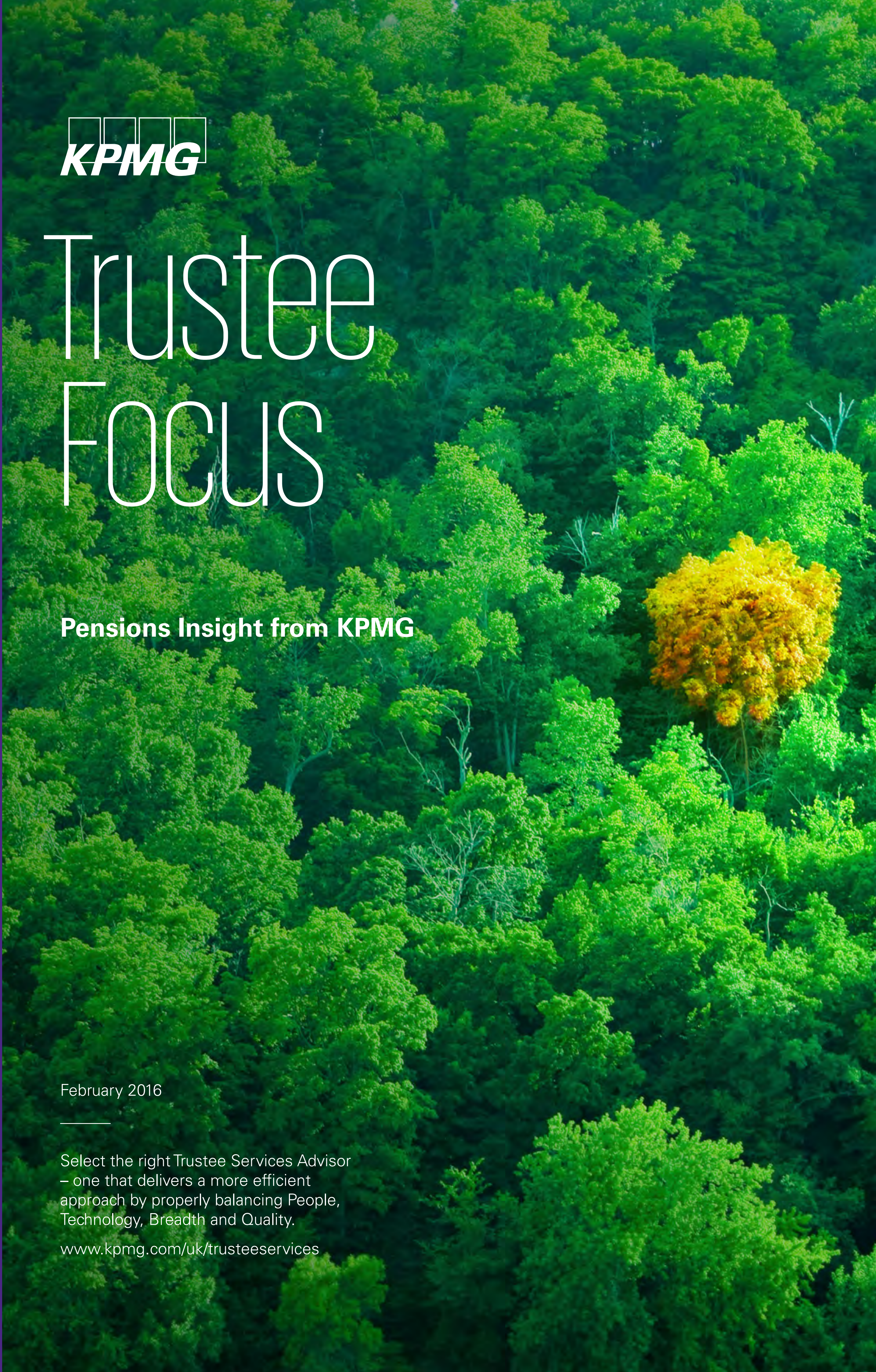

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Trustee Focus

Pensions Insight from KPMG

February 2016

Select the right Trustee Services Advisor – one that delivers a more efficient approach by properly balancing People, Technology, Breadth and Quality.

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Welcome

The pace of change in the pensions world does not look to be slowing anytime soon. Next month's budget could be the third in a row where pensions changes hit the headlines.

