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Executive Report

Insurance industry

IBM Institute for Business Value

The future of the pensions industry

Power to the members

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By Jason Nyilas and Christian Bieck

The retirement and pension industry is changing, shifting away from government and employer models to individual responsibility for finances in retirement. Retirement providers have to be aware of and implement five key principles – the pensions imperatives – to be successful in this changing market.

The world is going retail.

As uncontroversial as this statement is for most areas of life and thus for most industries, it poses interesting and significant challenges for the retirement industry.

Until recently, the three pillars of retirement funding – government pensions, corporate pensions and private savings – were separate, non-interchangeable areas and sources of business for its players. But now, a seminal change is underway:

- People are living longer, healthier lives, endangering the sustainability of most national government pension schemes. These models, mostly defined benefit or final salary, were designed at a time when a pensioner was expected to live only about ten years into retirement. The age pyramid allowed working populations to comfortably support their retirement communities. Today, however, with projected worker/pensioner ratios of 2-to-1 or worse, public systems are going to need additional overhauls and more funding.
- Rapid technology shifts over the past 20 years have led to the rise and fall of entire workforces. Lifetime employment with a single company has become a rarity. Where workforce turnover is high, the portability of corporate pensions becomes important. In some cases, this is mandated by law; in others, it is a differentiator when competing for scarce talent.
- When public systems fail and corporate schemes become portable, it is the end customer – the individual growing and protecting his or her retirement assets – who has to be served by the industry.

Instead of serving one corporate customer, retirement providers will need to serve many individual customers.

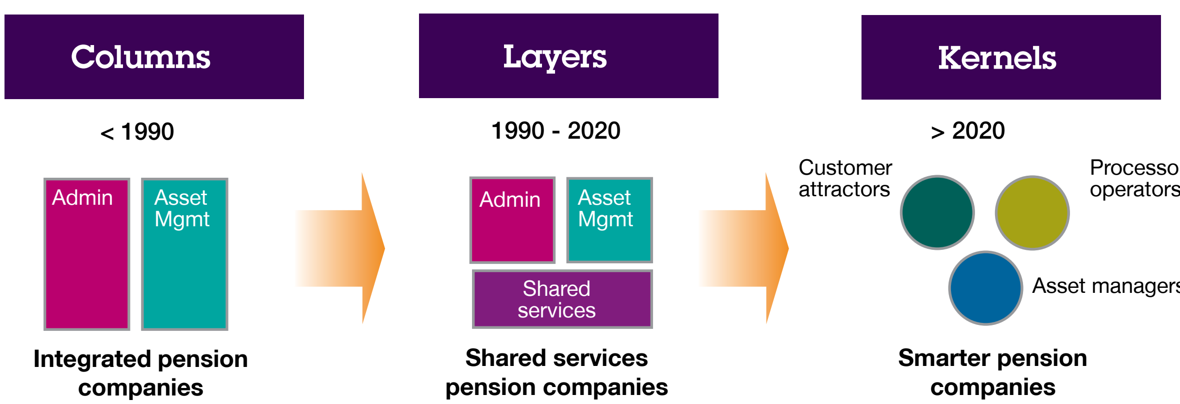
If the decision with whom and how to do business in pensions is shifting from companies and government agencies to individuals – if the world is, indeed, going retail – the comfortable "one-to-few" relationship that retirement providers had is changing to a much more demanding "one-to-many." Instead of serving one large customer, they will have to serve many empowered consumers. But how can they do this?

In this report, we identify the key issues that retirement providers will have to solve to participate and thrive in the future of the retirement savings and pension world. We base these "pensions imperatives" on our experience in working with successful retirement providers, and provide examples of application. It is no accident that many of these examples are from Australia. Driven by strong legislation over the past 20 years, the Australian pensions market is among the most advanced in the world.

An added challenge for pension providers is the accelerating rate of change. Nearly 80 percent of CEOs interviewed for the 2010 IBM Global Chief Executive Officer Study say the world is becoming increasingly complex, yet less than half feel prepared to handle that complexity.[1] Of those who say they are prepared, not all actually are. But, with the right toolbox, escalating complexity becomes manageable. For the pensions industry, this toolbox is represented by five imperatives.

