The Trustee toolkit downloadable

How a DC scheme works 2014

Tutorial three: Transaction processing

By the end of this tutorial you will better understand:

- the types of scheme transactions
- the implications of late or inaccurate transactions
- the employer and trustee roles in calculating and collecting contributions
- the time period within which the employer must pass contributions to the administrator
- what a payment schedule is
- effective methods of monitoring scheme transactions
- the steps trustees could take to pursue and resolve late or inaccurate transactions

This tutorial is part of Scenario one.

Glossary

A detailed glossary of technical terms can be downloaded from the Resources tab when you log in at www.trusteetoolkit.com

The Pensions Regulator

Introduction

Trustees look after the members' funds. They are responsible for the administration of the scheme even if they delegate some of the work. They therefore need to closely manage the risks inherent in the financial transactions associated with scheme administration.

In this tutorial you will find out about the processing of transactions on defined contribution (DC) schemes so that you are better able to manage these risks.

Processing contributions from the employer

There are many different types of transactions that occur in a DC scheme but the transaction type that will affect all of the employed members many times each year is the processing of contributions.

Legal framework: employer

And there are requirements on employers to:

- transfer the deductions from employees' pay and their own contributions to the pension scheme
- provide information (often known as 'payment information') to trustees and managers routinely as part of the day-to-day administration arrangements and also in response to specific requests

The employer has to provide additional information within a reasonable time period (The Pensions Regulator (TPR) considers this to be within seven working days).

Payment schedules

Trustees must prepare, maintain and revise a scheme payment schedule which shows the due date(s) on or before which the following payments are to be made:

- contributions payable to the scheme by or on behalf of the employer
- contributions payable to the scheme by or on behalf of the members
- other amounts to be paid to the scheme including, for example, expenses likely to be incurred in the coming scheme year

You can learn more about this by reading the guide to administration at **www.tpr.gov.uk/admin**.

Trustees of master trusts need to ensure that their systems and processes are sufficient for running the scheme.

See our Code of Practice 15 at **http://www.tpr.gov.uk/docs/code-15-authorisation-and-supervision-of-master-trusts** for more details

The definition of pensionable pay, as set out in the scheme rules, can vary from scheme to scheme. You learned about this in the previous tutorial, 'Contributions'.

Dates by which contributions must be processed

Employer contributions must be paid to the pension scheme by the due date set out under the payment schedule.

Member contributions deducted from pay must be paid to the pension scheme by no later than the 19th day of the month (22nd if made electronically) beginning on the first day of the month after which the deduction is made. If the payment schedule specifies an earlier due date then that earlier date applies. For example, if deductions were made on 17 April, they must be paid to scheme by 19 May, or 22 May if paid electronically.

Monitoring the payment schedule and reporting

Trustees are expected to:

- monitor payments due under payment schedules
- obtain sufficient information from employers to demonstrate that amounts paid reconcile with those due under the payment schedule
- provide clear and transparent information to members about contributions that have been made

If trustees monitor the payment of contributions by employers closely then they should be able to identify any problems quickly and this is likely to lead to the timely correction of payment errors.

Processing core scheme transactions

The current legal framework places requirements on scheme trustees to:

- set up a payment schedule
- maintain records of money received from the employer
- provide annual statements to members showing, among other things, contributions made
- notify The Pensions Regulator (TPR) and members if contributions are incomplete or paid late, and this is likely to be of 'material significance' to TPR in the exercise of its functions
- keep records of all payments to and from the scheme
- keep details of transfers of members' benefits to and from the scheme
- make sure that core financial transactions are processed promptly and accurately (these transactions include but are not limited to investment of contributions to the scheme, transfers of member assets in and out of the scheme and transfer of member assets between investments within the scheme and payments from the scheme to, or in respect of members)

- produce an annual chair's statement explaining how the scheme is complying with certain legal duties, including the prompt and accurate requirement

Types of core scheme transactions

In addition to the processing of contributions, there are lots of other important scheme financial transactions which impact on the benefits of members and beneficiaries.

Investing (and unitising) contributions

The administrator will arrange to invest the funds on behalf of each member. This is done by purchasing units in funds at the relevant fund price (unitising).

Individual transfer quotes and payments

Members of DC schemes often 'transfer in' the value of their pots from other pension schemes. After leaving the employer, they may choose to transfer the value of their pot out of the scheme. This is usually preceded by the member or their new pension provider asking for a 'transfer out quote'.

