The relationship between pension scheme administration and effective scheme governance

A survey by JLT Employee Benefits Limited
and The Pensions Management Institute

JLT BENEFIT SOLUTIONS LIMITED – SURVEY REPORT

Contents

Introduction and Executive Summary

Good governance matters and effective administration is at the heart of any well run pension scheme.

Without the right people, systems and controls to ensure its smooth operation, a pension scheme is destined to deliver a poor member experience, the sponsoring employer will be funding a scheme that is not valued by employees, and resolving complaints and disputes will become a full time occupation for the trustees or managers.

It is against this backdrop that we, **JLT Employee Benefits Limited**, agreed to collaborate with **The Pensions Management Institute** on a continuing research project to explore the relationship between pension scheme administration and effective scheme governance.

We have already published the results of a 'mini-survey' into pension schemes and record-keeping. This followed the publication of The Pensions Regulator's guidance in this area and a reminder of the survey results is provided in the **Appendix**.

The report that follows sets out and provides an analysis of the results of our main survey, which was conducted in the last quarter of 2010 and completed by over 250 respondents.

It is a very timely paper with the Regulator continuing its 'governance mission' and reminding schemes, only last month (February), of the importance of administration(1). The issue of its latest discussion paper on "Enabling Good Member Outcomes"(2) further evidences the importance that the Regulator attaches to pension scheme governance.

The main survey was broken down into a number of distinct areas, looking at current practices and how these may have to change in the future. It covers data quality, communication, decumulation, investments and prospective auto-enrolment requirements.

Key findings across these disparate, but all equally important, areas include:

- *almost one-third have not agreed targets for standards of data and a deadline for achieving those targets;*
- *nearly 40% of schemes do not provide members with access to any pension modelling tools (e.g. retirement benefit calculators) to support their decision making process;*
- *when communicating with members about their retirement options, 81% of schemes tell members about the open market option (OMO) but only 30% facilitate access to advice for members on the OMO;*
- *in terms of the pension scheme admission, over 60% of schemes still require members to apply to join;*
- *many employers have still to make up their minds when it comes to choosing a qualifying pension scheme for discharging their prospective obligations in respect of the auto-enrolment and NEST requirements; and*
- *in terms of the, potentially substantial, costs of complying with auto-enrolment, nearly 85% of schemes have not quantified both the direct (contribution) and indirect (ancillary) outlay that the reforms will entail.*

This small sample of findings is, of itself, interesting and relevant. The full results which follow are equally instructive and sometimes surprising. Our analysis of them clearly demonstrates that, in terms of many pension scheme administration arrangements, there is still work to do.

1. http://www.thepensionsregulator.gov.uk/press/pn11-05.aspx
2. http://www.thepensionsregulator.gov.uk/press/pn11-03.aspx

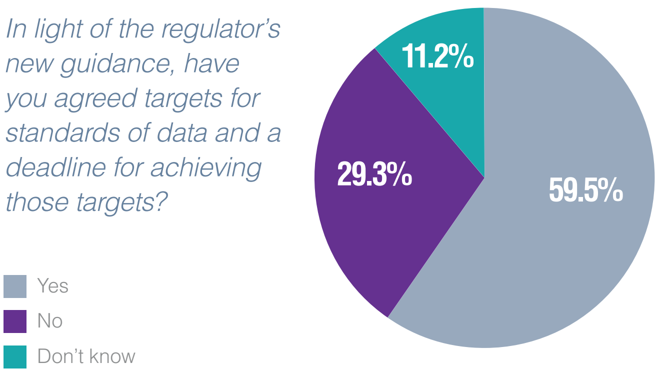
1. Data Quality

With the Pensions Regulator's deadline for accurate Common Data only around 20 months away (3), we start by continuing the theme of our earlier mini survey which was concerned with the quality of pension scheme data and records.

Despite the Regulator's guidance, as well as the threat of more formal requirements if schemes fail to comply with it on a voluntary basis, our survey found that nearly 30 per cent of respondents have yet to agree targets for standards of data and a deadline for achieving them. Worryingly, over 11 per cent 'don't know' whether such targets have been agreed.

Our survey included space for respondents to make further comments and a handful did observe that targets for data quality were *"under discussion"*. One respondent, with a scheme where the first target had already been met, candidly admitted that he considered the second target *"unlikely to be achievable due to difficulties with obtaining addresses and other comprehensive details for 'disappeared' deferreds"*, but there was a "major push to capture all we can". We suspect that this sentiment is in fact shared by many trustees and administrators.

