



# Perfect Storm for Pensions Transfers

Altus

BUSINESS SYSTEMS & CONSULTING  
FOR FINANCIAL SERVICES

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# Perfect Storm for Pension Transfers

Few in the pensions industry have failed to recognise that there is a storm brewing for pension transfers whipped up by a combination of regulatory, demographic and market factors. Yet there is little sign of a consensus emerging on how to respond. The very nature of the problem means that it cannot be solved by any one part of the industry acting alone and, however hard it may be, a cross industry approach is required.

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## THE GATHERING STORM

### Key contributing factors:

- 5 million new pension policies created by auto-enrolment
- 1 million new automatic 'small pot' transfers a year driven by the DWP
- 30% average annual growth in SIPP's, of which 70% is transferred
- Increased demand for more sophisticated decumulation vehicles
- Free flow of pension money to enable open competition between providers

In the UK we now each have an average of 11 employers in our lifetime (DWP), we will have 50% more over 65's by 2030 (ONS), and over half of employees over 50 are winding down towards retirement with some form of flexible working rather than a hard stop (EHRC). The pensions industry can hardly remain unscathed by this level of demographic change and the corresponding demand for policy consolidation and more sophisticated decumulation vehicles will inevitably lead to more transfer activity.

Auto-enrolment represents the biggest single change to the pension industry in recent years and will result in an estimated 5 million more pension holders by 2018. The DWP have recognised that without further controls this will result in a proliferation of small pensions and whilst their automated 'pot follows member' proposal should go some way to address this it will also introduce an additional 1 million pension transfers a year into the equation.

Although the RDR requirement for timely re-registration of assets between nominees has landed hardest on ISAs there is a growing expectation, from both the regulator and the customer, that pension providers will step up to the mark in the very near future. Clearly this has most impact on SIPP's where the assets in the pension can be re-registered between providers but the established industry SLA of 6 days for a transfer involving multiple asset re-registrations will set a challenging benchmark.

The market itself is changing too. As a result of auto-enrolment new 'super trusts' have appeared with independent trustees and the capacity to handle huge numbers of the very smallest companies economically. The most notable new entrant is the government sponsored NEST scheme but a couple of low cost rivals have also emerged.

And the platforms are coming. Combining a broad range of open architecture investment options, slick presentation, and lower costs, many of the retail platforms are investing heavily in adding pension wrappers to their offering. To get a return on that investment they'll be relying on high-levels of transfers from traditional providers. For competition to work effectively, both between different platform providers and between platform and traditional providers, it must be possible for pension money to be transferred freely and consistently across all parts of the industry.