Bulk transfers

A bulk transfer is the transfer of a group of members and the value of their pots from one occupational pension scheme to another. The process of transferring assets normally works in a similar way to individual transfers in or out. A bulk transfer out may occur, for example, on an employer winding up a pension scheme.

Purchase of annuities and payments of lump sums

When members reach pension age, they frequently choose to use their funds to purchase an annuity and take a tax-free lump sum. The annuity provider will give a time-limited quotation.

Payment of benefits payable on death

Different schemes have different rules, which the trustees will need to account for.

Member fund switches and redirections

Schemes usually provide a choice of funds in which to invest as well as the default strategy for members who do not want to choose their own strategy and underlying funds.

A member who chooses their own investment strategy may choose to move their invested funds (or a proportion of their funds) from one fund to another. This is known as 'switching'. A 'contributing' member may choose to make their new contributions to a different fund. This is known as a 'redirection'.

Investment and disinvestment of scheme assets

If a member chooses to 'switch' their investments then this will usually result in a disinvestment (sale) of units in the 'old' fund and an investment (purchase) of units in the 'new' fund. The funds are 'out of the market' (ie not invested) for a period of time when the switch happens. Trustees should have processes in place to minimise, to the extent they are able to, 'out of market' time.

You will learn more about this in the Tutorial: 'Managing performance' in the Module: 'Investment in a DC scheme'.

Investment or disinvestment of scheme assets also happens in other circumstances for example, transfers-in, transfers-out, when annuities are purchased and on death.

Lifestyling

In the years preceding the member's target date for accessing their benefits, many DC members will be invested in funds which are gradually transitioned to less volatile (often fixed interest and cash) investments.

Often the administrator, or investment manager, achieves this by switching a small percentage of the member's fund on a regular basis, for example every three months over a period of 5 to 10 years, whilst also redirecting part of the ongoing contributions for active members. This is known as 'lifestyling'.

You will learn more about this in the Tutorial: 'Default investment options' in the Module: 'Investment in a DC scheme'.

Divorce

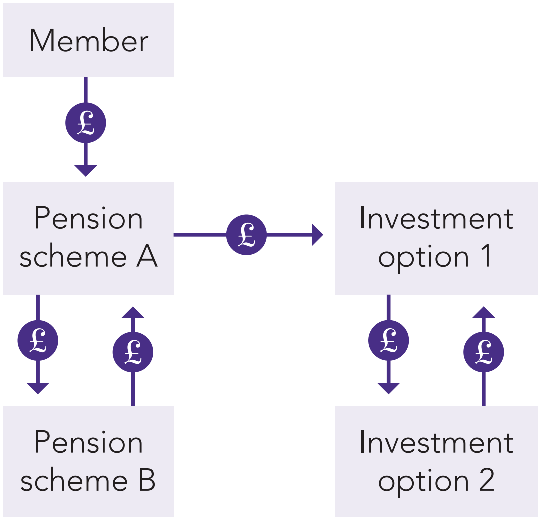
On divorce, the members' pension benefits can be split between the member and their ex-spouse/civil partner. The detail of this is agreed in either a pension sharing order, or less commonly, an earmarking order, both of which need to be obtained by the parties from a court.

Focus on the risk

The trustees are responsible for ensuring that the right benefits are paid to the right member at the right time, and are legally obliged to make sure that core financial transactions are processed promptly and accurately. Their relationship with service providers, and the information trustees receive from their service providers, must be sufficient to assure them that they are meeting their legal obligations.

Incorrect transactions

If a transaction is not processed and recorded correctly and this is not rectified, then it will result in the incorrect payment of benefits to the member.



What are the implications?

Trustees should be aware that:

- the monetary value of the error will compound over the years or decades that the member is in the scheme
- one systemic error can affect other members
- a member may make financial planning decisions based on incorrect information about their pension savings
- trustees themselves may face enforcement action from TPR

Losses resulting from incorrect transactions can be very significant if:

- a lot of members are affected
- markets are volatile
- the value of affected members' pots is large

Exercise: Focus on the risk

Take a moment to think about whether any of the following could happen in your scheme.

- Your employer has new joiners.
- Your employer has leavers.
- Employees opt out or leave the scheme after joining.
- Members take maternity leave or go off sick long term.
- Members get pay rises or increments.
- Members get bonuses or overtime which count towards pensionable pay.
- The pension calculation method is different for some members or very complex.
- Variations in employer and employee contribution levels is allowed.
- Payroll staff change or could be ill or on holiday.
- The staff at the administrator changes.
- The government makes changes which affect contributions.
- Computer systems fail.
- Human error.