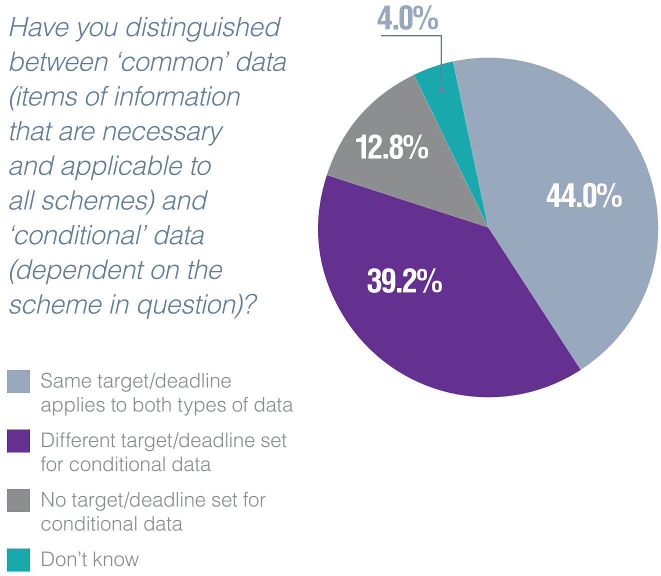
In light of the regulator's new guidance, have you agreed targets for standards of data and a deadline for achieving those targets?



The Regulator's guidance makes a distinction between 'common' data and 'conditional' data, with different guidelines apply to each. When we asked respondents whether they were making the same distinction in their data quality targets and deadlines, we found that schemes were fairly evenly split into those that are distinguishing between the two types of data and those applying the same target/deadline for both. There was also a similar response to the last question in terms of 'don't know '.

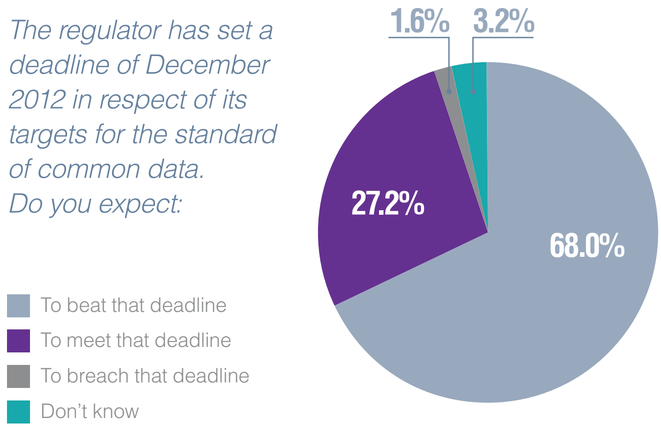
One respondent added *"Most clients do not have the resources – either fees or TPAs or spare resource amongst their own staff – to fill in the gaps in conditional data, so the main focus is on common data"*.

Have you distinguished between 'common' data (items of information that are necessary and applicable to all schemes) and 'conditional' data (dependent on the scheme in question)?

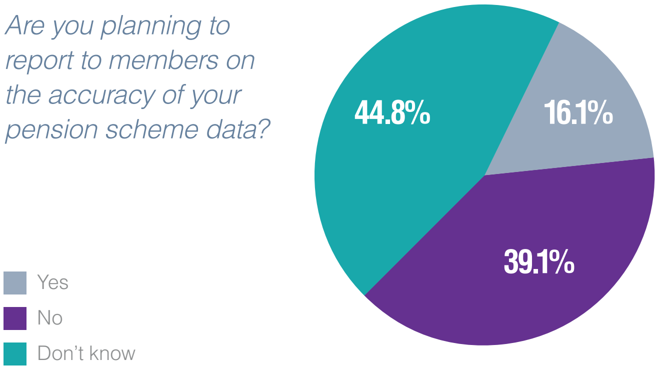


For those that have agreed targets and a deadline, it was reassuring to find that 68 per cent of respondents have set standards that surpass those proposed by the Regulator. However, contrary to the recommendations in the Regulator's guidance, only 16 per cent are going to report to members in the accuracy of their pension scheme data, with one respondent commenting that this is a *"double-edged sword if you do"*.

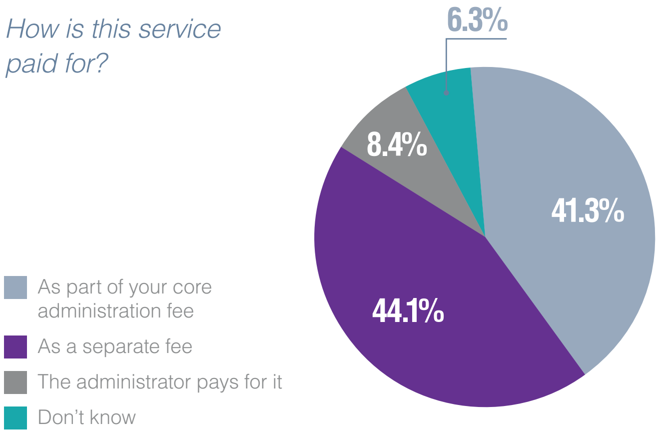
The regulator has set a deadline of December 2012 in respect of its targets for the standard of common data. Do you expect:



Are you planning to report to members on the accuracy of your pension scheme data?



