 for women. We will end the rules requiring compulsory annuitisation at 75.

- We will implement the

Parliamentary and Health Ombudsman's recommendation to make fair and transparent payments to Equitable Life policy holders, through an independent payment scheme, for their relative loss as a consequence of regulatory failure.

- We will explore the potential to give people greater flexibility in accessing part of their personal pension fund early.

- We will protect key benefits for older people such as the winter fuel allowance, free TV licences, free bus travel, and free eye tests and prescriptions.

- We will simplify the rules and regulations relating to pensions to help reinvigorate occupational pensions, encouraging companies to offer high-quality pensions to all employees, and we will work with business and the industry to support auto enrolment.

The Chancellor, George Osborne, has confirmed that there will be an Emergency Budget on Tuesday 22 June.

Pension Membership Continues Decline

Only half of employees in the UK are now in pension schemes run by their employers, according to the Office for National Statistics (ONS).

The latest chapter of the ONS publication *Pension Trends* says that membership of company pension schemes has continued to fall during the period from 1997 to 2009, with the proportion of employees in pension schemes run by their employers down from 55% to 50%

Within that, the proportion of employees in salary-related

pension schemes fell from 46% to 33%, whilst those in defined contribution schemes also fell, from 9% to 6%. However, this was partly offset by a rise in the proportion paying into group personal pension plans (up from 1% to 6%) and those in stakeholders' schemes, who amounted to 4% of all employees.

According to the ONS, there were nine million people paying into company schemes in 2008, down from the peak of 12.2 million in 1967.

2012 Pension Review

Steve Webb, the Pensions Minister, is reported to have announced a review of the 2012 pension reforms. The review, to take place over the summer, will look at 'whether the scope [of automatic enrolment] is right and whether the delivery mechanism [for personal accounts] is right,' Mr Webb said. The review will also examine whether to exclude some of the smallest employers from the auto-enrolment duty, and scrutiny of the contract with Tata Consultancy Services to administer NEST. The contract has a break clause which could be invoked to come into effect this October.

Tony Bacon, Lane Clark & Peacock, commented:

'This is an important and intriguing development for a number of reasons. The main purpose of the review is to examine whether to take out of the scope of auto-enrolment those individuals who would see no real gain thanks to reductions in their means-tested benefits as a consequence of having been auto-enrolled. This has been a long-standing concern recognised as an intrinsic problem with the 2012 reforms.'

'Combined with the concerns about NEST implementation and the fiscal background, it is starting to look as though there is the real possibility that the Government may run out of time before 2012, so we could be looking at yet another deferral. This may not necessarily be a bad thing for employers though, for whom it is still very much "game on" in terms of planning.'

In-house or Outsourced?

Weighing up the Benefits

Rob Bridgewater, Senior Associate at Muse Advisory, looks at the issues to consider in whether or not to outsource a pension scheme.

Anecdotal evidence from the pensions industry suggest that some very large pension schemes are now considering outsourcing administration to a Third Party Administrator (TPA): even only five years ago, it would have been inconceivable for them to do so. What factors have changed so that they are now deciding whether or not to remain in-house?

It is the changing nature of DB pensions in the UK that has caused this, and this article attempts to identify and understanding the specific reasoning behind administration sourcing strategy. It focuses on the issue of whether or not to continue with an in-house administration department, and doesn't therefore cover the performance management issues often associated with changing TPAs. On rare occasions, a scheme's trustees will 'insource' the scheme from a TPA. Although unusual circumstances tend to precipitate such a decision, the factors in this article are still relevant.

What prompts such a decision?

Some trustees regularly review administration strategy as part of their governance procedures. Trustee bodies that have delegated oversight to an operations or administration committee often ensure this is part of its terms of reference. While this is a wise thing to do, in my experience, it tends to occur more often when administration has already been outsourced. The review also tends to focus on the cost, particularly when some kind of benchmarking is carried out.

Generally though, a review of administration arrangements is normally prompted by a specific issue, and this usually means the trustees have to act reactively; consequently, it may reduce the number of

options available. These are the typical scenarios:

- A corporate decision. This may take be prompted by de-risking (buy-out, buy-in or longevity swaps); the physical closure of the pensions administration office; or a decision effectively to resign as scheme administrator, perhaps according to its core business activity policies. We have become aware of corporate decisions to use a global outsourced HR provider, including pensions administration. In those situations, trustees need to reassure themselves of such a provider's suitability for the job.
- Support ceases for a legacy system, or the need for a new system becomes urgent. This is a common reason, and the significant resources, cost and risk associated with installing a new system rightly prompts the trustees to consider future provision.
- Systematic failures emerge. Such errors instantly bring administration to the top of the trustee agenda. Substantial disclosure breaches or calculation mishaps normally betray issues that require a lot of effort to resolve.
- Failure of in-house teams to change. If the pensions team is squirreled away in some remote corporate office, cultural shifts in the scheme and the business may pass them by. A need for better technology or greater efficiency may prompt a review of the administration team.
- Retirement of a key staff member. Many pension administration departments rely on the encyclopaedic knowledge of one or two long-standing members – their retirement or resignation can often reinforce a decision to review administration.

