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Briefing note

Technology and pensions

This note looks at things to watch out for, to make sure technology is working for you in your pension scheme, at a time when there are lots of changes in the industry, so having the right approach can make a real difference to the outcome.

2015 will be a busy time in pensions as many factors align which will affect all workplace retirement savings:

- The 'Freedom and Choice in Pensions' changes in the budget allow defined contribution (DC) members to access their retirement savings in any pattern they like (once they are old enough). This leads to very complicated choices for those members.
- Employers with defined benefit (DB) schemes will be thinking about how those DC changes affect them. The changes are likely to lead to a restructuring of the liability profile of DB schemes, potentially making de-risking strategies for closed DB schemes more attractive.
- Employers with open DB schemes will also need to be planning for the abolition of contracting out in 2016. This may lead to benefit changes, possibly including some of the new flexibilities around risk-sharing being introduced in the Pensions Bill.

Luckily, this comes at a time when the technology is available to help steer a clear path through these complicated changes.

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Communicating complexity

Interactive models can make a real difference to the user's understanding of complex issues. Rather than just being told what might go wrong, users can play with different inputs, and see what might happen. If set up well, these models can be easily tailored to a user's situation, highlighting the important points for that user, rather than having to cover all the things that might be important to someone.

Guidance for DC members

The most obvious use for these interactive tools is in explaining all the different issues around DC benefits – particularly given the new flexibilities in retirement. One tool, accessed online can give a different experience depending upon the member's circumstances:

- Young, and hard to engage, or nearing retirement, and very keen?
- Low earners with many other calls on their money, aiming for the right level to get by on in retirement, or more wealthy, worrying more about tax planning and other savings vehicles?

In the absence of substantial funds available to pay for detailed, face to face advice, the only real chance most DC members stand of understanding the implications of all of the options available to them is with access to a decent modelling tool.

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Improving consultancy advice

It is not just members of DC schemes who need help understanding complex issues. Sponsors and trustees of DB schemes are faced with increasingly complicated decisions:

- understanding the interaction between funding, investment and covenant, in line with The Pensions Regulator’s new Code of Practice
- choosing between different liability management options
- setting an investment strategy containing liability-driven investment (LDI), and/or including trigger-based de-risking

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Targeting resources

Balancing strategy and processing

Pensions – particularly DB pensions – involve lots of calculations. In the past, a large part of the consultancy budget has been spent on doing the calculations, and probably much of the rest of the budget has been spent on understanding what the calculations say, with very little left for considering the options.

As noted above, technology can help with the understanding part, but it should also be completely changing the focus on the calculations. Calculations should just be there in the background, producing the answers you need, when you need them, allowing most of your time to be spent on making the right decisions to deliver the best outcomes for your scheme.

Example – Closed DB Schemes

One good example of where getting the right balance between strategy and processing makes a difference is with a closed DB scheme. In this case, it is likely that at some point, the scheme will wind up having transferred the remaining benefits to an insurance company.

Often, the sponsor will not be able to afford the cost of insuring the benefits straight away, but will be looking to pay for this by some combination of:

- **Managing the liabilities.** Looking for opportunities to reduce the liabilities in the scheme at a cheaper cost than the insurance policy would cost. One example of this might be if a number of members wish to transfer to a DC scheme as they reach retirement, to take advantage of the new flexibilities.
- **Working the assets.** Investing in growth assets to try to generate good returns, closing the gap with the insurance price cost. This needs careful understanding of the risks involved.
- **Reducing risk when the price is right.** Taking opportunities to move towards the insured position, when the costs of doing so are low enough. This might mean moving into protection assets that move more closely in line with insurer prices, or actually purchasing partial insurance cover. By spotting the right ‘trigger points’ for doing this, you can reduce the price of doing so.

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- **Waiting.** Over time, the scale of the scheme will reduce, and the membership will age – all of this will reduce the gap compared to the insured cost anyway, so (assuming the sponsor is still around), there will come a point when insurance is affordable, just by waiting long enough.

The first point to note here is that most of these strategies are based on taking time – waiting for investment returns, or for de-risking opportunities, or just waiting long enough! Therefore, reducing the costs of running the scheme while you are waiting can have a big impact on the outcome (more on this below).

The second point to note is that (other than just waiting), the options above are pretty complicated, and so putting a good plan in place involves developing a complicated strategy upfront, where technology can really help in cutting the calculations overhead out, and ensuring understanding.

Finally, having done the work at the outset, to put the plan in place, there is little need for any decisions going forward. If you got the plan right in the first place, you know:

- how you are going to fund the scheme over the rest of its lifetime
- how you are going to invest, and what will trigger changes to the investment strategy

Furthermore, if you have also carried out an exercise to ensure the benefits are completely understood, and the data has been cleansed, you also know all you need to know to pay benefits as they fall due.

Having got this all worked out upfront, the processing ability of technology comes into its own meaning that whilst you are waiting (for the plan to come to fruition), very little input/intervention is needed in the running of the scheme. The technology will calculate the right benefits; produce the figures you need to comply with regulatory requirements (actuarial valuations every 3 years), etc alert you when you need to do something (if a trigger is reached); and enable you to monitor progress against the plan on a daily basis (if you wish).

Please contact your Barnett Waddingham consultant if you would like to discuss any of the above topics in more detail. Alternatively contact us via the following:

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