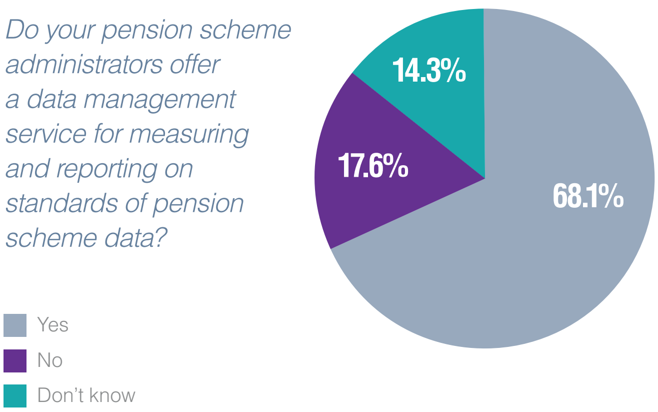
How is this service paid for?



Turning now to the services that some administrators offer to their clients, we found that nearly 70 per cent of schemes have the option of a data management service for measuring and reporting on standards of data. In terms of how this is paid for, there was a near 50-50 split between those who enjoy the service as part of their core administration fee and those who pay a separate fee. However, at least one respondent noted that *"In reality, some of it falls within the core fee and some work would fall outside".*

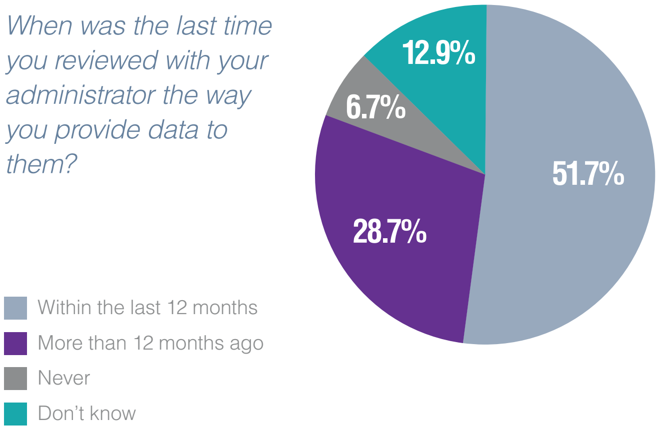
Interestingly, over 14 per cent of respondents do not know whether a data management service is available.

Do your pension scheme administrators offer a data management service for measuring and reporting on standards of pension scheme data?



In our final question on data quality we asked respondents whether they had reviewed with their administrator the way in which they provide data to them and, if so, when. In a positive response, over 50 per cent said they had conducted such a review in the last 12 months. Further, less than 7 per cent of respondents said that they had never reviewed the way in which data is transmitted. Based on the further comments received, this is one area where respondents seem to be content with the processes they have in place.

When was the last time you reviewed with your administrator the way you provide data to them?



3. http://www.thepensionsregulator.gov.uk/guidance/guidance-record-keeping.aspx

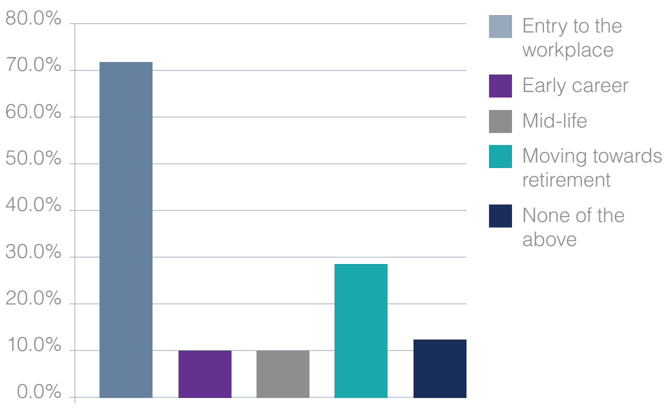
2. Communication

The auto-enrolment reforms, including 'NEST', are addressed in detail in section 5. However, there is also an overlap with this section because, if the objectives of auto-enrolment are to be achieved, through an increase in the number of people saving for their retirement and an increase in the overall level of private pension savings, the Government reforms need to be combined with 'member-engagement' and communication is at the heart of this.

We started then by asking respondents about the stage of working life at which their communication strategy first targets members and were pleased to find that almost three-quarters of schemes target members upon their entry to the workplace. However, there is still a significant minority (28.1%) that have a communications strategy that first targets members only as they move towards retirement (when it can be too late to address under savings and/or poor investment decision-making).

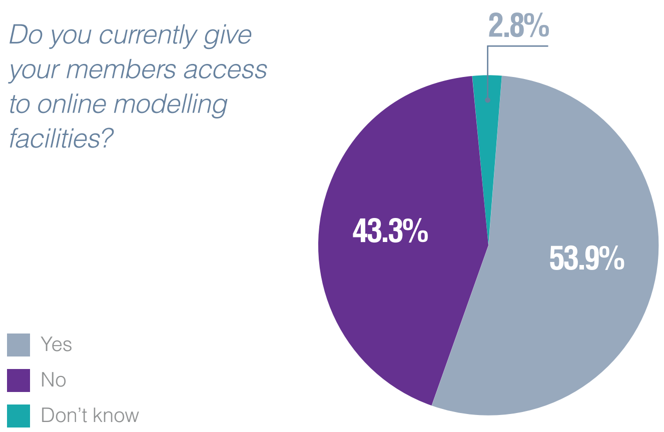
In an example of good practice, one respondent observed that members are *"Targeted specifically when joining, then annually as part of overall communications strategy - newsletters, combined benefit forecasts, etc"*.