If trustees properly anticipate events such as these, they will be in a position to

open up as many future solutions as possible. If these are the factors that prompt the need for a decision, which are the main factors that need to be considered to help decide future administration strategy?

Strategic factors

If the sponsoring employer has effectively resigned its role as pensions administrator, then a review of corporate strategic factors may be concluded quickly. Trustees should consider the general corporate outsourcing attitude: will it have any appetite for retaining administration in-house, and invest resources and money in upgrading the service?

A corporate pensions de-risking strategy will have a major impact – an impending buy-out will require both an extensive data cleanse and a transfer of the administration – buy-ins and longevity swaps still require the data cleanse, which may either be provided as part of a transfer of administration to a TPA, or by way of an administration data specialist.

Lastly, if a final salary scheme is closed and replaced with a contract-based DC scheme, it is often only a matter of time before the scheme administration is outsourced.

Trustees will often have their own strategic view. A data quality issue that might have a buy-in impact for the employer, will also have one for the trustee. The Pensions Regulator's focus on record-keeping may drive the trustee to take sourcing decisions for it to continue to work within regulatory guidance.

On rare occasions, trustees have decided to set up a directly managed administration service where the employer no longer wished to provide it. This is worth considering, but this puts the



trustees in the role of employer, systems contractor and property manager alongside managing the scheme for the members' benefit.

It may be that there are still a number of active members of the pension fund, and that the sponsoring employer is very happy to continue in-house administration. In such a case, there is every reason to continue doing so: it can maintain a pension scheme culture that matches the employer; administrators can be more motivated by providing administration services for colleagues, and it can be the cheapest solution. A well-run in-house arrangement can be very cost-effective indeed.

Making an administration decision is normally long term, so trustees are obliged to look at the corresponding medium to long pensions strategy factors as a first step towards making a sourcing strategy.

Capacity factors

Assuming the sponsoring employer and trustee are both ambivalent about in-house or outsourced provision, what other factors should be considered?

- Staff **capability** – if a major transformation of the service is required, trustees need to ask whether or not the administration team is capable of making and delivering the transformed service. Is there sufficient project management capability? Are there the people who can write calculation pro formas, set out workflows and determine new processes?

- Are there the **facilities** available? Is the TPA market deluged with new business which risks swamping providers with the requisite installation work, restricting capacity? Are TPAs able to recruit high calibre staff in sufficient numbers? The issues are similar for in-house arrangements: is there a physical location that is suitable? Is there a good supply of suitable staff? Is there a specialist firm that can help with the transition?

- What is the appetite for **risk**? Would a transition to a TPA provide more risk than the trustees would be happy with? Would the status quo allow acceptable risk? Some form of risk analysis ought to underpin a sourcing decision; with a recent client we found that cost and benefits were the same

across three potential solutions, but the risk of the service remaining unchanged presented most risk.

- What are the **governance** arrangements? If the scheme is outsourced, would this require a change in the way governance is delegated? Our firm has encountered two large schemes where the sponsoring employer has delegated the administration to a TPA, the choice of which the trustees have no formal veto over. Is this a suitable model? and are the agreements in place to facilitate this? Would any of the potential sourcing approaches require an unacceptable mode of governance by the trustee?

- **Costs** may be a factor in deciding between two external administrators but tend not to be a factor in making a decision over whether or not to outsource, unless current costs are unbearable high. Are the trustees willing to pay the cost of a transformed in-house service? A TPA is able to fully or partially amortise such costs over the life of a contract, which might or might not be attractive. Trustees and sponsoring employers frequently wish for lower cost 'undulation', in which case outsourcing, or some clever systems rental solution, will be required as well as some diligent contract negotiation.

Administration end state

Trustees and their sponsoring employees need openly to consider both the strategic and capacity factors set out above. It is also helpful to consider where the future might lie: the different types and models of administration service.

Some trustees conclude that maintenance of the **status quo** over the following 5-10 years, with some service transformation to a greater or less degree, is most acceptable. If an administration service is cost-effective, low risk and beneficial for all members, there should then be no imperative to outsource.

An alternative in-sourced arrangement is the HR Shared Service Centre (**SSC**). Some sponsoring employers have decided to locate all HR services in one 'centre of excellence'; the sponsoring employer is often keen for this arrangement (including costs of SSC investment) and the team can still be close to a pensions manager; in

practice, it tends to be a halfway house between being under the pension manager's nose and outsourcing.

Some TPAs will offer to '**contractorise**' or undertake a full TUPE transfer of a pensions administration department. This keeps scheme knowledge within the team, and transfers much of the transformation risk, as well as providing the TPA with a new office location. The downside is that an 'in-house' mentality frequently remains: fine for well run services, but less helpful for scheme administration in need of significant improvement.