I think it's fair to say that the 2014 budget changes that came in to force last year are still bedding in; yet we await further potential transformational change this year. Markets remain stormy and Trustees continue to grapple with volatile funding positions, now combined with ongoing discussions about how members of both DB and DC schemes should be empowered to access the new pensions freedoms.

As we await the outcome of the budget, and the inevitable barrage of technical updates that will follow, we have taken a slight diversion in this edition of Trustee Focus. This month, we have sought our consultants' views on the grass roots issue of DB pensions – data! We look at the benefits of professional Trustees; and we also critique the current approach that some Trustees take to appointing new advisors.

Data is the heartbeat of every pension scheme, and the security of that data has never been more important. With continuing changes to pension legislation and service delivery continuing to evolve, making sure that the foundations are robust is crucial in making schemes more adaptable. What should Trustees be doing to properly address data integrity? On page 2, Samantha Coombes shares her views.

Does the ever increasing complexity of DB Schemes make it unrealistic to expect lay Trustees to keep up to speed? Are opportunities missed due to the time it takes Trustees to react to issues? On page 4, Matt Collinson considers the benefits of appointing a professional Trustee to help run pension schemes.

When it comes to Trustees finding new advisors, the tried and tested approach to use is the traditional tender process. On page 6, Greg Wright considers whether this process results in the best advisers and explores alternative approaches to the tender process.

Finally, we take a look at what is often considered a not-so-hot topic on Trustee meeting agendas: GMP reconciliation. From December 2018, HMRC will no longer offer schemes the ability to reconcile GMP entitlements. On page 8, Sarah Twomey discusses how to deal with GMP reconciliation and the importance of doing so.

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Pension scheme data

Let's be honest: pension scheme data isn't a hot topic. It doesn't require the intellectual challenge that comes with investment strategy or the financial management that comes with funding discussions.

Often member data falls down the Trustees' agenda in favour of issues which seemingly present a larger risk to a scheme and therefore warrant greater attention.

When the scheme is running well it is easy to underestimate the importance of good quality member data for every aspect of running a scheme, but behind-the-scenes fixes can often mask significant data issues.

Put simply, data is the heartbeat of every pension scheme, and the security of that data has never been more important.

As an industry, we haven't helped the issue. We have, at times, struggled in articulating to clients the wider benefits of investing time in getting data right, aside from a requirement to adhere to record-keeping targets set by the Pensions Regulator (tPR). Those schemes that have taken steps to address tPR guidance often consider that as 'job done' where data is concerned, not recognising that this is only a small piece of the puzzle.

There are a raft of data items that are critical to effectively running a scheme but which are not explicitly covered by tPR's measurable targets (most notably tranched data detailing how members' benefits should revalue and increase), whilst data security is not covered at all by any guidance issued by the Regulator.

With continuing changes to pensions legislation and service delivery continuing to evolve, making sure that the foundations are robust is crucial in making schemes more adaptable. There is a tendency for Trustees to see data integrity either as a 'tick box' exercise or something that only gets addressed when problems arise; the reality is that this is an issue which every scheme needs to tackle head on, no matter what the long-term strategy.

To ensure that the time and effort spent is proportionate, data integrity should be considered in the context of the scheme's wider strategy, rather than just to fulfil arbitrary targets. With that in mind, there are three fundamental areas to reflect on.

Effective ongoing operations

With so much focus on investment strategy, funding and other strategic activity, it is easy to forget how important it is to get the business as usual activity running smoothly. Good quality member data is key to this for a number of reasons:

- Member experience – paying correct benefits and enabling the use of online modelling tools.
- Adaptability to change – ability to take advantage of legislative changes in an efficient way (e.g. Freedom and Choice).
- Understanding liabilities – ensuring that liabilities are accurate and not distorted by data uncertainties.

Poor quality data is often a barrier to Trustees who want to be more progressive and offer members an administration service that is fit for the 21st century. And with continuing changes to pensions legislation, it is absolutely essential to ensure that a scheme's foundations are solid to allow schemes to move with the times.

Enabling "journey planning"

With the vast majority of schemes now closed to accrual and looking towards a long-term goal of de-risking and ultimately discharging liabilities, data quality becomes crucial to fulfilling that aim. There are plenty of cautionary tales of schemes that have underestimated the importance of making sure that data cleansing work is carried out in advance of carrying out de-risking activity:

- Being in a position to make the most of advantageous financial conditions.
- Understanding scheme liabilities upfront, with no unexpected liabilities coming to light at a crucial time.
- Having the ability to discharge the correct liabilities in bulk.

