PENSIONSAge

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Equiniti Data Solutions head Neil Brady

New concepts, new opportunities

Neil Brady looks at the role of cryptocurrencies within the new world of saving

Every so often, new concepts emerge that revolutionise our society. Before long, everyone has heard of these concepts, even if they don't know what they mean.

This has happened throughout history – axe, wheel, candle, freedom, democracy. Strange at first, they became accepted as perfectly normal and indeed, in many cases, invaluable.

One of the latest has been cryptocurrency. Now, that word may give you a pang of trepidation, but bear with me; it really is where our future lies.

Most people will have heard of cryptocurrencies, – probably through its poster child Bitcoin – though the vast majority will readily admit they have no idea what it is. For the uninitiated, Bitcoin is simply a means of exchange that has no government standing behind it as in the case of formal currencies such as the pound, euro or dollar. It is valued upon sentiment – the stronger the sentiment, the higher the price.

I, along with many others, have witnessed the vast price inflation of Bitcoin over the past couple of years with nothing short of fascination. How could something that smacks of the emperor's new clothes, possibly be so valuable? A lot of it is down to speculation. However, there is an inherent and inescapable truth behind its rise in popularity, and why I raise it here: people don't trust the old ways and are looking for new opportunities.

Recreating the bad old days

In the decade since the start of the financial crisis, we have been slowly rebuilding our financial systems brick by brick. We have used monetary policy extensively to preserve commerce, but to the detriment of many sections of society.

Quantitative easing (QE) has had a detrimental effect upon the young and old alike. Those approaching pension age and seeking a secure income have seen the value of their savings drastically undermined. Those of working age have suffered years of wage freezes that have undermined their earnings – and of course, savings power.

Younger people under 40 – the generation Y (or Millennials) and generation Z – face a bleak future. Heavily saddled with debt from education, they can anticipate proportionally lower wages than much of their parents' generation, while the housing market seems unattainable without assistance from their families.

It is the young who need to save, as by the time they realise the power of compound interest would have been valuable to them, it will be too late. But they are not engaged about saving and it is easy to see why.

In our haste to rebuild our financial sector, we have singularly failed to apply simple best practice approaches to the new model. Despite stricter regulation, there have been regular consumer protection failures that have nothing to do with the world before the crash. Is it any wonder that people would seek an alternative – perhaps magical – way to generate wealth?

Different investment strokes

Millennials may have less to invest – when not spending their money on huge coffees or avocado on toast – but when they do, they have different requirements from the previous generation.

We know that ESG (environmental, social and governance) investing is high on their agenda. They should know not only that their investment is good for their future, but will not do harm in achieving it. And while their parents' generation still struggles with the concept of equities and bonds, these digital natives hold, and are open to, new digital investments.

Student debt and the difficulty of getting a foot on the housing ladder mean they are as hard to engage as any other group the pensions and savings industry has faced. However, while some millennials associate themselves with saving, and the data out there is somewhat mixed, they do not associate with the concept of investing.

If the industry wants to encourage millennials into saving for their futures, should the industry be looking to new and different ways to encourage engagement? Well of course we should.

The future is blockchain

It is easy to dismiss the use of cryptocurrencies within the investment sphere because they are unregulated, administration would be difficult and we don't understand them – but we do so at our own risk.

Cryptocurrencies not only have a future, but are the future. They are powered by a technology that will dominate our societies within a few years. That technology, blockchain, creates a digitised, decentralised, public ledger of all the transactions it processes. It makes multiple copies of a transaction and makes it very difficult for those records to be tinkered with afterwards.

This is why it is being used within the 'internet of things' – from household appliances to electric cars and beyond – and has been investigated by all major banks and many government agencies around the world.

For instance, the US Border Patrol looked at how blockchain could provide a system to monitor its cameras along the Mexico border to check for spoofing or disruption by those trying to cross illegally. Other projects are using blockchain to reduce fraud and increase transaction speeds, up to five times the volume of some of the largest payment services companies.

The elephant in the room

Don't worry. I'm not suggesting we start allowing pension contributions to be made by cryptocurrencies. Pricing is always going to be difficult, and administration could prove to be a nightmare. Then there are system requirements. How do you monitor and process the data from using such payments? Without a recognised central clearing authority, it seems impossible.

And even before you get to how HMRC feels about a cryptocurrency contribution, there is the glaring obstacle of anti-money laundering regulations. How does one square that circle?

At the moment, cryptocurrencies are a non-starter as savings contributions we can't escape the fact they are unregulated and admin is extremely difficult. However, there is no excuse for the industry to reject the concept simply because we don't understand it: there is much to be learned.

We know that the novelty appeals to younger savers. We also know they have reservations about the old institutions, and perhaps rightly so.

Technology has also been a major weakness in the financial service industry, with many banks and life companies struggling to maintain myriad legacy systems that are simply incapable of processing the business they conduct today.

We must not simply reject cryptocurrencies as a fad because they have no application in our business. We must look to how the blockchain technology it runs on might improve our own customers' experience.

Whether we like it or not, cryptocurrencies are here to stay, so do we need to rethink the limits we set our savers?

We also need to rethink the limits we set on our own ability to innovate. Because if we didn't ever 'think the unthinkable', we wouldn't have developed pensions in the first place.

Written by Equiniti Data Solutions head Neil Brady

Technology to the rescue?

Technology promises to transform pensions administration, lessening the need for manual intervention. Developments such as artificial intelligence (AI) and blockchain offer much as-yet untested potential. So why aren't they yet exploited to the max, asks Graham Buck

Daily bulletins from technology's expanding frontiers might suggest that pensions administration is undergoing a revolution. New technologies have already transformed industries such as wealth management, where investment decisions are guided by advanced analytics and cognitive technologies and more clients are willing to use the services of a robo-adviser.

