In or out?

Maggie Williams considers the pros and cons of outsourced versus in-house administration, at a time when ensuring data standards is ever-higher on trustees' agendas

Summary
- There is a general trend towards outsourcing pensions administration, driven by skills needed, technology and changes in pensions practice.
- Retaining administration in-house may still be the best choice for some very large schemes.
- Fluctuating work levels, partly driven by the pension freedoms, can put particular demands on in-house teams.

Back in the heyday of defined benefit (DB), pensions administration might have been a key ingredient of good governance – but one that sat a long way down the agenda of a typical trustee meeting. 'You only notice it when something goes wrong' could have been its motto.

The rise of defined contribution (DC) and the introduction of the 2015 pension freedoms has changed all that. Administration is now more visible than ever before, and there is nowhere to hide if systems, data and communications are poor.

And 2018 is the year that administration standards really will be put to the test. Compliance with the new General Data Protection Regulation (GDPR) is due in May 2018; The Pensions Regulator is demanding more comprehensive information on scheme data in returns this year; and GMP reconciliation is expected to be complete by 31 October. If that wasn't enough, 2019 should see the introduction of the pensions dashboard, putting even greater pressure on schemes to deliver good quality data.

Given those changes, perhaps it's no surprise that enquiries from pension schemes about outsourcing to a TPA are at a peak. "We saw more enquiries in the last year than we've seen in 10 years," says TPA Trafalgar House client director Daniel Taylor. "Many of them were from schemes exploring this approach for the first time."

Taylor says that the bulk of those enquiries were from small or medium-sized schemes, but Barnett Waddingham partner and head of pensions administration Paul Latimer says he sees larger schemes, such as those with between 10,000 and 20,000 members, taking an interest as well.

Every scheme will have its own rationale for deciding to maintain administration in-house or to outsource it, and value for money will always be a key consideration. However, cost aside, there are three key drivers that are encouraging schemes to examine their approach: people and skills; technology and changes in pensions policy.

People and skills

"When individual administrators retire or leave, they are not always easy to replace," says Pensions Administration Standards Association (PASA) deputy chair and KG Associates director Kim Gubler. "There isn't a big pool of talent to draw on".

"Availability of skills is an issue," agrees Latimer. "We've seen schemes struggling to replace administrators and realising that it is a key man position."

The skill set requires a deft blend of forward-looking technology focus, and pensions history. "There has been so much change over the years that it's hard to teach a new administrator everything that they need to know," says Latimer. "They need to understand the evolution of pensions in order to be able to deal with issues such as GMP reconciliation, as well as future-looking skills such as the potential of technology and knowledge of forthcoming legislation. Trustees want high-quality experience and that's something that TPAs put a big emphasis on."

Even if an in-house team does have the required combination of past, present and future knowledge, resourcing may still be an issue. "The level of demand can be variable," says JLT director Mark Adamson. "Some activities require a lot of resource for a short period of time, which may not suit the in-house model." Processes such as liability reduction exercises can require not just more resource but also niche skills, again putting pressure on in-house teams. "The demand for more specialist resources, particularly over the short term, is the biggest driver for schemes starting to investigate outsourcing," adds Taylor.

Members as well as trustees are making greater demands on administrators' time. Adamson says: "The pension freedoms have driven increased workloads and unpredictable peaks of work for administrators. Members want access to all of their information, even if they don't ultimately use their freedoms. For a small in-house team who may not have significant automation either of calculations or of letters and workflow, this can be hard to manage."

Technology

The pace of legislative change has meant the end of the road for some older administration technology. "A number of providers are not willing to maintain older systems any longer," says Taylor. "They are telling schemes to upgrade or move – and that can be a catalyst for trustees to start looking at their entire approach."

Out-of-date systems leave schemes open to risks, from non-compliance to cyber threats. In a third-party arrangement, it will be the responsibility of the provider to maintain its technology, but with an in-house arrangement that duty sits within the scheme. "There are a lot of DB legacy systems that aren't appropriate or are not capable of doing everything that's required," says Gubler. "But most of the technology focus now is on DC, where there is demand for lower-cost, technology driven solutions. That balance needs to be addressed, to make sure that DB is still fully supported."

Good quality data is a core component of any well-run pension scheme. The Pensions Regulator is stepping up its demands on schemes, and will require trustees to report on their record-keeping in scheme returns from 2018 onwards. Data also underpins the forthcoming pensions dashboard – and DB schemes are not exempt. "Underlying data is still not good enough in many schemes," says Gubler. "There is a lot of room for improvement."

The case for in-house

Given these onerous demands, is there a future for in-house administration at all? Despite the general trend towards outsourcing, there are still schemes who believe that bespoke is best. One of the most notable is the 300,000-member £49 billion BT Pension Scheme, which decided to part company with its TPA, Accenture, in December 2017 and bring its administration in-house.

"For very large schemes, there are some instances where having an in-house administrator remains a credible service option, but these are very few and far between," concedes Taylor.

"Keeping an in-house team may be a case of don't fix what's not broken," says Gubler. "Or, it might be the culture of the employer, which is more paternalistic and likes the idea of managing it themselves."

Some schemes may also opt for a combination of in-house and outsourced approaches, says Gubler, such as retaining DB administration, but outsourcing DC. "Alternatively, a scheme might keep the majority of its admin in-house and then outsource particular projects."

Retaining administration in-house might be the right decision for some schemes but, says Gubler, there is a less positive spin as well: "The scheme may simply not appreciate the risks it is carrying – the argument might be that it hasn't caused an issue to date, so there isn't a need to change it."

As the amount of data grows exponentially, and requirements for accessing it increase, the importance of security will also increase. "In-house administrators mustn't get left behind," says Latimer. "Most TPAs have invested in cyber security and resilience and it's important that in-house teams do the same."

Pensions practice

Broader pensions practices also impact the decision to retain administration in-house or opt for a third-party approach. "Once a DB scheme closes to future accrual, you have broken much of the connection with the workforce," says Gubler. "At that stage you might not be looking for the latest trends in communications, for example. You want administration to be robust and minimise risk, but at the best cost and value."

Gubler also believes that the tighter regulation of master trusts introduced by the Pensions Scheme Act 2017 will be "a watershed moment", accelerating the move of single-trust DC schemes into multi-employer arrangements. "Even large schemes are starting to consider this now, and that will have an impact on administrators, both in-house and third party."

And while schemes might be racing for the line to hit the May 2018 deadline for GDPR compliance, that's not the end of the story. "GDPR is an ongoing commitment, not a one-off activity," says Gubler.

All pension scheme administrators have a busy year ahead of them, and trustees will want to ensure that value for money goes hand in hand with best practice. While for some schemes that will mean continuing with an in-house approach, increased workloads, new legislative demands and closer scrutiny from The Pensions Regulator may make the lure of outsourcing irresistible.

Written by Maggie Williams, a freelance journalist