Imperatives for change

In searching for better ways to manage complexity, successful companies realize they can no longer try to be everything to everybody. In the past, few products, few customers and clean interfaces allowed integrated pension companies to operate well with functional silos. This is the model we are still seeing today, often with the addition of shared-services layers. The latter provides cost benefits. But, as the model is still largely monolithic, flexibility is limited. In the future, agile pension companies will focus on a few specialized units, or kernel functions, around a provider's actual core competencies – what the company does best and where its competitive advantages are. These kernels are concentrated on serving the customer, handling the administrative details or managing the assets. (See Figure 1.)



Source: IBM Global Business Services.

Figure 1: **Strong demand for individualization and increasing economic pressure will drive transformation in the retirement industry.**

The transition from silos to kernels is a tough one, as it requires more than just a switch in business focus and technology. Rather, it requires a change in business model and thinking – away from the traditional approach of "we can be good at everything" to the necessary specialization the kernels imply. This change can be accomplished by implementing the five imperatives of pensions:

- Acquire business via employer and retain it by member
- Provide centricity around the member
- Enable members to self-manage their pension decisions and affairs
- Invest in innovative technology
- Drive investments by stakeholder needs.

These imperatives are not options to pick and choose from. Depending on the role a company wants to play in the future, the level of implementation can vary. But, ultimately, all five imperatives will have to be accommodated to position for success. Why? Because the imperatives are based on industry developments that no company is likely to escape.

Imperative 1: Acquire via employer and retain by member.
In the past, a major part of retirement business was acquired through employer schemes and industry funds (also known as affinity groups). While the manner of acquisition will change, with lifetime employment being the exception rather than the rule, these avenues will still provide access to the greatest number of member accounts. With growing employee turnover, providing flexibility for employers to manage pension schemes will be a key requirement. The most successful pension providers will be those who make it easiest for employers to update member information, generate reports for themselves and their stakeholders, execute pension payment transfers and implement changes to performance measures.

The five imperatives are not options, but must be accommodated by all providers to some degree.

The obvious instruments to achieve these goals are pension portals, but they have to be more than a simple bundling of functions. They have to be workable and easy to use for large corporations, the shop around the corner and the individual member. They have to be flexible in terms of the devices with which they can be used, and they have to integrate into the employers' businesses, i.e., payroll and HR systems. The latter is worth repeating: in the past, employer portals were well integrated into the provider's business, but not the employer's. This created redundancies, forcing the employers to manually transfer output of their own HR systems to the pension provider. In the future, those providers with the best enablement of straight-through processing are likely to come out ahead – the idea is not to shift work from the provider to the employer, but rather to remove those redundancies.

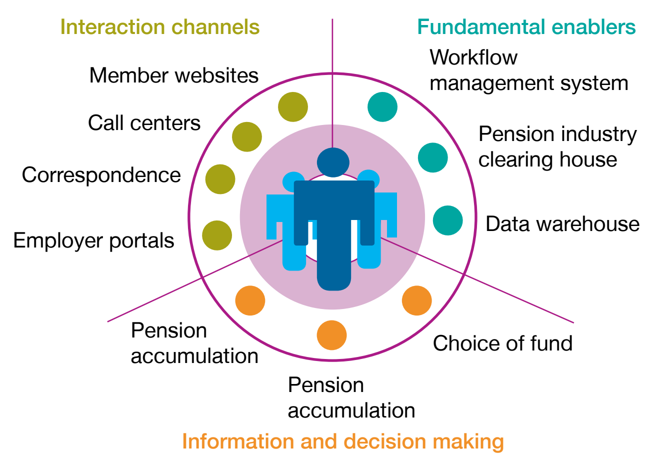
As an example, Russell Investments provides investment products and services to individuals and institutions in 47 countries and focuses on a multi-manager investor approach.[2] In Australia, Russell also administers corporate pension services for a variety of leading corporations and has developed a specific set of services for corporate clients. These employer services, consisting of software to complement and consolidate an employer's payroll and HR activities, as well as scorecards to report on contracted service levels, have been incorporated into an employer portal. The portal allows easy access for employers to execute pension contribution payments to their members.

Two benefits are achieved by vertically integrating Russell's administrative operations into client payroll and HR processing functions through the employer portal. First, employers can plan, coordinate and control the member contribution process directly between themselves and Russell. Second, Russell can streamline the entire contribution process and re-assign where some of the work is performed and who does the work within the two organizations. In an era where administration costs are on the rise as employers demand more services for the same price, providing additional functionality into a client's business can, in some cases, lower the costs of running an administrative business, while adding benefits to clients.