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This is a view shared by buy-out providers. "Good quality data is really important if looking to insure your liabilities. Schemes which can demonstrate high quality data will be more attractive to insurers and may also pay a lower premium when looking to insurer certain risks. In the worst case, missing or incorrect data can lead to transactions being delayed, cancelled or even unwelcome surprises if errors are uncovered years down the line and need to be corrected. Further, if the data is accurate and complete then the process of completing a wind-up is much more likely to be quick, efficient and on budget", commented Guy Freeman, Head of Origination at Rothesay Life.

Cyber security

This is an area which is only now starting to become a board level issue for corporate entities, but is something that Trustees must begin to consider. With an increasing number of high-profile cybercrimes, online security is becoming a significant issue for individuals and Trustees need to understand how they can actively protect their members' data.

There is a continuing trend towards online member access for not only defined contribution, but defined benefit members.

Whilst this provides significant benefits in delivering an efficient and engaging member experience, it does increase the potential risk of cybercrime. Online member access typically includes access to information including sensitive personal data, bank details and salary information, all of which could be attractive to sophisticated cyber criminals. Trustees need to take greater interest in how their data is protected, not just as a one-off activity but as technology and software continue to develop. Without taking these steps, it will be difficult to provide the necessary reassurance to members to make online access a successful part of scheme operations.

Matthew Martindale, Director in KPMG's Cyber Security team commented: "Personal data and financial information are two of the key elements which are attractive to cyber criminals who are actively looking for opportunities to take advantage of organisations which have not properly addressed cyber security. There is every chance that a pension scheme or pension provider could be the next big cybercrime news story."

Conclusion

So, what should Trustees be doing to properly address data integrity?

- Assessing the quality of data that is actually important to the efficient and effective running of a scheme and undertaking rectification work as necessary.
- Treating such activity as a risk management priority.
- Actively managing cyber risk with administrators to provide comfort to members that their data is safe.

As an industry, we need to get our clients to take data seriously. In the digital world where data is everything, we cannot continue to ignore an issue which is so fundamentally important to every aspect of a pension scheme.

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Professional Trustees are like gold dust

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Defined Benefit (DB) pension schemes are as complex as major financial institutions. In many cases their liabilities are as large as the market value of the companies they belong to. No-one would ask you or me, with unrelated full-time jobs, to take a leading role in running another financial institution, to have a hand in its fate. Yet this is what we ask lay Trustees to do. It does not make sense.

Now that an increasing number of schemes are closed or closing to future accrual, managing DB pensions is largely a financial problem, not an HR one. The link to existing employees, which was one of the main reasons for lay Trustees, has gone. Almost all lay Trustees are well-meaning, take their roles seriously and want the best for their scheme members. But I am certain that if you asked them whether they were best placed to carry out the financial management of over £2 trillion of DB pension liabilities, they would just say "no".

This complexity within DB pensions increases with each passing year. It is unreasonable and unrealistic to expect lay Trustees to be able to keep up to speed across all areas of pensions. This is a full-time job for professional Trustees, both in terms of keeping abreast of developments, and also being able to devote sufficient time to react quickly to events.

Quarterly meetings, which are the norm currently, slow down the ability to take actions that are in the best interests of schemes and their members.
It can take months to educate lay Trustees on industry developments, such as new legislation, or trends within markets. By the time the Trustees have got to grips with an issue, an investment opportunity has often passed.

"Act now to get your pick of a scarce and valuable resource that will soon be like gold dust."

This leads to frustration from corporates, who are used to acting quickly and decisively. It is as though they are operating in different time zones to Trustees and that can create a further barrier to collaboration and detract from the job of managing assets and liabilities effectively.

The wide-scale use of professional Trustees could overcome this, so I urge the pension advisory and regulatory community to embrace the rigour and dynamism that they can bring.

That is not to say that there is necessarily no role for lay Trustees, who may retain an intimacy with and understanding of the scheme membership that a professional Trustee perhaps could not bring. But the strategic and financial management of schemes should be in the hands of those with the expertise and time needed to the job most effectively.

Most companies have the power to appoint a professional Trustee to run their scheme, either alongside or as replacement for the existing Trustees. Without doubt, this would get schemes operating more strategically and more efficiently. To these companies, I would say: act now to get your pick of a scarce and valuable resource that will soon be like gold dust.

