Internet: The only way ahead for pensions?

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graduated in Actuarial Maths from Heriot Watt university in 1982 and after a brief spell at Scottish Provident spent the next 12 years with consulting actuaries Buck Consultants, where he was responsible for developing a portfolio of corporate clients. During that time he was involved with the specification and development of various pension administration systems, both internally and for a number of external clients. After a short stay at Punter Southall he joined Scottish Life's Third Party Administration division as Business Development Manager in 1999 and played a major part in developing DC Solutions, the technology-based third-party administration service. His responsibilities now cover client development, ongoing service developments and scheme implementations.

Abstract The underlying philosophy of introducing stakeholder contracts was to ensure that low income and part-time employees would have access to a low-cost, easy-to-understand pension arrangement. However, the changes required to copy with these new arrangements have had a real impact on almost the entire pensions industry.

The technology required to operate in this new low-cost regime has been rolled out to all existing arrangements and Trustees of group occupational schemes are being required to react to the demands from scheme members who are pressing for Internet technology in particular to be made available to them.

But the Trustees must move cautiously into this new arena, as there are a number of pitfalls that could arise. This paper sets out to highlight some of these issues and to suggest methods of controlling the technology that is now readily available.

Keywords: *Internet access in pensions; registration process*

Introduction

With Stakeholder now imminent there is an ever-increasing number of predictions as to what impact it will make, with some experts forecasting that well in excess of 60 per cent of employers will not be introducing Stakeholder schemes at all. The actual take-up and persistency rates will no doubt be analysed ad nauseum throughout the year, and probably not more so than in 2002 when the government considers compulsion with a safe margin of another four years before the next election. However, irrespective of these statistics, the real impact of stakeholder has been felt within the industry for the

last 18 months, from about December 1998 in fact, when the green paper inferred that the 1 per cent cap was to be the maximum charge.

From that point the forthcoming Stakeholder charging structure became a benchmark against which all other Defined Contribution (DC) pension contracts would be compared, and providers of all DC contracts have had to address how to survive in what has become an extremely cut-throat environment. Inevitably, existing traditional methods of providing pension scheme administration, from the sales channels through to the day-to-day administration and then to the retirement

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process, have had to be radically revamped; and this in an age where the spotlight is also focusing on administration standards.

To many in the industry, the key elements of providing the required level of service in the future will be how new technology is used to improve the efficiency of all communication aspects, and also how the client relationship is managed while still providing the assurance that the business model is not being undermined by the charging restrictions.

Hitherto within the pensions industry, the Internet has been seen as a useful gimmick at best, but the new regime has accelerated Internet-based administration facilities to the status of its being a pre-requisite. The advantages that the Internet affords are very significant. It provides not only a lifeline opportunity for administration providers to restructure their existing back-office systems and procedures to operate within the expected margins, but also (simultaneously) allows trustees and employers to promote the value of the pension scheme in addition to solving a number of the existing problems surrounding communicating information to members.

The advantages to the members are seemingly never-ending. Looking back to only two years ago with many members receiving their statements annually (usually 2–3 months after the renewal if they were lucky), all illustrations needing to be requested from Trustees and then issued in hard copy (with the process to then to be repeated if a different basis was required) and in many cases only an outdated booklet being made available along with all the other new employee induction pack; those schemes that now offer on-line access have indeed made a giant leap. Their members are

now at a stage where booklet, rules, forms, useful numbers, FAQs, fund values, contributions, fund options, pension modellers and the rest are all available anytime, anywhere.

The traditional image of the pension administrator is thus changing and becoming more and more that of a high-tech communication enabler. However, if all this sounds somewhat utopic, the use of the Internet must not be seen as some form of universal pension administration panacea, as it should not be overlooked that in the short term there will be a very significant number of employees without access to the world-wide web, and there will always be an element of the population (including some employers) who do not wish to adopt this approach.

Member registration

Irrespective of the access issues, once it has been established that administration will involve an element of on-line access for members, there is the issue of member registration to deal with. The principles behind the process of a member logging onto any Internet site are tried and tested — the member requires a user name and password — nothing could be simpler. But it is the logistics behind the initial distribution of these items that causes some consternation, principally to ensure that the necessary log-in name and passwords are distributed securely and, in this new low-cost regime, efficiently.