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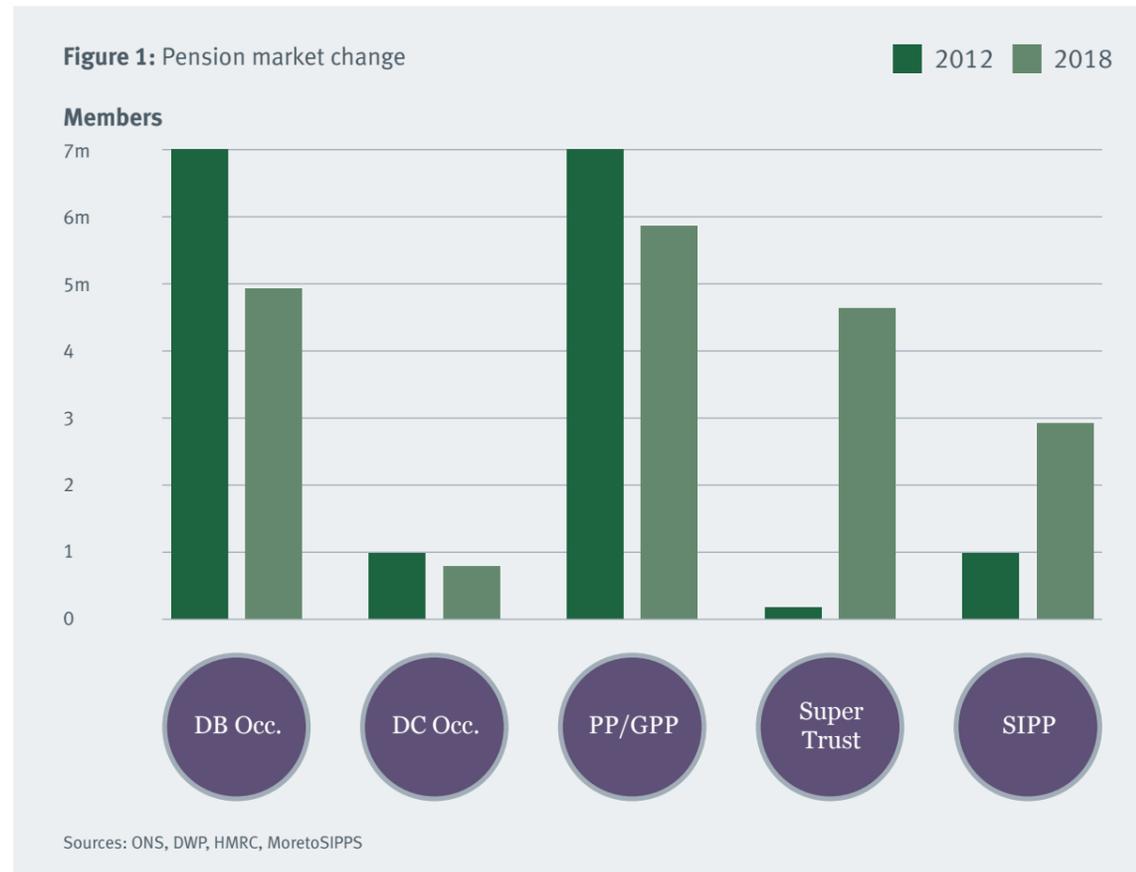
# The changing landscape

So how will all these developments change the pension landscape? As illustrated below, the current market is dominated by the traditional occupational defined benefit pensions and life office personal pensions. Our suggested figures below showing what the balance of power could be in 5 years rely on a certain level of guess work but there is no doubt that things will look very different.

97% of companies in the UK have less than 50 employees (DWP) – well over a million companies in total. The bulk of these will come under auto-enrolment rules from 2014. NEST alone expects to attract between 2 and 5 million members by 2018.

SIPP volumes have been growing by nearly 30% a year for the past 5 years (MoretoSIPPs). This looks likely to continue, or even accelerate given the recent investment from retail platforms and the likely increased demand for drawdown facilities, and we should expect to see the SIPP market move very quickly from niche to mainstream in the pensions market.

Private sector DB schemes will almost certainly continue to decline. The life offices will be caught in a competitive pincer movement by the super trusts and the platforms, but we can expect a robust response with life offices capturing some of their own auto-enrolment business and promoting their own retail platforms. Whether this results in a net loss or gain for the life offices remains to be seen.