Imperative 2: Provide centricity around the member

The length of time a typical employee works at one company is decreasing.[3] To help this worker mobility, legislation improving pension portability has been or is being introduced in many countries around the world, as in Australia since the introduction of SuperChoice in July 2005, or as in a pending European Union directive. Once their pensions accounts become portable, members will not only want to move funds from employer to employer, but also will want to add other retirement offerings, such as long-term savings funds or annuities, into the mix. In the past, without portable pensions, providers never had to care about the retail aspects of the business, such as customer experience. The consequence is that many players are not very good at it. Ninety percent financial services CEOs interviewed for our 2010 CEO study named "getting closer to the customer" as their top strategic investment priority over the next five years (2010-2015). Further discussion indicated that these CEOs were quite aware of the gap between customer expectations and their companies' ability to understand and meet them.[4]

Member centricity begins with information designed for one purpose only – accessibility and decision making for the member. Figure 2 shows the factors that have to be considered for member centricity to work. First, access has to be easy and across a wide variety of channels, something that consumers are coming to expect from all industries, including insurance and pensions. Indeed, a recent study shows that more consumers are using several channels simultaneously, and with each new interaction point that becomes available, we expect a significant number of people to use it.[5] Second, consumers want decision making power over their pensions – a point on which we will elaborate in the next imperative. To enable that, they need the tools of decision making, i.e., information and choice. Last but not least, some underlying functions are necessary, such as an industry-wide clearing house that can transfer retirement funds efficiently to a member's nominated retirement account(s) if those accounts are not with the employer.



Source: IBM Institute for Business Value.

Figure 2: **Member centricity begins with information designed only for one purpose: accessibility and decision making for the member.**

Even though Figure 2 is not intended to be comprehensive, it shows the challenges that pensions providers face when trying to do member centricity well. An example of a company moving in the direction of member centricity is Australia's BT, a subsidiary of Westpac. Its superannuation (pension) accounts are similar to regular bank accounts, including the ability to make ATM withdrawals. Members can choose their level of involvement in decision making, from a fully automatic investment mix, depending on age and personal risk preference, to a hands-on approach where members manage their funds more or less individually. Fees are per month or year, without entry or exit fees, encouraging individual fund management. Finally, invisible to members, the BT superannuation accounts link into employer systems, again facilitating the transfer of funds.

Imperative 3: Enable members to self-manage pensions

In 2011, the Australian pensions industry had a volume of approximately US$ 1.3 trillion pension assets under management, according to the Australian Bureau of Statistics. Forty-four percent of the pensions funds under management were self-managed by 750,000 members or trusts.[6] As noted previously, the Australian market is among the most advanced in many respects and is indicative of where the industry is heading. We believe that self-managed pensions will become one of the fastest-growing categories in the future. Markets in Asia and emerging nations will be catching up first, as they are expected to bypass much of the legacy corporate pensions phase. The United States and Canada will likely follow. In Europe, most governments appear to shy away from a compulsory type contribution regime and may start to introduce softer types of savings compulsion.

As the concept of self-managed pensions becomes more accepted, advisors and pension providers will have to rethink their role and the value they add to the industry. Advice and decision making support will start to move from traditional pension providers to boutique firms, accountants, tax consultants and individuals who want to do everything on their own. Existing pension providers can still play these roles, but a different level of advice and service regarding fund and share information will be required and delivered through a more interactive and customer-centric business model. The main issue will be one of customization. Each member's requirements regarding market assessments, fund performance information, relevant legislation, accounting and tax advice will be largely the same in terms of the broad building blocks, but members will appreciate the ability to tailor to individual needs.

This will lead to "pensions-in-a-box" concepts that, based on a portal structure, can incorporate everything from completely anonymous, do-it-yourself models through to personal advice. Generally, they operate for a reduced fee or even for free in order to offer a variety of other related services, including tax and accounting advice. The philosophy behind these concepts is to let individuals take control of their retirement savings and invest in the way they want. Typical support with self-managed savings by these companies includes setting up the self-managed fund (and trustee arrangement), online self-learning, the ability to execute stock and bond transactions through e-broking, an online educational library and fund transfers for additional rollover and other contributions. It is up to savers to determine how much do-it-yourself activity they desire and how much support they want to manage their affairs.

As self-managed pensions become more prevalent, providers will need to reassess their roles in the industry.