At what stage of their working life does your communications strategy first target members?

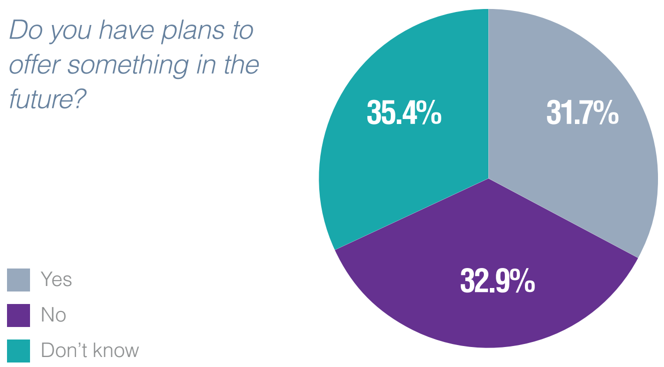


Engagement with members can be further enhanced by providing 'tools' that allow them to model different scenarios (increasing contributions, impact of different rates of return, etc). However, only around 50 per cent of the 178 respondents who answered this question said that they currently give members access to online modelling facilities with 31 per cent of the 82 respondents who skipped the question stating that they had plans to offer something in the future (with one adding that *"But it's at the bottom of the wish list"*).

Do you currently give your members access to online modelling facilities?



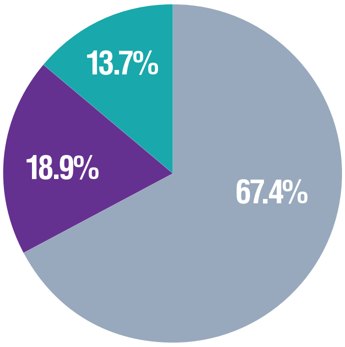
Do you have plans to offer something in the future?



Of those schemes that do give members access to online modelling tools, over two-thirds keep management information on the levels of use. In terms of perception of how members' view the facility, however, over 60 per cent of respondents said there was general apathy towards it and only 17 per cent believe it to be highly valued by members.

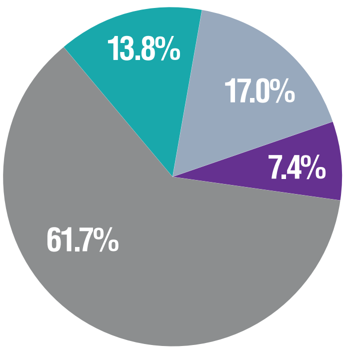
It may be that more needs to be done in terms of member education. It was also acknowledged by one respondent, in a sentiment that may resonate with others that *"We need and are looking to do more to promote the modelling tools"*.

Do you keep Management Information on the levels of use?



- Yes
- No
- Don't know

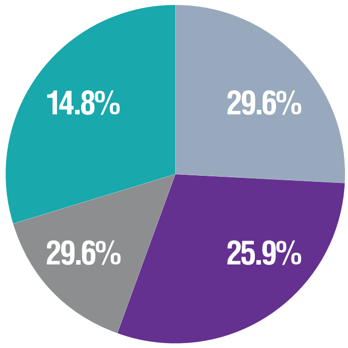
How do you perceive your members' views of this facility?



- It is highly valued by members
- They are too busy to use it
- There is a general apathy towards it
- Other (please specify)

Finally, for those schemes that do not already give members online access to modelling tools, there was a tie for first place in terms of the reasons for this, with 29.6 per cent of respondents saying its was due to cost and exactly the same percentage saying it was because they did not believe it would be valued. The next most popular explanation (25.9%) was that there was no demand from members. One respondent noted that the *"Trustees do not think it should be offered to members"*, suggesting that some may take the view that there are risks involved in the provision of modelling facilities.

Which of these factors is preventing you from giving members on line access?



- Costs of set up
- No demand from members
- Don't believe it would be valued
- Other (please specify)

3. Decumulation

By decumulation, we mean the process by which members, with defined contribution benefits, turn their savings into a retirement income. There is some commonality with the previous section but this process warrants a section of its own for at least two reasons.