Yet as wealth management sprints down the track towards greater automation, pensions administration appears to be stuck on the starting block. While much of the technology needed to automate routine tasks already exists, barriers to implementation have prevented widespread adoption, says Trafalgar House Pensions Administration client director Daniel Taylor. Poor source data quality, high costs for configuration and low levels of digital member adoption too often contribute to a negative return on investment.

"Automation done well is an unrivalled way of improving efficiency. However, poor automation is worse than no automation at all. Too many administrators are still throwing up inaccurate calculations, despite the integrity of the data. Costs are driven up by the need to cover our tracks and rectify human error. In short, we need to stop fumbling around in the dark with the tools in our reach before we can even contemplate what's down the line."

For Equiniti's EQ Paymaster chief executive, Ric Williams, applying technology begins with considering what the role of pensions administration entails. It ensures data on identity, earnings and benefits is captured accurately; that benefits are accurately paid at the right time; that members can understand their benefit entitlements at any given point; and they can transact within the parameters defined by the scheme rules, which tend to be less restrictive for defined contribution (DC) than for defined benefit (DB).

"Automation can be applied to each of these areas and while pensions administration has gone a long way in adopting technology, it can go further. Most schemes, certainly those on modern platforms have already gone some way to using workflow to control processes and guide processors, and many of those tools also provide the automation that saves repeated data entry," he explains.

"However, many pension processes go beyond one single system and so integration or interfaces with other systems are often required. Again, here, many operations will have automated their frequent or high risk touch points, but depending on the capabilities in those systems not all are automated."

Administrators have just started

Summary
• Pension funds too often have assets invested in cutting-edge technology, instead of utilising it to their own benefit.
• Blockchain could prove transformative, but expectations should be kept realistic.
• Pensions admin tends to lag behind sectors such as wealth management in adopting new technologies such as robo-advisers.

using the added benefits of deploying robotics to replace more manual tasks, says Williams. "Those that are repeatable – often involving multiple systems – are prime candidates for robotics. Also, as the technique of these robotics tools is to mimic the user, integrating multiple systems no longer relies on programming and coding to let machines talk to each other. Instead, the robotic processor merely uses the user interface that already exists."

Hold the revolution

The Asset Management Exchange (AMX) global head Oliver Jaegemann recently wrote: "Pension funds, even in 2018, are much more likely to have assets invested in cutting-edge technology than to actually benefit from such technology in the delivery of the services they use."

This is despite the fact that a more flexible workforce can tackle more of the higher-value work. "Pension funds tend to be time-constrained so anything that frees time up is a bonus."

While the institutional pension funds admittedly do a thorough job, completing a transaction can take weeks, Jaegemann says. "Nor is this due to regulation, in fact the wealth management sector is probably more heavily regulated. So while other sectors have seen the likes of Amazon, Airbnb and Uber transform the experience of doing business, the revolution in asset management still hasn't yet taken place."

Williams suggests that a degree of caution is understandable though. "Being at the forefront of new technologies can be an expensive place to be until those technologies have proven themselves and begun to repay their investment," he suggests. "It is therefore entirely appropriate that pension funds choose proven solutions rather than dance on the cutting edge. As with all things pensions: you need to balance growth with risk."

The Pensions Administration Standards Association (PASA) board director Girish Menezes adds that recent high-profile pension admin disasters have had some positive effect in causing trustees to flee toward the quality end of the market, paying prices that are reflective of this higher service. He also sees major opportunities for automating work, particularly for DC schemes. "One could conceivably automate the entire end-to-end process: contribution investments, online member switching, lifestyling and even a transfer-out process," he observes.

While DB schemes are more complex, Menezes believes that with the digitisation of data and trustee focus on data quality, there have been vast improvements in automation here also. However, given this complexity "it is critical to have highly experienced administrators to check the automated calculations for exceptions, provide governance for potential fraud – for example when members transfer out, support the trustees with cashflow decisions and manage complex investments".

Blockchain as catalyst

Could blockchain prove to be the catalyst that revolutionises pensions administration? Its proponents cite the many new abilities the new technology could potentially open up, such as its ability to improve the liquidity of previously illiquid assets. Yet not everyone is convinced.

"Blockchain's an amazing technology disruptor, but overhyped," suggests Menezes. "It could be utilised in a number of areas from acting as an underpin to the pensions dashboard to enabling cost effective transfers of pots between providers.

"However, there are considerable investments required to enable this. There are also alternative technology-based options to achieve the same results. As such, the timing and extent of a blockchain revolution within the pensions industry is an open question."

Williams is more hopeful, citing IBM chief Ginni Rometty's famous observation that blockchain will do for transactions what the internet did for information. "It's hard to disagree and blockchain projects are already in evidence in the industry," he says.

"Equiniti has two proof of concepts running currently, along with our sponsorship of research projects at Cardiff University. One of those projects is a consumer app that allows peers to trade stocks with each other securely, quickly, indisputably and without the need for a central intermediary – for example a stock exchange or a CREST interface. That certainly lends weight to the example of being able to do the same for more illiquid assets.

"Our assessment is that any activity showing the following characteristics is a good candidate for blockchain: those with more than two persons involved; where there's an absence of trust; where regulatory or audit scrutiny is required; where transparency is needed; and which involve more than just money

"It's easy to see any number of pensions activities fall into these criteria: switching, transfers, investment – indeed, one excellent use case for blockchain would be the pensions dashboard."

Written by Graham Buck, freelance journalist