There would appear to be no specific guidelines laid down in the Data Protection Act on how to protect member privacy during the registration process, except that the trustees must endeavour to maintain the maximum security during the process. Passwords can, of course, be generated by the

administration system and distributed either by letter to the individuals, or in schedule form to the trustees, who can then distribute them to the members. Either method is reasonably labour intensive, and the various problems with this are:

- Can this in fact be achieved securely?
- Can these be distributed efficiently in a multi-site environment which many of the bigger employees (who are now tending towards DC arrangements) now operate?
- Is there any point in providing a member with a user-name and password until he or she is 'ready' to use the system — if they do not intend logging on for the next few weeks, say, then it is highly likely they will have forgotten their password (which of course should not be written down).

As it currently stands, there seems to be no real universal use of digital signatures, which in any event are currently cumbersome and expensive. Many employees will access the pension site using their work PCs (some employers have set up Internet cafes in the staff restaurant, but many others will use a combination of work and home-based facilities, thereby requiring more than one signature).

So, for the above reasons, some form of straightforward on-line registration is normally called for. This is usually achieved by the member inputting personal data (including a unique member reference number that would have been issued to the member as part of the application process) that is then compared with data held on the pensions administration system. This then allows the members access to as many of the facilities that the trustees have made available.

On-line transactions

It is important that the trustees can disable any of the functionality at member level; because of the possible absence of digital signatures, the trustees must have a means of limiting any potential security breaches. This can be achieved by restricting access to enquiry only, especially for the initial period after first registering.

But even after the transition period, can the trustees introduce the more advanced transactional facilities whereby a member can essentially update their own data, and provide on-line instructions to the trustees to transact switches or AVC increases, etc?

Updating member records is the least controversial, but it is likely that the pension system will be separate from both the payroll system (which may well be bureau-based) and the HR system. Many employers are expressing the desire that all database updates emanate from a single source and that the HR system will drive changes to both payroll and pensions by means of some interface. Allowing members to update their pension records on-line creates the potential for there to be different information held on each system.

Much more serious are the implications surrounding on-line switching. One of the key advantages of enabling on-line transactions is the seamless flow of instructions from the member through to the pensions administration systems that then automatically create the switch instructions for the fund manager. The member will receive a statement (again automatically produced and issued by the system) acknowledging the switch post event. So what are the implications when a member denies a switch was intended?

As yet this has not been tested in the courts, but certainly in the absence of

digital signatures the trustees would need to look very closely at the procedures they would intend to implement to ensure that they were not left with a potentially expensive transaction to reverse.

So, the current position is that on one hand the cost implications and demand for on-line access are suggesting that the Internet is indeed an ideal medium to satisfy both demands, and the technology is now readily available to deliver; but on the other hand, the procedural issues required to ensure security and transaction validation are by no means clarified. It is likely the commercial pressure will result in a recognised solution being adopted in the near future.

'What-if ?' questions

Another area where the Internet will potentially meet demand from both administration provider and the members is the facility to offer on-line projections and quotations. There are a number of stand-alone modules now available, but realistically, to produce anything other than a fairly generic illustration would require the average scheme member to input a significant number of details — any one of which if incorrect would very likely result in meaningless figures. Using the old adage 'rubbish in, results in, rubbish out' there is a serious possibility that members would be taking some action (or even some inaction) as a result of inappropriate quotations obtained from the intranet site.

Even when using a significantly simplified model, when we asked some (non financial-services) employees to interpret the information on the projections, some of their interpretations of the output (which was based on PIA standards), and the basic

misunderstandings of crucial notes and figures were of real concern. Pension scheme members have, of course, been receiving these sort of projections for some time, but the fundamental difference is that previously someone with a better understanding of pension issues, such as the IFA, scheme advisor or the trustees, would be aware of who was receiving the information and would have been in a position to intercept if it was suspected that there was a misunderstanding.

Now members can request, receive and then act on projections in a completely unsupervised environment. Again, there have not yet been any cases brought against trustees in respect of members acting on a (mis)interpretation of these statements, but as society becomes more and more prepared to seek litigation and compensation, trustees must give serious consideration as to the potential consequences of providing such information.

Furthermore, all of this has neatly sidestepped the topic of financial advice, which the member may well assume (albeit incorrectly) be available within the illustration system. The thought process that requires to be followed when designing the 'what if?' illustrations should not be underestimated. A fine balance needs to be established between ensuring that the input and output is fully understood by the member, but that the illustration system is not so simple that the resulting figures are too generic.

So there is a real conflict here for trustees, who are trying to provide as much useful information as possible to allow members to perhaps take self-service decisions based on information. At the same time, however, they are also trying to protect members from making incorrect important strategic decisions based on a misinterpretation of an on-line quotation.