Let's call ITT off!

AKA a better way to choose your advisers

Every few years or so, I need a bit of building work done on my house. I know I can't do it myself so I call in an expert. I might be spending significant amounts and I have to live with the results, so I want to choose wisely. How do I go about doing this?

I'll probably google what I want doing, find someone who looks professional and experienced, and has examples of doing similar work well (ideally with client testimonies that I can see or follow up). I'll ask them to pop round, get their views on what I'm planning, see if they can suggest any improvements and ask them for a quote.

What I don't do is send out a 100 question RfP asking them about their company history and their approach to plastering walls, score their answers, ask them to send through a PowerPoint presentation and interview them (I might meet the MD but not the guys who will actually be doing the work – they'd never be let near a client until they've signed up).

I'll assume anyone I see can technically do the job – what I'm really looking for is evidence of how they can assess my requirements, deal there and then with my queries and suggest better ways of doing it. So long as the fees seem reasonable, they've got the job.

And yet…is my situation really that different to when Trustees are looking for new advisors?

OK, I accept my analogy is not perfect. As a Trustee I'm looking for someone for the long term, not a short term project. Perhaps a better analogy is finding a builder to go on a retainer for my portfolio of buy to let properties (I wish). So I do need to know we can work together and there is a good cultural fit and level of trust between us.

However, **I do still have a real concern that the tried and tested approach is failing everyone**, and that Trustees are not ending up with the best advisers for their situation. There are a number of reasons for saying this:

- Producing a response and learning a script for a pitch is expensive, clunky, an inefficient use of time and doesn't teach you anything about the adviser. Ultimately this cost probably has to be passed on to clients in some form.
- I suspect that not everyone reads the responses fully (and I probably wouldn't blame them – they are often the size of telephone directories); so it's a double waste of time.
- A written response rarely captures what advisors are like to work with in practice – which is what you will be buying.

- Does a 30 minute presentation really tell you what someone is like? Can you gauge their depth of knowledge, their own views, what they would do when faced with a new situation? Are they simply good presenters?
- We are often told "you were the best candidate on the day…far better than the other presenters… best proposition"… but we still don't win. This is usually because we haven't met you before the pitch and the Trustees just don't feel they know us well enough to take that leap of faith (understandably, after only 30 minutes of knowing us!).

So what might an alternative approach entail? My suggestions include:

- Spend the time instead meeting and talking to possible providers – forget the RfP! Even the basic data around firm history and people numbers – does it really matter?
- Give them real time to discuss their ideas, ways of working and possible solutions for you. Ideally this would be 2 to 3 hours. I know it sounds a lot, but only then can you really assess their ability, expertise and what they would be like in meetings advising you. No genuinely interested provider would object to this, trust me. And you will be saving much more time than this as you no longer need to draft an RfP, mark it and so on.
- If you like, even meet them "blind". Only show them your situation and objectives there and then. That will really test how well they can deal with the unexpected, as opposed to trotting out a house view or scripted lines.
- Alternatively, send them enough information to help them suggest what they would do instead – and give them time to properly walk you through it.

I honestly think this approach adds no more time for Trustees, and probably involves less time overall. I can tell you the bidders will be weeping with joy at being able to genuinely show what they can do for you. To be clear, there is still a role for independent advisers to help identify candidates, check the hygiene factors of the firms involved and sit in on the discussion if required – in fact, that may keep the presenters "honest". And you will probably get more out of their involvement as a result.

Builders and actuaries – we're just the same really!

> **"I honestly think this approach adds no more time for Trustees, and probably involves less time overall."**

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Irreconcilable differences

From December 2018, HMRC will no longer offer schemes the ability to reconcile GMP entitlements. Schemes that do not take the opportunity to conduct an exercise now risk leaving themselves open to claims for benefits from non-members and limiting certainty over liabilities.

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With contracting out being abolished with effect from April 2016, Trustees need to consider how to deal with reconciling legacy Guaranteed Minimum Pension (GMP) liabilities with HMRC. From December 2018, HM Revenue & Customs will begin sending statements to several million people who have a GMP entitlement, giving them visibility of which schemes will be responsible for paying them a GMP in retirement.

Whilst GMP reconciliation has rarely been a hot topic on Trustee meeting agendas, there can be a real financial impact to schemes if Trustees do not give such exercises due care and attention.

"Don't miss the opportunity to reconcile your schemes data with HMRC records."