To date, it is interesting to note that no asset manager or administrator has captured a significant part of the self-managed market. By its very nature, those individuals who wish to have a self-managed pension scheme have, to some degree, decided to not utilize traditional providers of asset and administration services. Instead, the self-managed schemes or trusts are created by individuals in conjunction with their local accountant or lawyer. The funds are bought directly in shares or government bonds or held in cash. For individuals and small-to-medium-sized businesses, the tax benefits in a self-managed environment can be far more advantageous than holding assets in a regular fund-driven pensions account. At the time of writing, there are more than 400,000 self-managed funds in the US$400 billion market, with an average asset size of less than US$1 million.[7]

As a result, several Australian professional organizations and websites offer self-managed services, each with different slants to what they offer. The common goal is to place control in the hands of the individual and then to drive services from the activities the individual wants to contract out.

In 2011, Australian wealth manager, AMP, took a 49 percent stake in Super IQ, a specialist self-managed fund administrator.[8] Super IQ is an online platform that enables an IT-literate advisor to immediately set up a self-managed account for its client, including the trust deed, corporate trustee and application for a self-managed tax number. It also enables the trustee to set up some default investment arrangements. Increasingly, financial planners are aligning themselves with accounting professionals to better target the self-managed market. Platforms such as Super IQ allow collaboration between such professions.

Customers do not care about innovation – only its results.

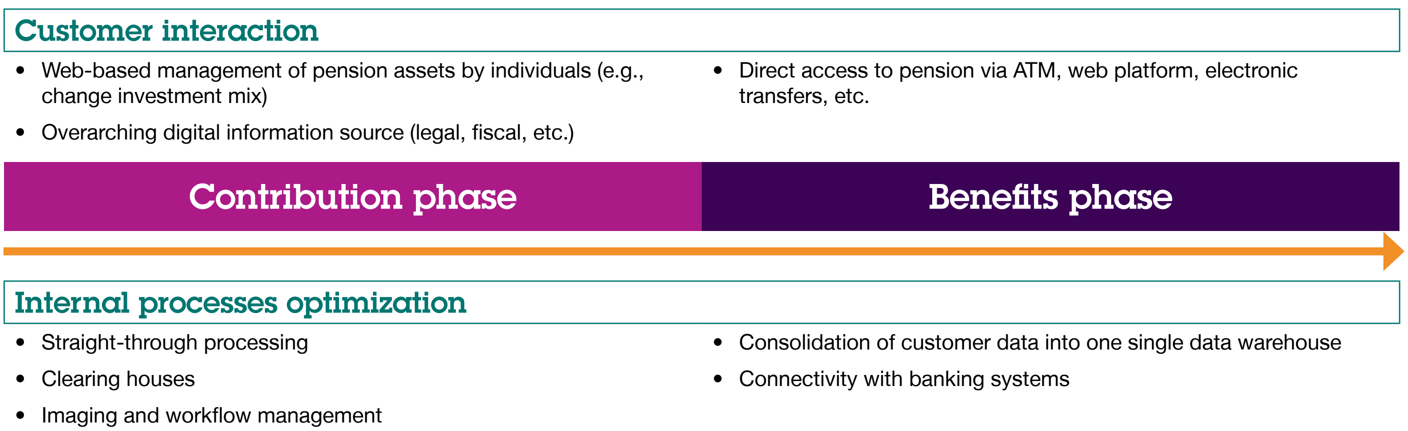
Another example of a wealth manager who is investing in the self-managed market is ANZ Bank. ANZ has a subsidiary, Super Concepts, the second largest self-managed administrator in Australia.[9] Super Concepts provides accounting and related services to more than 4,200 self-managed clients, with assets under administration in excess of US$4 billion. Similar to Super IQ, the company provides a range of services or packages for the member or trustee. Again, the idea is to aggregate as many self-managed services as possible and provide default services or allow individuals to customize their own mix.

Imperative 4: Invest in innovative technology

"Innovation" tends to be a frequently misunderstood (and misused) term. When in an early study we asked consumers how important they felt innovation was for a financial services provider, the most enlightening answer was "an innovative provider is one that finds new ways to take our money."[10]

Ultimately, the customers of pension administration services don't care about innovation per se, but rather about its results. Whether these results are the lowering of cost, an increase in speed or depth of service, or some completely new offering, the market will reward providers with the highest agility in implementing them.

In most cases, we are not talking about anything radical or new. Internet technology has been around since the inception of the web, and pension providers can make use of tools that the banking industry has successfully developed out of these technologies, from connectivity to management platforms, all the way to withdrawing pensions per ATM (See Figure 3.)