Even if the trustees and employer agree to outsource the administration, there are alternatives. **Partial outsourcing**, alongside systems provision to the remaining in-house team (perhaps focused on actives) appears to offer the best of both worlds. It is unlikely to be inexpensive, however, and capability is required both to manage an in-house team, and contract manage the TPA. The complexity of administration will increase because of the additional interfaces between the two teams.

Full outsourcing offers, superficially at least, many advantages: lower transition risk, predictable cost; expertise on tap; staff availability for high workload and access to best practice administration. There is a trade off, though: outsourcing helps to sever the link between fund and employer; the TPA focus is on a profitable contract before member satisfaction, and inevitably some compromise has to be made on service delivery. In addition, when the TPA fails to perform to expectations, it can be frustrating to get service back up to requirements – the levers of power are fewer.

Although the potential factors and outcomes are reasonably numerous, the experience at our firm is that trustees and their sponsoring employers are presented with only one or two realistic options for future pensions administration sourcing. It is helpful to consider all the options and factors, however briefly, at least to ensure that the obvious choice is still the best one. Whether or not companies may concur with their aims, trustees must remain wisely focused on acting for the benefit of scheme members – administration is often the only interface that members have with their scheme.

Latest Developments

Date	Description	Date	Description
02/06/10	The Pensions Regulator has published new guidance on record-keeping. The final guidance sets out a strengthened approach that includes: recommending specific targets for standards of common data; using regulatory powers to investigate standards within schemes, including sampling schemes for data audit; potential enforcement action where there is a breach of legislation; setting a deadline of December 2012 for the resolution of outstanding data issues; and enhancing the education material on its website. Revised guidance on winding up occupational pension schemes has also been published.		the growth in this expectation gap since the last survey six years ago. The equivalent calculation from 2004 put this at £0.8 trillion, meaning that the gulf between expectation and reality has grown by 50% over the last six years.
26/05/10	Final salary pensions have surged to second place in the list of corporate risks, now ranking behind only the market environment as the biggest risk facing employers, according to new data from Aon Consulting.	19/5/10	Figures from HM Revenue & Customs show that the amount of money paid into personal and stakeholder pension plans fell by £1.1bn during the recession. Employers, employees and the self-employed paid £19.7bn between them into personal and stakeholder pension plans in 2008/09, down from £20.8bn in 2007/08.
20/05/10	Defined contribution pensions require significant re-engineering if they are to better serve millions of individuals worldwide who were exposed to its failings during the financial crisis according to a Towers Watson publication. The publication, entitled 'Journey Well, Arrive Better', looks at why employees have felt the full force of investment risks and the many weaknesses which fiduciaries need to address to restore trust in defined contribution schemes.	19/05/10	Bob Summers, Chair of the Pensions Panel of the Chartered Institute of Public Finance and Accountancy (CIPFA), gave a warning at the National Association of Pension Funds Local Authority conference. Mr Summers told the conference that in 2008/09 public servants contributed more than £8bn to their pension schemes, a sum which was effectively used to pay the pensions of today's public sector pensioners, which would need to be paid from the public purse were the schemes to close. Ways to reform public pension schemes to make them affordable could include raising the retirement age and increasing employee contribution rates.
19/05/10	Hewitt Associates has published the results of its second omnibus survey on attitudes towards saving for retirement in the UK, which reveal a stark gap between individuals' expectations regarding their income during retirement and the likely reality. Hewitt has calculated the gap between current behaviour and the likely reality as £1.2 trillion – equivalent to 80% of the UK's GDP in 2008. This is based on the current level of contributions to a non-state pension, expected age of retirement and individuals' prediction of their level of pension income. Equally alarming is	12/05/10	Punter Southall reports that despite positive trends in the latest insolvency statistics released by the Insolvency Service, the risk of sponsor insolvency remains a reality for UK pension schemes.
		12/05/10	The cost to companies of transferring their pension scheme risk to an insurer looks set to rise as demand starts to outstrip supply, according to LCP Pension Buyouts 2010 published by Lane Clark & Peacock LLP.
		11/05/10	The Pension Protection Fund says that the funding position of the UK's defined benefit pension funds worsened in April 2010, to a deficit of £2.2 billion.

Editor Nigel Voak
Publishing Operations Director Nicola Briggs
Tel (editorial) 01865 751341
Tel (customer services) 020 8662 2000
Fax 020 8662 2079
E-Mail (editorial) nigel.voak@lexisnexis.co.uk
E-Mail (customer services) csd.th@lexisnexis.co.uk

Published by LexisNexis, a Division of Reed Elsevier (UK) Ltd, Halsbury House, 35 Chancery Lane London WC2A 1EL and London House, 20-22 East London Street, Edinburgh EH7 4BQ. All rights reserved. No part of this publication may be reproduced, stored in a retrieval system, or transmitted in any form or by any

means, electronic, mechanical, photocopying, recording or otherwise, without the prior permission in writing of the publishers. Printed by Windsor Print Production Ltd, Tonbridge, Kent.

© Reed Elsevier (UK) Ltd 2010.

ISSN 1742-0393