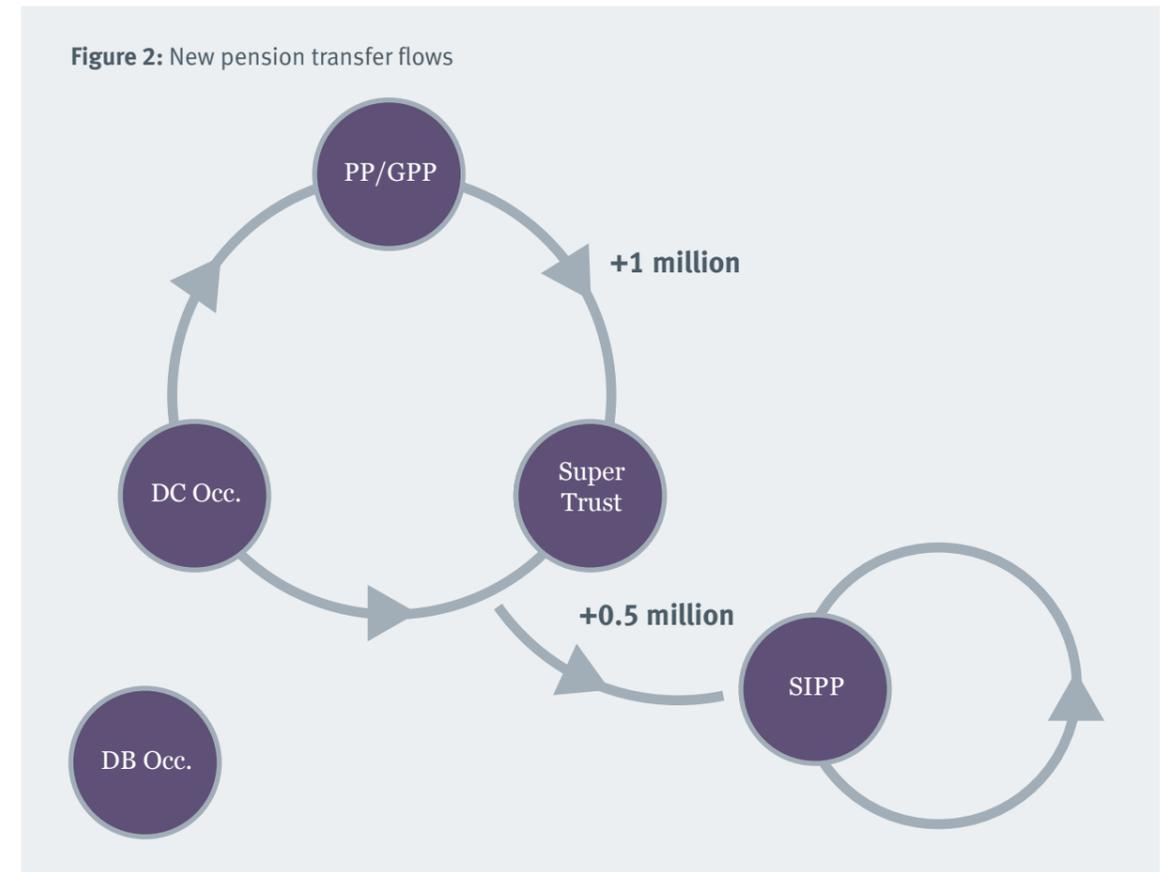
# New pension flows

These market changes will have a correspondingly dramatic impact on pension transfers.

The pensions bill currently working its way through parliament will introduce the automatic transfers of small pension pots between providers. Depending on the agreed definition of 'small' the DWP estimates this will create an additional 1 million pension transfers a year. Given the nature of the pensions being transferred, these transfers are likely to flow between the super trusts, life offices and occupational DC schemes.

The extraordinary growth in SIPPs has largely been driven by transfers from other types of pension. Over 70% of new SIPP business in 2012 resulted from transfers (MoretoSIPPs) and assuming, as seems likely, this trend continues, then 5 years from now we can expect this to be creating at least half a million transfers a year.

More generally, competition across the industry is increasing. Whilst the growth of the super trusts will be driven by new money through auto-enrolment rather than transfers, the platforms will expect to attract business both from more traditional pension providers and their more direct competitors in the SIPP market. If the ISA market is anything to go by this will create significant transfer volumes in itself.



