The Challenges of Administration in the DC Environment

It can’t be that hard…..can it?

Many do not understand the complexities of Defined Contribution administration. Because it so systems driven by its nature, the thought is that you just…press a button.

DC pensions are the younger sibling of DB schemes

- **Defined Contribution suffers from the ‘middle child’ syndrome – there are hand-me-down rules and regulations from Defined Benefit.**
- **Defined Contribution is akin to a savings account.**
- **Many of the rules governing Defined Contribution have their roots in the methodology and thinking that went into Defined Benefit.**
  - Governance structure and Trustee Annual Report
  - Retirement process – an over reliance on the methodology that underpins DB retirement calculations
  - Adequacy – there is a general lack of understanding of what Defined Contribution means amongst members
- **There is a lot more day to day administration involved in running a Defined Contribution pension plan than there is in a Defined Benefit.**
  - Joiners and leavers
  - Contributions
  - Refunds and transfers
  - Investment switches
  - Member queries

- Treasury and bank account reconciliations
- Unit reconciliations
- Administration Reports
- Trustee meetings
- Redundancy and PAOs

Monthly processing

- **Adding new pension members to the pensions system**
  - A reliance on timely data from the employer that is both correct and also complete.
  - Thankfully someone thought of the need for a ‘default’ fund or strategy.
  - Preparation of welcome packs with SoRPs, introductory letters and online access provision.
  - Any data that is missing or inaccurate leads to delays

- **Monthly contributions**
  - Accuracy is key to ensuring the scheme runs smoothly.
  - Ensure that funds received match the contribution schedule.
  - Provide a split of the funds to the investment managers and arrange fund transfers

- **Leavers**
  - Process the previous month’s leavers.
  - Refunds for less than 2 years.
  - Transfers for those who request them.
  - It may surprise you that many former members are never heard from again!
- **All of the above is underpinned by our statutory disclosure obligations**

Lets take refunds as an example….

- **Rule of the pension plan is that automatic refunds are made after 3 or 6 months to all members with less than 2 years of service.**
  Picture this scenario:
  - John who's 22, took a job offer in Dublin, moved into a flat with 3 strangers and goes to work.
  - He joins the pension plan as that's what his parents advised.
  - John leaves after 18 months to go travelling to Australia.
  - Registered Administrator is advised of John's departure 3 weeks after he has left. It will be another 3-4 weeks until he is processed as a leaver as there is a final partial contribution to be received on his behalf.
  - A Leaving Service Option (LSO) statement is produced and posted to the address he provided during his employment – the flat. In addition to that, his only e-mail address was his work e-mail.
  - The LSO is never seen again – 3 months later an automatic refund is to be issued.

The problem with that is….

- **Refunds are made via cheque as bank account details are not taken at exit interview**
- **Where's John?**

- **When rules are put in place for a scheme – ensure that the rules can be put into practice effectively!**

Online Pension Accounts – a double edged sword

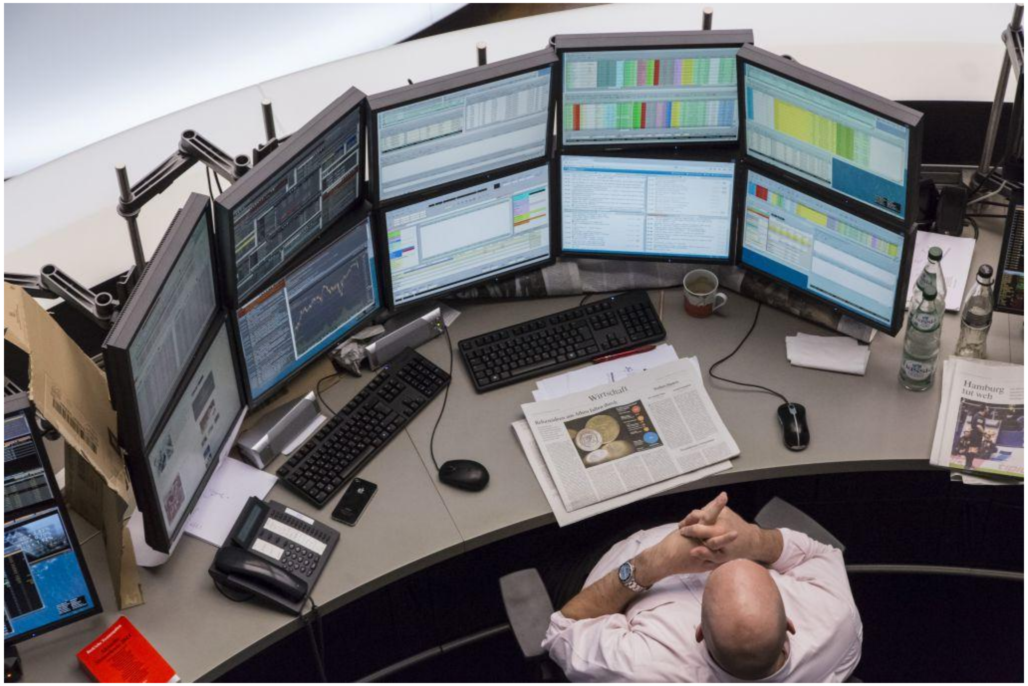
- **Online pension access allow members to review their pension plan progress and make a variety of changes including:**
  - Switch funds
  - Update their personal information & add beneficiaries
  - Raise queries with the scheme administrator
  - Allows deferred members to retain a level of control of their fund
  - Reduces the number of queries and allows members to keep track
  - Provision of Trustee/Employer access

- **Usage by members varies from 14% to 57% of active members across schemes**
  - No discernible patterns from one scheme to the next as to reasons for variance.