Disclosure

Internet access also neatly solves a significant number of disclosure issues and providers are now introducing a number of features to allow trustees to obtain stewardship statistics and renewal information as and when required, rather than the traditional six to eight weeks after the scheme year end. With additional pressures being placed on trustees to have the report and accounts finalised within the 1995 Pensions Act timescales, again the Internet can play an important part in reducing the administration burden.

The administrators' biggest task is often to overcome uncertainty. Trustees are happy to let scheme contributions be invested by fund managers — they do not normally insist on investing the scheme's money on their own — but when it comes to administration, they are frequently concerned about relinquishing control. It re-emphasises the point that in some respects, records, data and administration are more valuable than the funds invested. The Maxwell saga has proved that you can recover a pension scheme even after the funds have vanished — would that have been the case if the records had disappeared?

Allowing the trustees unlimited access to the data and records enables the trustees to monitor regularly the state of their scheme records and to gain access to data downloads on-line (ie, immediate access), rather than rely on the administrator scheduling such a request into the work schedule.

Of course, from an administration provider's point of view, although they are then working in a goldfish bowl environment, removing the sometimes awkward ad-hoc queries for data downloads or member data output removes yet a further layer of administrative complexity.

Moreover, as society moves towards

a paperless age, disclosure requirements are changing to cover information distribution via the electronic medium: either distributed over the intranet, or Internet. However, and ironically, the new provisions do not actually reduce the distribution workload. Indeed in some circumstances they could actually increase the complexity of the task. For, whereas proof of postage is sufficient to satisfy the disclosure requirements, using the electronic method proof of delivery is required! The logistics behind the latter are not feasible, with the administrator being required to trawl through the read-receipts and being obliged to re-issue to any member who has not opened their e-mail.

Outsourcing

From a company's point of view, the decision to outsource their pension administration is based on many factors. Many companies can probably retain Defined Benefit administration in-house and run it quite successfully. However, for Defined Contribution arrangements, the need to set up and maintain individual member records and to meet the deadlines for processing regular contributions, increases dramatically the importance of ensuring accuracy of the administration records, as the implications of having to correct a previous error can be significant. For many small- to medium-sized companies, it may not be viable to have the necessary experienced resource dedicated to pension administration and if somebody tries to fit the administration into their normal daily activities there is a real danger they will omit to do something one day, or will not do something properly, that could impose the PA95 reporting requirements and all of the ensuing issues.

Although the underlying fundamentals of delivering accuracy, meeting deadlines and being proactive in ensuring that trustees do not breach any legislation continue to be pre-requisites, the demand for Internet access means that third-party administrators must have a technology infrastructure capable of accepting and providing information through this medium. So saying, the need to be seen to adopt new technology can place companies looking at the services offered by third party administrators in an interesting dilemma. On one hand, they want a company that has proven experience in running the administration of pension schemes while, on the other, they are looking for a specialist administrator that does not have the baggage of legacy systems.

However, the communication issues go much further than just the contact with the membership, with administrators often being required to act as a 'communication hub' and co-ordinating the flow of information between trustees, company, fund managers, auditors, solicitors, the Registrar and various Inland Revenue departments. The use of web-enabled systems will allow the administrator to exchange readily and distribute information along these various communication channels. This will not only increase the speed and efficiency of the operation, but, of course, will allow administrators to reduce their costs without reducing the level of service.

In third party administration, as in most modern businesses, the key to success is in ensuring that customers are satisfied. The use of new technology can improve a number of the aspects of the

service being provided and trustees may well be reviewing their decisions to outsource the pension scheme administration to capture the efficiencies that the Internet offers; safe in the knowledge they will still be able to monitor and control one of their most valuable assets.

Conclusion

The pensions market has gone through a transition never really been seen before, and this before a single stakeholder contract has actually hit the market place. Previously, such a proposed restriction on charging structures would potentially have resulted in a significant reduction in the breadth of the services offered by administrators. However, the Internet has opened up channels never before anticipated which has allowed employers to involve their pension scheme members in a way that should encourage real participation and at the same time drive down the charges.

However and unusually, the readily-available technology has outstripped the capabilities of trustees to make full use of the facilities, and although market conditions have very much forced some use of the new technology to be adopted, the power of the Internet must be harnessed: at least for the immediate future. There are a number of procedural issues that need to be dealt with very carefully and we can now look forward to a catch-up and consolidation period prior to the real pension explosion when we reach the anticipated compulsory pension environment.