Firstly, there is the importance that the Pensions Regulator attaches to the decumulation process. It is featured in their new '*Enabling good outcomes in DC pension provision*' paper mentioned in the Introduction and is a 'key risk' in the Regulator's Internal Controls guidance which was updated last year(4). Secondly, there are the statistics(5) on the 'at retirement' market which, quite frankly, speak for themselves:

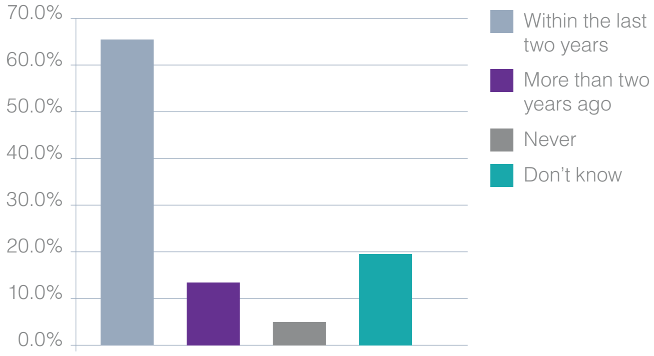
- *in the UK, up to 50,000 members buy an annuity every month;*
- *maturing DC pension funds amounted to £3.7 billion in 2009 and are expected to reach £6.2 billion by 2012; and yet*
- *only 35 per cent of members access the 'open market option', a percentage virtually unchanged since 2004 notwithstanding the fact that the OMO can improve the level of a member's pension by up 20 per cent.*

The same attention needs to be given to 'decumulation' as is given to 'accumulation' (such as the design of default funds and the range of investment options offered to members), but our research has found that there is work to be done if this is ever to become more than just an aspiration.

Communication and education are key and, whilst two-thirds of respondents told us that they had reviewed their scheme's retirement processes and literature within the last two years, there are still over 30 per cent who have not conducted a recent review or don't know when the last review took place. Taking into account respondents with schemes that provide DB benefits, only almost 4 per cent of schemes have never had a review.

In feedback to this question, one respondent did mention that a review was conducted "*a year ago in response to noises from tPR in this area*" indicating that Regulator activity has had some (positive) effect.

In relation to DC benefits, including AVCs within DB schemes, when was the adequacy of your scheme's retirement processes and literature last reviewed?



At first glance, the response to our next question on decumulation might imply that communication with regard to the OMO is very good. This is because over 80 per cent of respondents said that they tell members about the OMO when communicating about retirement options.

However, it must be borne in mind that, for any scheme with DC benefits (including AVCs in DB schemes), it is a legal requirement to give members the opportunity to secure their pension on the open market. Moreover, our survey found that:

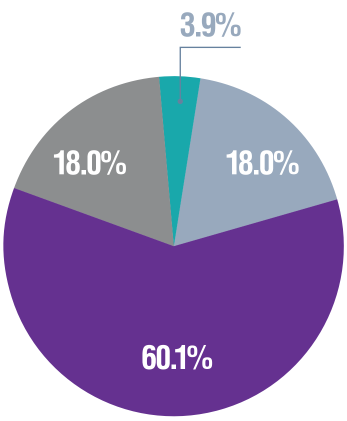
- *less than 14 per cent of schemes encourage the use of the OMO, regardless of fund size;*
- *less than one-third facilitate access to advice on the OMO;*
- *only 20 per cent provide members with combined benefit statements (covering State and private pension benefits); and*
- *just 12.5 per cent of schemes monitor member behaviour with regard to take up of the OMO.*

On the first bullet point, notwithstanding Regulator and FSA attempts to allay fears in this area, a concern still was expressed about the risk of trustees being seen to give advice.

Moving on, when asked about the timing of retirement process communications, only 18 per cent of respondents thought that communication should begin more than one year before retirement date; the majority suggesting 'between six months and one year before', largely in line with legal requirements. Those going beyond the 'letter of the law' recognised the benefits of this with a respondent observing that communication should start "*Ideally 5 to 10 years before with some education sessions and then 6 to 12 months in terms of quotes*".

In terms of communication with members, when do you think the retirement process should begin?

- Less than six month's before a member's expected date of retirement (NRA)
- Between six months and one year before retirement date
- More than one year before retirement date
- Other (please specify)



Finally, on decumulation, in the June 2010 Budget it was announced that the effective requirement to buy an annuity by age 75 would be abolished. Draft legislation for this is contained in the Finance Bill 2011 clauses.

Although very recent, this is a potentially significant development for defined contribution arrangements and not just in relation to high earners. We expect this change to have a material impact on retirement processes in some schemes and, notwithstanding the fact that the provisions are not even on the statute books yet, a significant proportion of respondents appear to agree, with over 30 per cent having already considered the impact on their scheme and others saying that 'it was on the agenda'.

4. http://www.thepensionsregulator.gov.uk/codes/code-related-internal-controls.aspx#s2415
5. Source: various (Pensions Regulator and ABI)

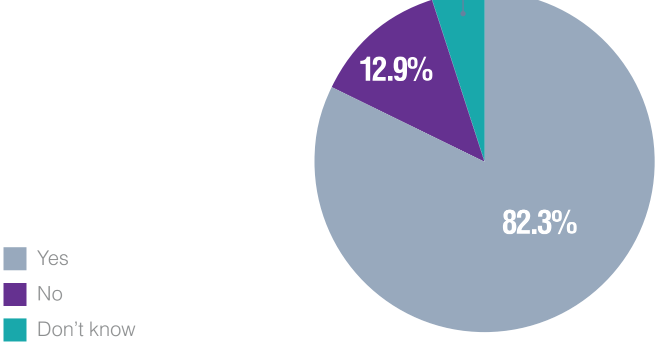
4. Investments

With the recent publication of the Investment Governance Group's 'DC Principles'(6) and, at the time of writing, a recently concluded consultation on *'Offering a default option in defined contribution auto-enrolment schemes'(7)*, investment and DC remains as topical as ever.