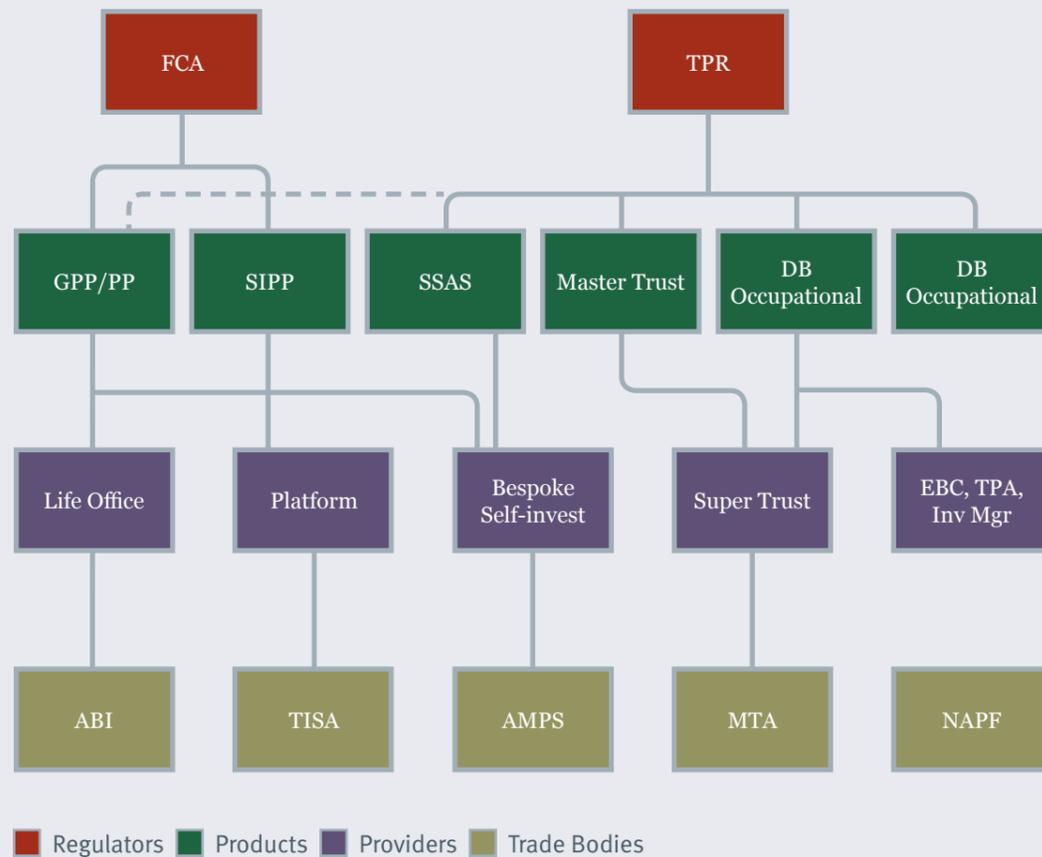
# The transfers challenge

So it seems we have an order of magnitude increase in pension transfers on the horizon. This presents two key challenges.

Firstly, as illustrated in figure 2, the major new flows of transfers are between different parts of the industry. Unless everyone handles transfers in a compatible way then we haven't solved the problem. As with many challenges in the pensions industry the answer is that you wouldn't want to start from here.

The complexity of the landscape – with two separate regulators, a plethora of different products with complex rules, and silos of providers each with a separate trade body – hardly encourages cross industry solutions. But we must find some minimum set of common standards that everyone can sign up to if we are to solve the transfer problem.

Figure 3: Pension landscape



# The industry response

Secondly, the profit margins in pension administration are small. And the profit margin in the kind of low value business generated by the auto-enrolment of a mass of small company employees is vanishingly thin. So the huge volume of new transfers has to be processed at a very low cost. Pension administration companies come in many shapes and sizes and the ideal low cost solution for one company will look very different to another: one size definitely doesn't fit all. Pension companies must be allowed to implement the right process for their operations and keep tight control of their own costs.

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In recent years, there have been three significant industry initiatives concerning pension transfers: the TISA led re-registration programme, the DWP small pension pots consultation, and the life office Origo Options service.

