

Issue 103: Is the time right to outsource your pension scheme administration?

While some companies and trustee boards have previously opposed outsourcing their pension scheme administration, times are changing. The constant stream of changes to legislation, the changes to the structure of scheme benefits and the increases in the demands of members are leading them to question whether now is the right time to outsource.

The in-house versus outsourcing argument has been around for almost as long as pension schemes have been administered and, until recently, both options had their merits in the right circumstances. However, sponsors are now fairly unanimous in thinking that it would take a very brave person to take the decision to set up a new in-house pensions function. Outsourcing can deliver an efficient, member friendly, secure and cost effective service which relieves the sponsor from the headaches of programming and updating an administration system, recruiting and retaining good quality administration staff and managing quality service delivery.

Many company sponsors took the decision to provide in-house services some time ago and may still regard this as the right option going forward. Sometimes this is because it is difficult to assess the case for outsourcing in a robust way and thus difficult to make such a recommendation. For those who wish to consider alternative options to the status quo, undertaking a feasibility study can be the answer. Such a study will help sponsors to:

- understand cost drivers and identify the full costs of their pensions administration function;
- identify the merits and demerits of the alternative options ranging from full outsourcing to an alternative in-house strategy; and
- identify the inefficiencies of the current structure and the potential future cost savings, benefits and pay back period, for a preferred new strategy.

One of the biggest arguments for maintaining the in-house solution is often 'greater control', 'confidentiality' and 'it's in-keeping with our paternalistic culture'. While in some cases these may still be valid arguments, the world of administration outsourcing has moved on since the 1990s when the first large schemes began to outsource. It is possible to maintain a high level of control through contract terms and conditions and working patterns. Confidentiality is rarely an issue now since professional firms have high levels of accountability and ethics.

Some of the arguments for outsourcing include:

- Significant savings could be achieved by using a third party administrator's (TPAs) systems. System up-grades to take account of legislative change become the burden of the TPA and the costs can be spread across all clients. Maintaining systems in-house can be very expensive and IT support from the supplier can also be expensive and slow in delivery, particular when trying to achieve change;
- Some forms of scheme change such as Career Average and/or Defined Contribution, can generate such a large requirement for systems modification that an entirely new system or a significant rebuild may be required. The cost of this may be prohibitive and the disruption to services unacceptable;

- The growing desire by members for on-line access will require clean data, regularly up-dated and high levels of accuracy. A TPA will be geared up to high levels of automation in order to provide instant and cost-effective services while maintaining good levels of profitability. Outsourcing can provide ready access to such facilities; and
- With the demise of defined benefit schemes, the arguments for retaining costly in-house functions become more difficult to justify. Outsourcing provides access to a service that will match the size and profile of the scheme automatically with each contract renewal and without the need to consider redundancies and the cost of employing, training and maintaining a diminishing in-house resource. Companies in all business sectors are coming under pressure to reduce headcount and non-core business areas may be a target, particularly if other functions such as payroll and other HR services have been previously outsourced.

A feasibility study on outsourcing can be used to consider all the arguments carefully and to provide a reliable business case for the chosen solution. It can offer:

- a full appraisal of the options – outsourcing can be full or partial depending on circumstances and objectives; one size does not fit all and alternative in-house solutions could also be considered;
- a careful appraisal of the risks – it is important that risks are identified and measures are implemented to avoid and mitigate risk as much as possible including nasty surprises;
- identification of the issues that will inevitably be faced including allaying the fears of those who have previous poor experience of outsourcing;
- a clear indication of the costs, the factors that affect the trustees' ability to control costs and the time period over which any pay back will be realised. This will help to manage expectations and in measuring and monitoring performance and delivery of objectives; and
- information to enable a robust decision to be taken either way.

Hewitt conducts outsourcing feasibility studies to help companies make reliable comparisons around the packaging of outsourced services i.e. deciding what to outsource, and the identification and collection of data relating to the true cost of pensions administration. A thorough cost review will also help to ensure that no services inadvertently "fall between cracks". Direct costs are easy to identify by a pensions department but indirect costs can be very difficult. To say that a cost does not exist because it is not identified or charged to the pension scheme is a mistake and one that will inevitably lead to disappointment later. Indirect costs and services include those which may be:

- incurred by other parts of the company as part of another budget such as work carried out by finance, HR, company secretary;
- centralised costs such as stationery, postage, electricity, IT support, accommodation, HR services, etc; and
- staff management, training and development carried out by the employer and not re-charged to the pensions department.

All of the above could be passed to the TPA

An effective feasibility study should provide all the relevant information required to make a clear comparison of the relative strengths, weaknesses, opportunities and threats of each option and lead to an easier and more reliable decision, providing the business case for the chosen option, demonstrating due process and providing confidence in the decision.

To discover whether you are getting the best value for your administration please contact your usual Hewitt contact or [Lorraine Harper](#) +44 (0) 20 7939 4414.

If you would like to receive these bulletins by e-mail, please contact spotlight.enquiries@hewitt.com.