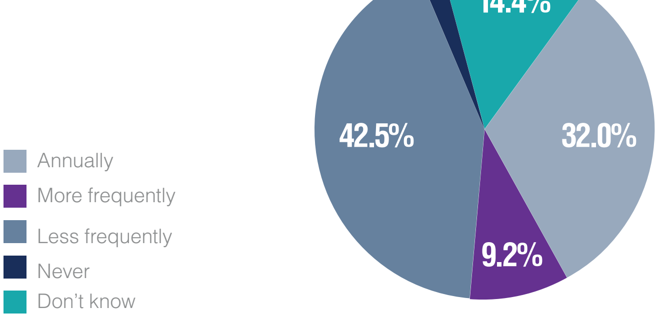
Not surprisingly, almost all respondents in our survey said that they have a scheme default fund in place (with a number of those that didn't answering in the negative simply because the question was not applicable to them).

However, views were much more mixed when we enquired about the frequency of review of the default fund with only 32 per cent of schemes reviewing it at least annually. In the feedback to this question, a few respondents felt that a review every 3 to 5 years was sufficient in determining whether their default fund remained appropriate.

Do you have a scheme 'default fund'?



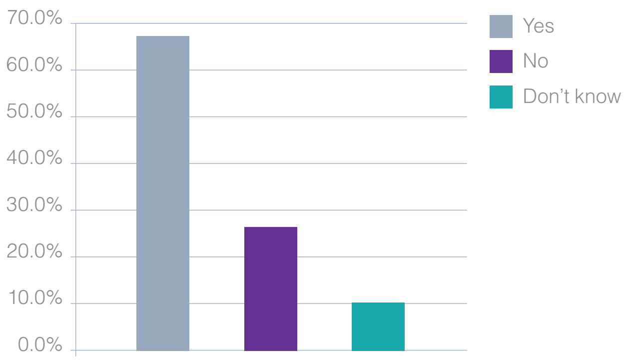
How often do you review the suitability of the default fund?



With regard to communication with members, nearly two-thirds of schemes regularly advise their members to review and consider their investment choices and benefit statements appear to be a popular medium for this purpose.

Nevertheless, a quarter of schemes do not advise their members to revisit investment options on a regular basis to ensure that they remain appropriate.

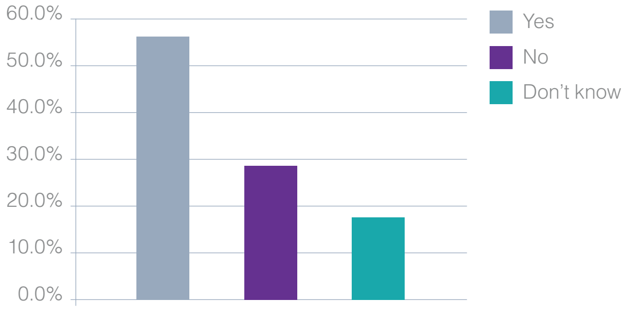
Are members regularly advised to review and consider their investment choices?



We concluded our questions on investments by asking about the intelligence that is made available to respondents.

Over 50 per cent of schemes receive investment analysis that helps to identify risks and examines the pension scheme investment profile. Nevertheless, there are still over a quarter not receiving such information despite its value in reviewing default funds and other investment options.

Do you receive investment analysis that helps to identify other potential risks and examines the investment profile of the scheme (e.g. significant exposure to investment risk for members approaching retirement)?



6. http://www.dwp.gov.uk/consultations/2010/dc-default-option-consult.shtml
7. http://www.thepensionsregulator.gov.uk/about-us/investment-governance-group.aspx

5. Auto-enrolment

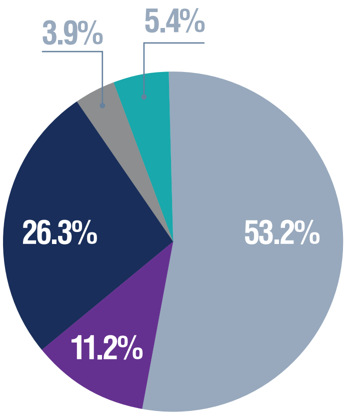
Our survey concluded by considering readiness for and other administrative aspects of the auto-enrolment requirements which start to take effect from October 2012.

The reforms seek to utilise inertia in a positive way by providing for employees to be automatically enrolled into a pension scheme and then requiring them to opt out if they do not want to be a member.

Pension scheme joining processes are, therefore, fundamental to the success of the prospective regime but, according to our research, schemes are far from ready.