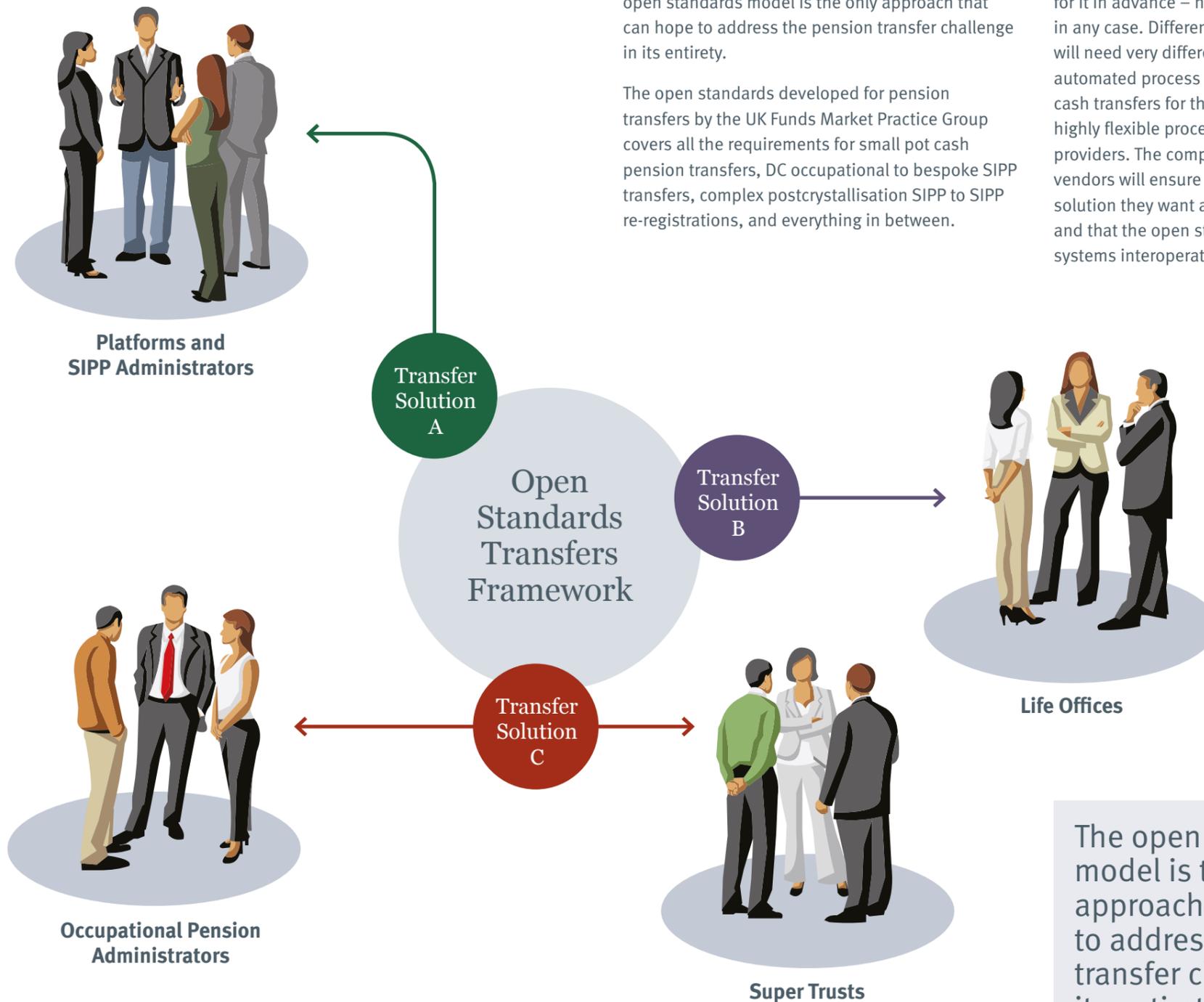
In response to the RDR re-registration requirement, TISA initiated a widely supported cross-industry programme to thrash out an approach. The result was an open standards based framework comprising ISO 20022 electronic messages, the UK Funds Market Practice, the industry owned SWIFT network and a new contract club, the TISA Exchange. No upfront technology investment was required. Instead, half a dozen technology vendors developed competitive solutions, each motivated to make sure they offer the best solution to their target market at the most competitive price.

In the six months since the start of RDR, the volume of transfers executed under the TISA framework have mushroomed from nothing to nearly 100,000 a month and continues to grow exponentially. Transfer times are down from many weeks to a few days, and in a significant and growing minority of cases, just a few minutes. The initial focus of the initiative has been ISAs and funds but the open standards have now been extended to handle pensions and the corresponding technology will be available for live transfers later this year.