Feedback is at the back

Late payment of contributions

Try this question and don't worry about getting it wrong, the feedback includes the learning on this topic.

The employer is five days past the due date for making the payments in the payment schedule. Which three of the following statements are correct about this problem?

1. A 'statutory debt' is created
2. The trustees must report this to TPR immediately
3. The trustees need only report this to TPR if they suspect that the failure is material to performance of TPR's functions
4. The trustees should seek where possible to identify the reason for non-payment and rectify it as quickly as possible

Answers are at the back

Late transactions

Why are 'late' transactions in DC schemes such a problem?

Example one

A member requests a ‘switch’ of their investments from an ‘equity fund’ to a ‘cash fund’ but there is a significant delay in processing the sale of the equities during a period when the equities fall in value by 5% but the cash fund stays the same value. The member has lost 5% of the value of their fund as a result of the delay. The trustees may need to reinstate the member to the position that they should have been in had the delay not occurred. If the delay was caused by a service provider, the trustees may be able to recover the cost of reinstatement from the service provider under the terms of their contract.

Example two

The member (and the administrator) has received an annuity quotation from an organisation which is only valid for 10 days. The administrator is so late in processing the payment of the funds that the annuity purchased is less than originally quoted. The member will have less income in retirement as a result of the delay. The trustees may have to purchase an additional annuity for the member to make up the difference, or agree an equivalent lump sum settlement. If the delay was caused by a service provider, the trustees may be able to recover the cost of compensating the member from the service provider under the terms of their contractual agreement with the service provider.

Internal controls

To minimise risks, such as those we’ve covered so far, and to ensure that transactions are processed promptly and accurately trustees should put in place appropriate controls.

Promptness

To enable prompt transactions trustees should review, and where possible, streamline their processes taking account of new technologies where available. Particular areas to focus on include:

- trustee board sign off processes and whether sign off can be delegated to avoid delay
- the reasonableness of transaction times set out in service level agreements, where possible in comparison to typical transaction times across other similar schemes
- the time taken to invest contributions to the scheme. TPR expects contributions to be invested within a maximum of five working days (or three working days where the scheme operates a daily dealing cycle)
- payment methods, for example whether they are digital
- the timing of information and contributions paid by employers (see the information on late payments already covered)

- **Master trusts:** Trustees of a master trust will also need to ensure they have processes in place to process financial transactions accurately and securely to remain authorised. Find out more in our Code of Practice 15 at http://www.tpr.gov.uk/docs/code-15-authorisation-and-supervision-of-master-trusts.pdf.

Accuracy

Trustees will not be able to process core financial transactions accurately if the data held by the scheme is not complete and accurate. TPR expects trustees to ensure they hold the basic member information known as common data, such as member addresses and dates of birth, as well as scheme or member specific data items, such as investment choices or salary, known as conditional data.

You can learn more in the Tutorial: 'Scheme admin and member data' earlier in this module, and in the Module: 'Running a scheme'.

Member addresses

Given that members of a DC scheme bear the risks relating to their benefits, it is very important that they receive communications throughout their membership, particularly in relation to the decisions they will have to make at pension age.

Therefore, trustees need to make every effort to keep member addresses up to date. Where trustees become aware that address data is not accurate they need to take steps to trace members.

Conditional data

When thinking about the conditional data in their DC scheme, trustees should pay particular attention to the following areas.

- Contributions and investments reconciliation – regular reconciliation will help to prevent incorrect or late transactions occurring or to identify errors quickly.
- Lifestyling – for members that have a lifestyle investment strategy trustees should check that the members' investments accurately reflect each stage of the strategy.
- Flexible access – if the scheme permits members to partially access their benefits, trustees need to check that the records accurately reflect any amount that has been accessed, and when.

You can learn more about this by reading the guide to administration at **www.tpr.gov.uk/admin**.

Software

Having the right software also improves the accuracy of core financial transactions. Any software used to process transactions should be checked regularly to make sure it is working correctly.

Data review exercise

TPR expects trustees to carry out a data review exercise at least annually.They also need to undertake a full review and data cleanse when certain events occur such as a decision to wind up the scheme, there is a change of administrator or the scheme is affected by a merger or acquisition.