In one of the most instructive findings of the whole survey, we found that 64.5 per cent of schemes still require members to apply to join (most of them by requiring completion of a paper-based form) and only 4 per cent of schemes automatically enrol employees using a fully online process.

How do employees currently join your pension scheme?

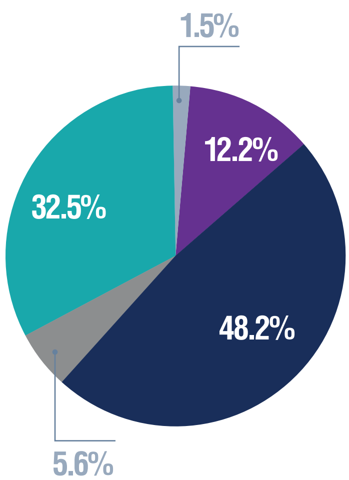


- Employees must apply to join, by completing a paper-based application form
- Employees must apply to join, but an online process is available
- Employees are automatically enrolled but can opt out by completing a paper based opt out form
- Employees are automatically enrolled but can opt out online
- Other (please specify)

Another key finding, but one that is much more positive in terms of readiness for auto-enrolment, is that three-quarters of schemes have no waiting period at all before employees are allowed to join. The majority of respondents that do operate a waiting period have one that is less than a year. Some of the schemes in our survey were closed to new entrants but, even taking this into account, it appears that waiting periods will not be an obstacle for employers that want to use their existing arrangements for auto-enrolling employees from 2012.

On the subject of which 'qualifying pension scheme' employers are likely to use for auto-enrolment purposes, early indications are that NEST (the National Employment Saving Trust) is not viewed as a panacea. In fact, only 1.5 per cent of respondents said that NEST would be used for all employees. Over 48 per cent plan to use their existing scheme for everyone but a significant minority have not yet reached a final decision. One respondent added that the "consultation on company preferred method [was] still ongoing" and we suspect that many other organisations are in the same position.

If NEST or a similar arrangement is established by legislation to help employers with their duty to auto-enrol employees into a pension scheme, will you:



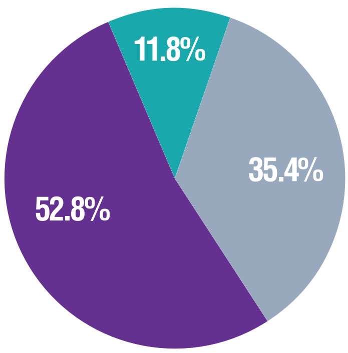
- Use NEST for all employees
- Use your existing scheme(s) for some employees and NEST for others
- Use your existing scheme(s) for all employees
- Use your existing scheme(s) for some employees and set up a new scheme for others
- Don't know

If employers are to use their existing arrangements to comply with the auto-enrolment requirements, there are a number of issues to consider including enrolment and re-enrolment provisions, eligibility rules, contribution / benefit structures, pensionable earnings definitions and default funds (see Section 4).

Changes to systems and procedures will also be required for the vast majority of schemes but these discussions appear to be at an early stage and, as the graph below shows, in most cases, they have not yet even started. Our view is that that the changes to pensions and payroll arrangements will be one of the most challenging issues and early consideration is recommended. On a positive note, as is also shown below, 51 per cent of respondents already provide contribution and salary data direct to their administrator by direct upload.

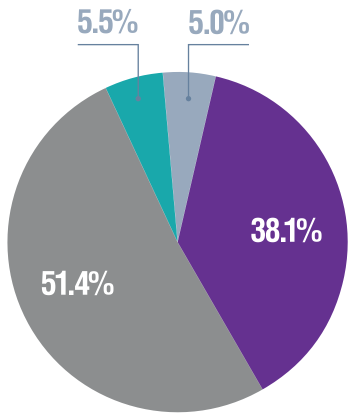
Two respondents indicated that discussions had not taken place because the detail was still unknown. Following publication of the Independent Review and more recently the Pensions Bill, however, the final form of auto-enrolment and NEST is almost there.

Have you discussed with your pension scheme administrator any changes that you will need to make to systems and procedures by 2012?



Yes
No
Don't know

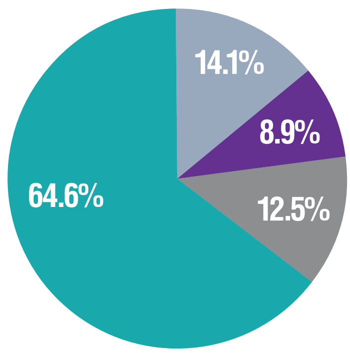
How do you currently send contribution and salary data to your scheme administrator?



On paper
By email
By direct upload to the administrators systems
Other (please specify)

Alarmingly, only 14 per cent of respondents have quantified both the direct and indirect costs of complying with the reforms and nearly two thirds have not considered either. For many organisations, contribution and administration costs could be significant and modelling of these, well in advance of an employers staging date for compliance, is vital for budgeting purposes and to avoid unwelcome surprises.