In December 2011, the DWP launched their ‘small pots’ consultation. With the introduction of auto-enrolment and the demise of short service refunds, the DWP reasonably anticipated a considerable increase in the number of very small pension policies. The outcome is a provision in the new pensions bill for the automatic transfer of these ‘small pots’ so that an individual’s pension will follow them to their new pension scheme when they change jobs. The DWP are still considering how best to achieve this outcome and it is too early to make decisions on what, if any, technology solutions are required. But it’s been enough to raise the spectre of another expensive and ultimately ill-fated central government IT system and the big IT suppliers have started circling.

In collaboration with the ABI and leading annuity providers, Origo Options was launched in 2008 to speed up the purchase of annuities at retirement. More recently, the service has been adapted to also support cash pension transfers. To their credit, Origo have played their part in the TISA re-registration programme, launching their own compatible ISA transfer solution and contributing to the development of open standards for pension transfers. However, it remains to be seen whether the Options service for pension transfers will similarly be opened up to interoperate with other suppliers using open standards.

Figure 4: Open standards solution



# A joined-up solution

Given our upbeat assessment of the TISA initiative above it will come as no surprise that we think the open standards model is the only approach that can hope to address the pension transfer challenge in its entirety.

The open standards developed for pension transfers by the UK Funds Market Practice Group covers all the requirements for small pot cash pension transfers, DC occupational to bespoke SIPP transfers, complex postcrystallisation SIPP to SIPP re-registrations, and everything in between.

It won't be necessary to get the whole industry to agree to use one system or to get them to pay for it in advance – neither of which is very likely in any case. Different segments of the industry will need very different solutions: a highly automated process for huge volumes of simple cash transfers for the super trusts; a low cost but highly flexible process for the small bespoke SIPP providers. The competition between technology vendors will ensure that providers get the solution they want at the lowest possible price, and that the open standards will ensure all those systems interoperate.

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# A bright future

12 A joined-up solution will do more than simply cope with the expected wave of new transfers. With simpler and cheaper pension transfers across the industry, the emerging competition will be able to act more freely – to the benefit of the long suffering customer.

We may also see a move towards more in-specie re-registration. Providers in the ISA world now find that re-registration of assets is far quicker than selling assets and transferring cash. More importantly the out of market risk for the customer can be minimised and carefully managed by the new provider.

Importantly, given the increasing pension liberation problem, the process will also be more easy to police. Reputable providers will sign up for the contract club with its associated guarantees and liabilities, and transfers between such companies can flow automatically without touching the sides. Requests from less reputable sources can be easily identified and subjected to more rigorous checks.

# Conclusion

Pension transfer volumes will be increasing by an order of magnitude over the next 5 years and it's widely accepted that radical improvements to the transfer process are necessary. It won't be possible or practical to get all providers to agree on one process and one system, but by agreeing a minimum set of standards we can connect the industry up in a consistent way and still allow each part of the industry to go their own way when it comes to solutions.

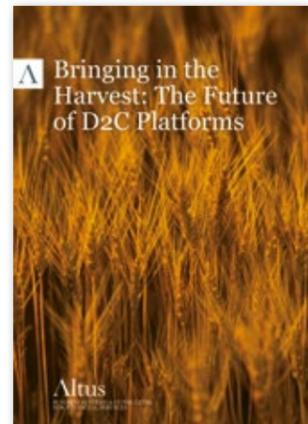
Many have worked hard to create the right technical and legal framework to bring this about, building on the successful open standards foundation laid down by the TISA re-registration initiative. But there are still some who are arguing for new central systems or solutions sponsored by just one part of the industry. We hope they come round to the logic of an open standards approach because, quite frankly, we can't see it working any other way.