There are three key challenges facing Trustees: **Trustees (and sponsors)** often question the merits of carrying out a GMP reconciliation when considering the cost/benefit scenario. However, a well-run process need not produce significant costs when compared to the benefit for members and the scheme, if the exercise is planned properly.

Knowing your membership

It is not uncommon for HMRC to record members with a GMP liability in a scheme from which they transferred many years ago or, in some cases, never even joined.

Unexpected liabilities

Inconsistencies between data held by HMRC and that held by the scheme can result in changes to a scheme's liabilities.

Future-proofing your data

This represents the final opportunity to reconcile GMP data with HMRC; schemes that fail to do so may see any future insurance options become more expensive as a result of not having "clean" data.

What type of exercise should you run? The answer to this question largely depends on the Trustees' attitude to risk and appetite to adopt pragmatic decisions. There are broadly three potential options:

- Membership reconciliation – this is the minimum that schemes should expect to carry out to have certainty over the number of members for whom they are expected to pay a GMP benefit.
- GMP reconciliation "lite" – in addition to the membership reconciliation, this would include reconciling GMP entitlements, but employing greater pragmatism in setting tolerances and accepting HMRC data than you might otherwise expect.
- Full GMP reconciliation – a full reconciliation service, operating limited pragmatism, to ensure that members receive an accurate entitlement from the scheme.

Trustees need to consider the merits of each option against practical factors, such as resource availability, time constraints and cost, when balanced with their duty to provide members with the correct benefits under the scheme.

How can you effectively manage cost? Trustees can be understandably nervous about signing up for an exercise where it is difficult for administrators to accurately predict the cost at the outset. However, there are a number of ways in which Trustees can encourage their administrators to deliver the exercise cost-effectively:

- Use of technology – HMRC are encouraging use of both the Scheme Reconciliation Service and Shared Workspace to allow more efficient analysis of data and interaction to resolve queries.
- Preparation is key – Encourage the administrator to carry out initial analysis to understand the issues and agree where to adopt areas of pragmatism so that administrators can focus on the "difficult" cases.
- Divide the process into manageable sections that can be more easily analysed and costed.

Schemes which do not take the opportunity to conduct an exercise now leave themselves open to risk of unexpected liabilities. There can be real financial impact as well as implications in connection with insured solutions further down the line.

KPMG events and services

What is Reshaping Retirement?

The new flexibility has affected different employers and Trustee groups in different ways. We've developed a range of strategies which take advantage of this rare opportunity to provide better outcomes for everyone.

From DC scheme review to redesigning the DB 'At Retirement' process and designing robust member options exercises to employee education software, Reshaping Retirement has it covered.

Our web page has all the information you need and if we can be of help to you during this radical change to our industry, please do let us know.