Checking administrator quality and monitoring performance

There are various methods trustees can use to review their administrator. These may include:

Independent assurance reports

The scheme administrator plays a crucial role in the processing of transactions so it is important that they have good manual and computerised systems and processes.

TPR recommends that trustees check that their administrator is subject to an independent assurance process which demonstrates their ability to deliver quality administration services.

Independent accreditation is available from the Pension Administration Standards Association (PASA) and there are also reports, known as AAF reports, which are produced in accordance with guidance from the Audit and Assurance Faculty of the Institute of Chartered Accountants in England and Wales.

Contracts, service level agreements and administration procedures

Trustees use contracts and service level agreements with third party and in-house administrators to:

- define their requirements including timeframes for processing key transactions
- monitor performance
- enforce standards where necessary

The administrator will report on their performance against the standards set out in contracts and service level agreements, and trustees will be able to discuss reasons for delays, if they arise. They can also consider invoking any penalty clauses/compensation payments that are triggered. Trustees should make sure that administrator reports are specific to their scheme.

The administrator’s procedures should include quality assurance and should be well documented and clear to enable a smooth transition in the event of a change in administrator.

All administrators, whether in-house or third party, should have a business continuity plan in place which is regularly reviewed and sets out what actions to take if certain events take place that could affect the good administration of the scheme, including the prompt and accurate processing of financial transactions.

External review/audit

Trustees may choose to commission an external review of the scheme's systems and controls to check that they are adequate. The auditor will normally 'sample' a number of transactions to determine that they are being implemented correctly.

Trustees often wish to be assured that the employer's processes for calculating, deducting, and remitting member contributions, and ensuring that eligible members are given the correct information about joining the scheme, are robust and verifiable.

Master trusts: Independent assurance and external audits play a key role in evidencing that a master trust continues to satisfy us that they meet the authorisation criteria on systems and processes. More information can be found on the Pensions Regulator's website at **http://www.tpr.gov.uk/trustees/master-trust-pension-schemes.aspx**

Resolving problems

Dealing with administrative errors can be very expensive and complex. Generally if there has been a breach and the member has suffered loss, trustees must put the member back in the position they would have been if the breach had not occurred. This may not be straightforward, in particular:

- if problems are not identified early then a member may be sent incorrect benefit statements, be charged the wrong amounts and may have switched some of their funds in the meantime
- sometimes, mistakes do not become apparent until after members have died, transferred out of the scheme or reached pension age
- putting the member back to the right position is only part of the cost. There can be considerable associated legal and administrative costs
- members can lose confidence in the scheme when errors are identified
- there may also be reputational damage for the sponsoring employer

However, trustees need to undertake a thorough review of all the issues and, if they are unsure, take advice.

Answers and feedback

Exercise: Focus on the risk

Trustees need to ensure that the amount that the employer pays to the scheme is correct. Administering contributions would be easy if the same amount was paid every month. In reality, the payment schedule is likely to change quite often because of all the reasons you've selected. Administrators sometimes struggle to reconcile contribution amounts received from the employer with the payment schedule.

Changes to membership since the last 'pay-run' can cause particular problems so, in well-run schemes, the employer and the administrator should put processes in place to ensure that they have a consistent understanding of the scheme's membership.

TPRs Code of Practice 'Reporting late payment of contributions to occupational pension schemes' suggests that trustees might take a risk-based approach to monitoring contributions, perhaps by sampling contributions to ensure that there are no significant errors occurring. You can view the code at www.tpr.gov.uk/code5.

Late payment of contributions

The first, third and fourth answers are correct.

A 'statutory debt' is created if the employer does not make the correct payments in the payment schedule by the due date.

However, trustees do not necessarily need to report problems to TPR immediately as many late payments are short-term administrative errors which can be corrected very quickly. TPR expects trustees to try to find out, where possible, the reasons for any failures and to determine if errors can be identified and corrected. TPR suggests that three attempts should be made to contact employers, preferably by phone, before taking further action.

Trustees need only report this to TPR where they suspect there is a material payment failure. This could be an unwillingness to pay on the part of the employer, suspected fraud or if the employer becomes absent. However, if a contribution remains outstanding 90 days after the due date then this should be taken as evidence of an employer's unwillingness to pay and trustees should report the problem.

You can find out more by reading the 'Reporting late payment of contributions to occupational pension schemes' code of practice at www.tpr.gov.uk/code5.