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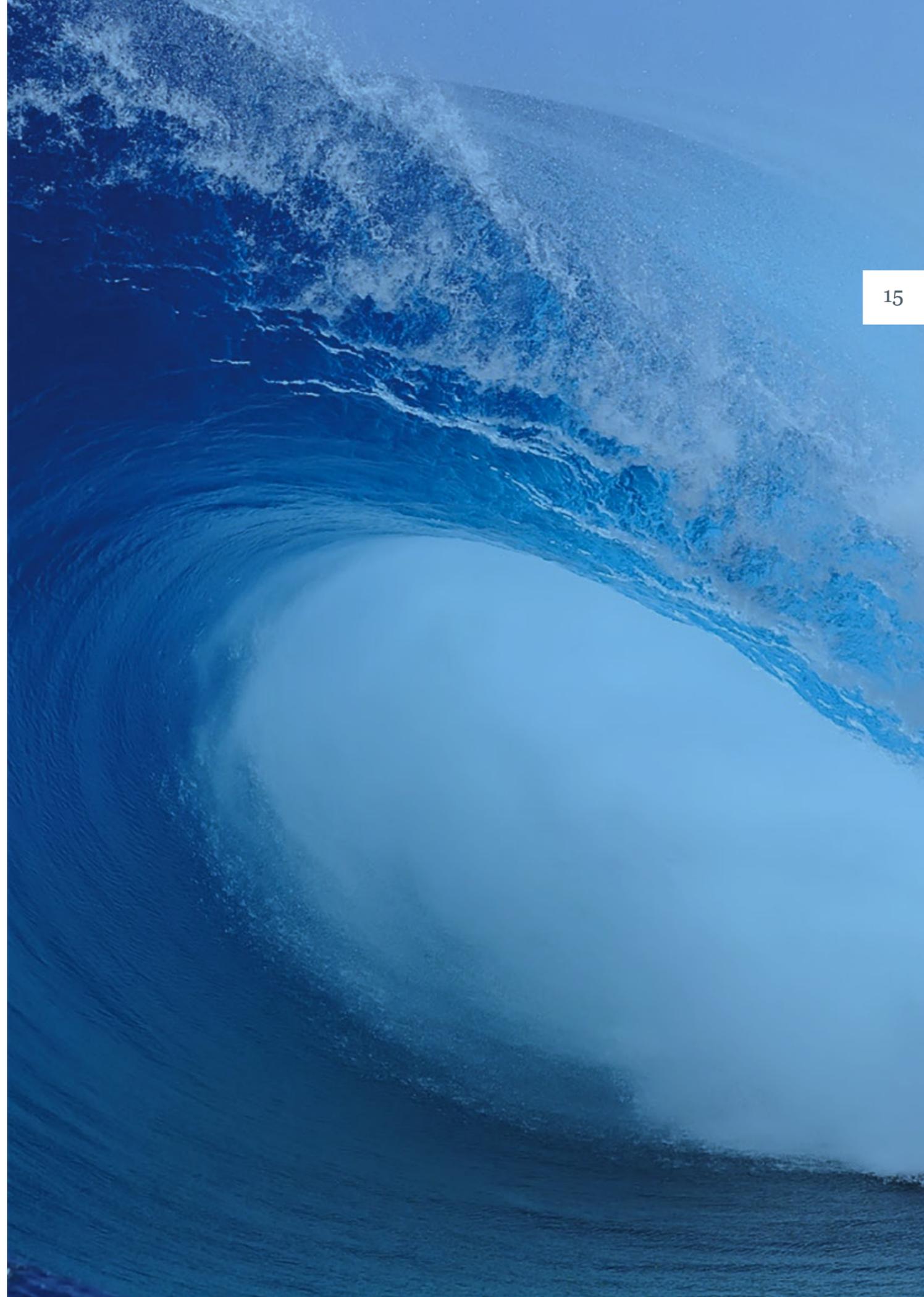
## The Platform Machine: Tuning for Efficiency

Our white paper 'The Platform Machine' takes a good, hard look at the economics of the platform industry lifting the bonnet on platform operations and asking the all-important question "how do you turn scale into profit?"



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