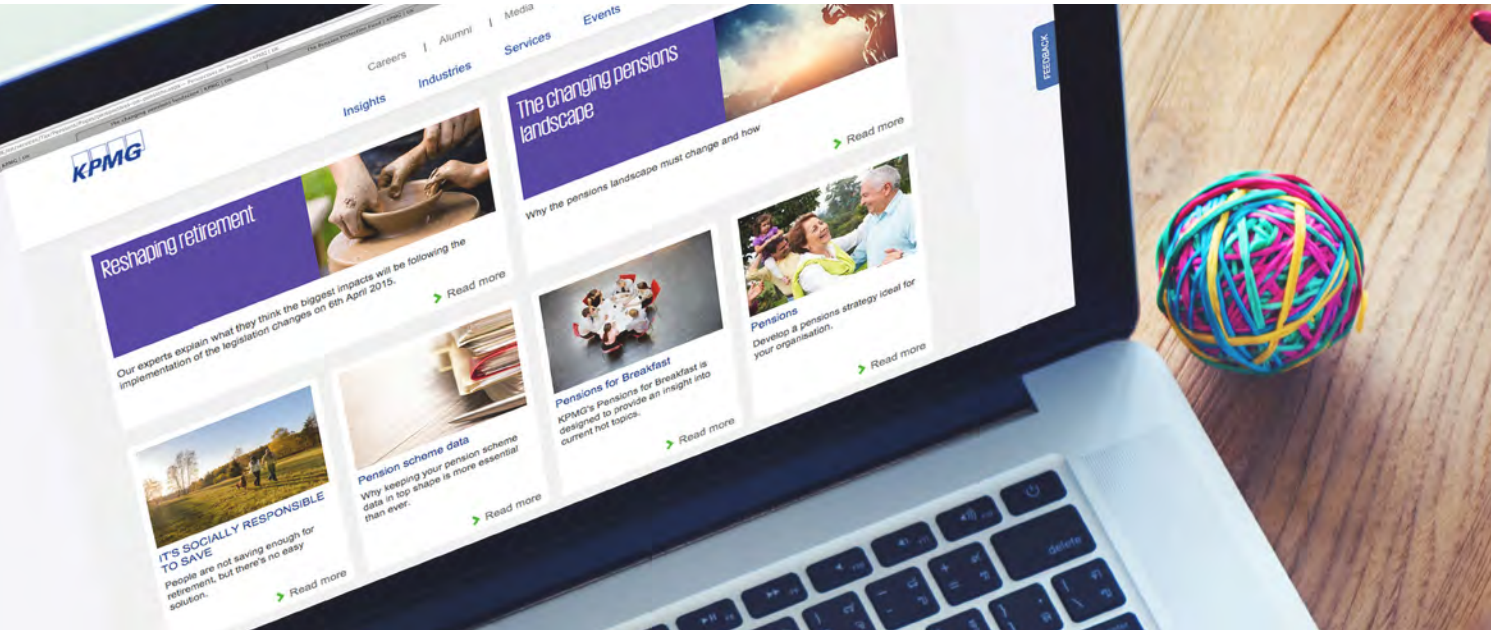
kpmg.com/uk/reshapingretirement

KPMG Pilot

Our technology solution helps your members understand and make the most of the new retirement flexibilities whilst also reducing IFA costs and your governance burden and improving your workforce management.

If you would like a demo of our new technology and to discuss how KPMG Pilot could help you, please get in touch.

kpmg.com/uk/pilot



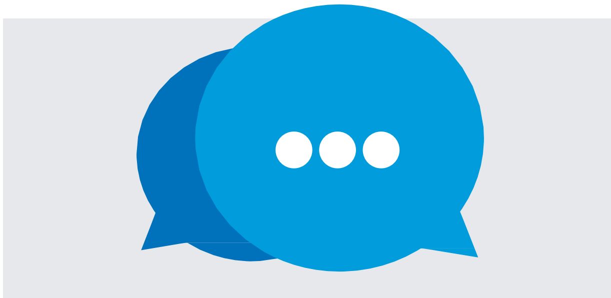
Perspectives on Pensions

We also wanted to let you know about our thought leadership pieces, Perspectives on Pensions.

You will find nothing but honest opinions on our industry, including some that may surprise you.

kpmg.com/uk/perspectivesonpensions

Pensions for Breakfast



The Chancellor will be setting out the results of Government's review of the current tax relief system for pensions in the Budget on the 16th March. This will include whether to align pensions savings with ISAs in terms of upfront tax relief or to move to a flat rate system.

If, as many expect, we do get a major reform this will have significant implications for all involved in UK pensions saving, Defined Benefit and Defined Contribution, public and private sector.

Join us for a debate at one of our "Pensions for Breakfast" events in March and April 2016.

To register please visit **http://bit.ly/20XDpma** or email **pfb@kpmg.co.uk**

KPMG Pensions Trustee Services

People
By balancing the right level of knowledge, experience and technical skills together with our passion, we provide Trustees with the advice to help them make the big decisions and members with the clarity to make informed choices.

Technology
We utilise technology. This encompasses our online modelling system, giving Trustees access to real time information and our online administration system, which gives members the ability to run their own retirement scenarios.

Breadth
Not only do we provide the core services needed by Trustees (administration, actuarial, investment and consultancy) we are also able to utilise the breadth of services offered by a Big 4 firm. This gives Trustees invaluable business insights.

Quality
Overriding all of the above is the commitment to quality that KPMG brings to everything we do. Nowhere does this matter more than in managing member data and getting their benefits right.

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Contact us

Would you like to talk more about the services KPMG can offer Trustees? Our regional Trustee services leaders are listed below.

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Wherever, Whenever

Introducing KPMG Fusion® – our online tool fuelling insight, powering conversations and igniting action for your pension scheme.

Designed to be simple and easy to use, Fusion® helps you better support pension risk management decisions with real time information, analysis and insights. It lets you dynamically model options for managing cost and risk – and helps you see immediately what you can achieve.

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Accessible on the move and available across a range of devices

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