- **Online access for members can substantially increase workloads**
  - Depending on the company and the time of year, workloads trends can change substantially
  - Allocation of member allowance for benefits for example
  - The dreaded 'I forgot my password' or 'I locked my account' e-mails

Online Pension Accounts – a double edged sword

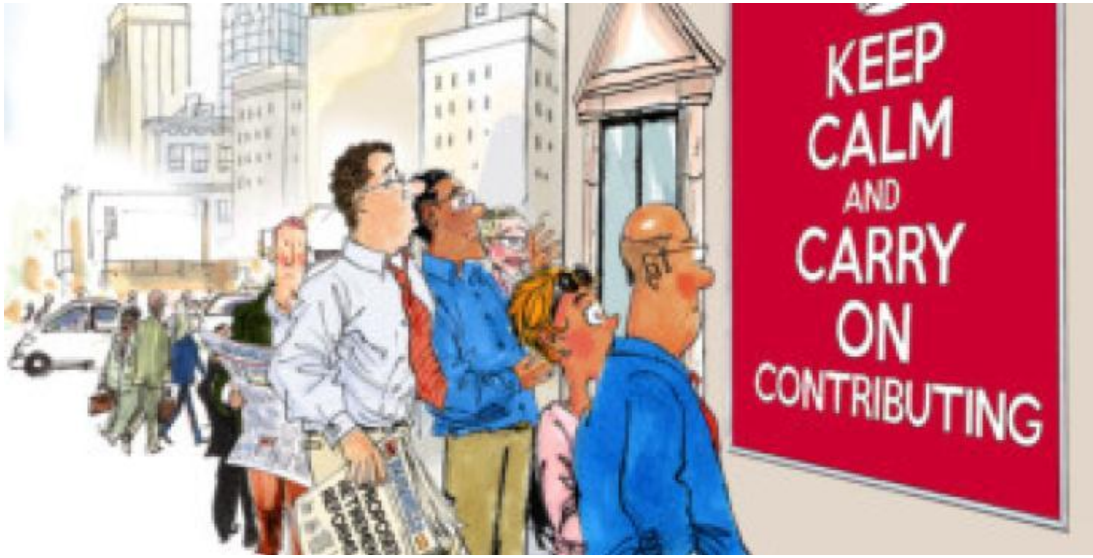
- **Members become overly worried about their fund value – it becomes the centre of their attention**
- **Taking last month as an example – the top 10 users online go from:**
  - 19 logins in the month
  - up to 82 logins
  - Some members treat their DC account like a share trading account
    - switches from members that are so frequent, the previous switch is still being processed!
  - Can be mitigated by straight through processing



- **This leads to members taking the view that when the value of the fund has decreased, they have physically ‘lost’ money.**

Online Pension Accounts – a double edged sword

- **Take for example a member who's fund has fallen in value by 17% and the value is now less than the sum of the contributions paid in. He's invested 100% in equities.**
  - The first thing they do is panic
  - Switch instruction is received to move 100% into cash or bonds as they are the 'safe' bet
  - Do a quick check of the member and you realise he's 26 years old
  - Perhaps a quick phone call is in order!
  - But where does education end and advice begin?



Challenges of investment switches

- **The increasing complexity of Lifestyle strategies**
  - Some are now based on a High/Medium/Low risk path to either Pension/Cash/ARF options at retirement – that make 9 different strategies.
  - Systems need to cope with this.

- **Where you have multiple investment managers, you in turn have out of market risk**
  - Money in transit between investment managers – you run the risk of missing gains or incurring losses.
  - Investment managers based in different countries – you're only as quick as the slowest manager.

- **Changes to investment manager**
  - As you're dealing with member funds directly, a clearly laid out plan is required.
  - Funds must be switched with minimal delays and quite possibly pre-funded.
  - Not like a DB scheme asset movement.

The systems

- **System are becoming more sophisticated and have moved away from the ties to DB based systems.**

- **The aim is to have zero manipulation of client data in order to load it to the pensions database however we do come across some common errors**
  - Negative contribution amounts
  - Recycled staff numbers
  - Inconsistent data from different company locations

- **The pension database must be flexible and agile**
  - Must be able to handle different data set formats from various clients
  - Lifestyle strategy – movement away from the typical 75:25 Bond and Cash split at 65
    - Schemes are getting more adventurous with lifestyle strategies
  - Support in place to handle changes in legislation – Pension levy and AVC drawdowns for example
  - Provision of real time online access to members/employers/Trustees.

- **Security of the data and retention of correct up to date records**
  - Disaster recovery

Finally – the things we'd like to see

- **Pensions tracing service**
  - The growing problem of deferred members and small pension pots.
- **Pension Adjustment Order & tax free cash entitlement – a central registry.**
- **Simplification of the retirement rules**
  - Job for life is a rarity – member could have 8-10 retained benefits and calculations are complex. Perhaps a different approach to the governance structure on accounts.
- **Simplification of Trustee Annual Report requirements**
  - Audited fund accounts – necessary? Does the approach of looking at the overall fund work?
- **Can member online pension access fulfil the obligation to issue benefit statements and SoRPs?**
  - A SoRP or benefit statement is out of date before it is even printed! Using online, members can plan their retirement in real time by adding in AVCs etc.
- **Straight through processing with all investment managers – the adoption of a common standard.**