Have you quantified the additional costs of complying with the auto-enrolment requirements?

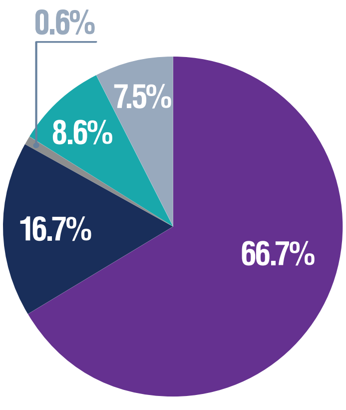


Yes, both the extra employer contributions and additional administration expenses
Yes, but only the additional administration expenses
Yes, but only the extra employer contributions
No

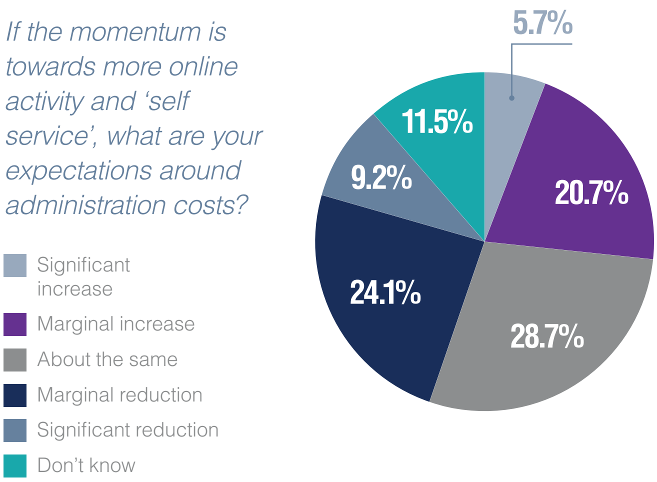
We concluded this section and the survey by asking respondents for their views on how auto-enrolment would affect the amount of administration that is completed on line and the costs of administration.

There seems to be a consensus that, in future, more routine administration will take place online, but predications over costs are much more diverse. That said, comments in the survey feedback section suggest that a number of respondents believe costs will come down over time after some initial one off disbursements.

Looking to 2012 and beyond, what proportion of routine administration is it reasonable to expect to be done online?



If the momentum is towards more online activity and 'self service', what are your expectations around administration costs?



6. Conclusions

There are lots of positive findings in this survey in terms of pension scheme administration and effective scheme governance.

Nevertheless, whilst the majority of pension schemes are well run, there is always room for improvement.

In particular, more could still be done in terms of member communication and engagement. Interaction with members will become all the more important with the continued trend from defined benefit to defined contribution pension provision, a trend that will only accelerate after the introduction of the auto-enrolment reforms from October 2012.

Speaking of the reforms, it is clear that further 'automation' of scheme processes is needed if they are to be properly complied with.

Before then trustees, employers and administrators still need to give more thought as to practical measures required to resolve data gaps.

With the Pensions Regulator recently launching its 2011 education drive(8), highlighting the importance of administration in enabling good outcomes from pensions saving, the subject matter of this report is likely to be relevant for some time.

We hope that readers find the survey results and analysis to be both interesting and useful.

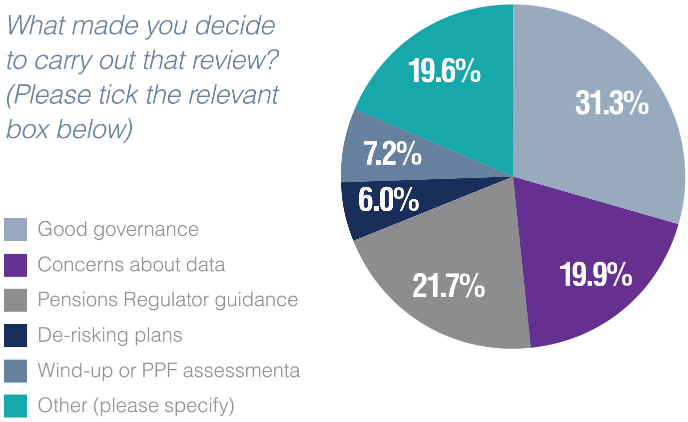
8. http://www.thepensionsregulator.gov.uk/press/pn11-05.aspx

Appendix :

Results of 2010 Mini Survey – Record Keeping July 2010

- Nearly 45% of schemes have NOT carried out a review of their member data in the last two years.
- For those that have carried out such a review, there were a variety of reasons behind the decision to do so (see the graph, below).
- Nearly one-third of schemes that have carried out a review in the last two years received a rating of 'average' or worse; only 20% were rated very good.
- Nearly 60% of respondents believe that data quality issues have resulted in increased costs for their scheme.
- In light of the Regulator's final guidance, 75% of schemes will carry out a data review in the next 12 months; over 80% will carry out regular review in future.
- In terms of respondents' view on ultimate responsibility for record keeping, it is pretty much 50-50 between trustees and the pension administrator provider.

What made you decide to carry out that review? (Please tick the relevant box below)



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