Source: IBM Institute for Business Value.

Figure 3: **Technology innovation will play a dominant short- and long-term role in customer interaction.**

Why is technology an imperative? We are talking less about hardware or software per se, but rather their effective and efficient use. This is important to keep administration costs down while maintaining competitive advantage in services. At the same time, technological cycles are becoming shorter, so investment decisions have to reach a reasonable ROI in much shorter time than the industry was used to, often in under one year.

A side effect of this imperative is worth noting: size matters. For a pension provider, volume of members is critical, if only to spread investment costs across the greatest number of stakeholders. That means that providers have to aim to reach a critical mass, which can be lower depending upon the efficiency of their technology use. Size and agility will allow an evolutionary trial-and-error approach to innovation – “test quick, fail fast, keep what works.”

With the 49 percent stake in Super IQ, AMP has introduced new technology into the advisor world. The front end access to Super IQ can be through an iPad or similar devices with rich functionality for handling a number of self-managed individuals and businesses. There are real-time links into the tax office to create tax account numbers on the spot.[11]

Supporting Super IQ and other self-managed providers, a number of packages have emerged to aggregate data for the preparation and lodgment of individual and business tax returns. Technologies such as CLASS and SuperMate, have been designed to support and simplify activities in the self-managed arena by the consolidation of data and electronic presentment of a number of previously manual activities.[12]

SuperChoice is an online clearing house and pensions contribution processing system. It standardizes and handles default and choice payments made by over 50,000 Australian employers for 1.75 million employees annually. The clearing house is aimed at the employer, who can utilize standard remittance formats, eliminate rejected payments and re-badge the clearing function as part of their own pension processing environment.[13]

Traditionally, employers in pension processing have been burdened with manual processes, paperwork and check processing and reconciliation. The SuperChoice pension clearing service receives any non-standard contribution item and transfers the data and funds via a secure network to the intended administrator.

Russell Investments, which we cited earlier, uses the everyday banking channel for quick and easy customer access to funds.[14] This solution, while simple in its concept, is a strong example of using technology to retain an existing customer base. Many customers leave pension providers when their working lives and accumulation phase has finished, as they take their funds and put them into retirement products with someone else. Most providers wish to retain their customers at this key life stage. In providing an easy-to-use withdrawal mechanism, Russell's customers, rather than look elsewhere for their pension products, can have a seamless benefit when moving into their retirement phase.

Imperative 5: Drive investments by stakeholder needs

Each dollar invested by a pension provider should directly benefit at least one of the key stakeholders – the member, employer, advisor or trustee. While this seems like a truism for all business, in our experience real-world companies surprisingly often ignore this rule. Even in the old silo times, not having a clear idea and definition of who your stakeholders are, what each of them wants (and gets) and in what order of priority was hardly a recipe for success. Fortunately for the providers of yesterday, the closed-off nature of the market was sufficient protection. Unfortunately for the providers of tomorrow, in a world of portable pensions, the slow and vague will be left without stakeholders to define.

Over the next three-to-five years, the member will become the prime beneficiary of corporate discretionary spend.

Most of today's pension providers invest in satisfying the employer and, to a limited extent, the member. We believe that a significant shift is on the way to satisfying individual needs and that, over the next three-to-five years, the member will become the prime beneficiary of corporate discretionary spend. This does not mean the employer is not critical – however, as governments encourage more self-reliance by individuals, the power of where funds are invested will rest with the member. The examples we showed previously – portals, member-centricity and self-management facilities – could be directly reused here to underscore our point.

As the pensions emphasis becomes more and more about what the member requires, we will see that all four stakeholder groups – member, employer, advisor and trustee – will demand more specific benefits from their providers. Therefore, pension providers will increasingly develop value propositions for all four stakeholder groups. In truth, there may be very little discretionary spend given to some of these stakeholders, but companies will devise ways to differentiate offerings to all four areas.

A look into the future

In previous sections, we described where we believe the five areas of action are for players who want to stay successful in the market for retirement products and services. We stated that, in our opinion, all of them will be important – we call them "imperatives" for a reason. But what are the priorities? Where should providers focus first? Before we attempt an answer, we have to take a look at some of the influencing variables.

We are convinced that by 2020, the pension fund industry will have moved significantly towards a retail marketplace with individual responsibility for retirement savings. That said, the speed and flavor of this change depends on a variety of parameters.

Markets

- Economic climate: how fast will GDP grow? Will it grow at all, and if not, how can a growth-less economy work? High growth will mean more market potential, but not necessarily less cost pressure, depending on the overall innovativeness of the industry.
- Level of regulatory intervention: considering the turmoil we have been seeing in the financial services industries since 2008, and the political declarations of intent to regulate said industries, surprisingly little has happened in actual regulatory change. As this is a political process, any prediction what will happen is difficult. For pensions, we are still fairly certain that any regulation will facilitate shrinking government pensions and growing the private market.

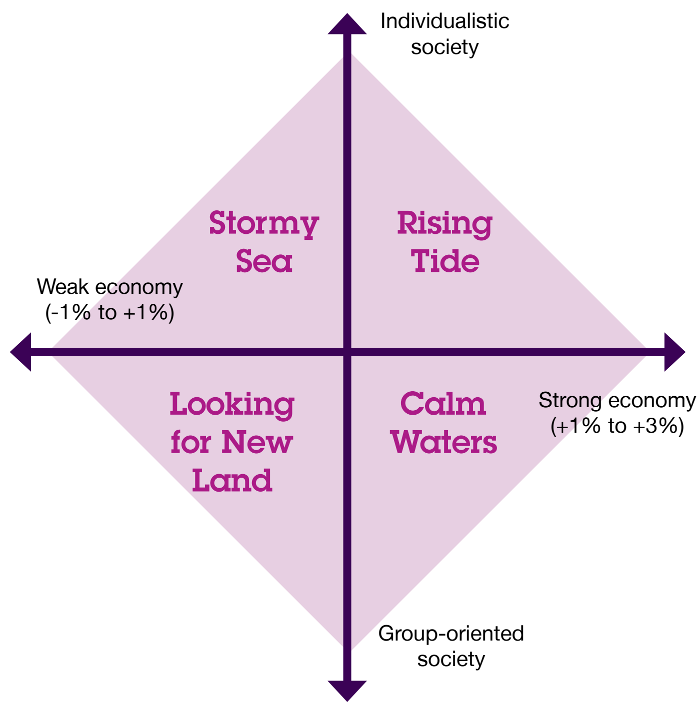
People

- Level of consumer empowerment: how much will consumers take charge of their business relationship with providers? More means more pressure on innovativeness and cost levels.
- Speed of digital lifestyle adoption: this will affect the channels providers have to serve, including those that use technologies not even in existence today.
- Talent shortage: while shrinking workforces make talent shortages in the developed economies a virtual certainty, how exactly the economic players will deal with it is a matter of speculation. In the end, the less talent there is, the more technology will have to replace it, even in areas where traditionally people had the advantage (like qualified advice).

Other environmental factors

- Societal orientation: will society become more or less individualistic? This will mainly influence the options providers have for services and offerings, but also prices they can charge and thus niches that can be carved.
- Impact of climate change: this can have effects on longevity or health, and so indirectly affect the retirement industry.

Combining these parameters and possible actual future values would allow us to generate scenarios for the future of the retirement. Figure 4 shows an example of where this exercise could lead, using economic climate and societal development as parameters.



Sources: IBM Institute of Business Value.

Figure 4: **: How pensions will look in developed markets by 2020.**

In the “Rising Tide” scenario with strong growth and an individualistic society, there are huge opportunities for providers to develop customized offerings, whereas in the “Looking for New Land” scenario (low growth, stronger collectivism) the market is smaller and the cost pressures much higher.

How does this help to answer the initial question of this chapter, how to prioritize the imperatives? In our opinion, the very uncertainty about the future and which scenario will hold shows that providers should not put too much weight on prioritizing. Instead, they will need all five imperatives to survive. No matter which of the scenarios in Figure 4 comes to pass, retirement industry players will need to define and serve their stakeholders, continuously invest in innovation, and serve members and employers in various ways. If any prioritization can hold, it is one of organizational mindset: be agile enough to implement the imperatives quickly and adapt to any scenario that comes along.

Financial services industries are quite good at inventing new products, but all too often wait for regulatory pressure to enact deeper change, both to operational and to business models. Of course, existing regulation protects incumbents, but in today’s open world, waiting is not enough. A pensions provider that follows the five imperatives can quickly move into an opening market with the business model that works elsewhere, tweaking where necessary to local conditions.

And there are some conditions we can count on everywhere: the world is growing older. And it is going retail.

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