LCP INSIGHT CLARITY ADVICE

The end of the road for 'one-stop' retirement?

How DB pension schemes are supporting members as they shape their retirement journey

June 2022

Executive Summary

Growing numbers of Defined Benefit (DB) pension schemes are offering new benefit options to members and are appointing a financial advice firm to help members, and are meeting some or all of the costs of doing so.

This paper reports on an in-depth survey of seven of the largest advice firms active in this market who between them have standing appointments to more than 300 DB pension schemes, including many of the largest schemes, as well as advising on one-off 'exercises'.

Key findings of the research are:

- The growth in the number of schemes appointing financial advice firms seems set to continue, not least as members are finding it increasingly hard to source affordable and independent advice with regard to DB transfers;
- Such appointments are more likely to be initiated by the trustee than by the sponsor;
- The typical model (in around three quarters of schemes) is for advice to be wholly free to the member;
- Simply appointing an adviser is not enough to drive take-up – all the advice firms agreed that good communications were essential to make an appointment a success for scheme and members alike;
- There has been a clear shift in recent years from schemes undertaking one-off exercises to 'business-as-usual' appointments of advice firms; many of the advice firms also prefer this approach;
- On specific options:
    - Pension Increase Exchanges remain popular with members, in some cases in combination with the process of resolving issues around equalisation of Guaranteed Minimum Pensions; interestingly, the current surge in inflation has not so far led to a significant reduction in demand for PIEs;
    - A growing number of schemes are offering 'bridging pensions' and there is likely to be growing interest in this option as state pension ages increase;

  - Demand for DB transfers is down on its peak of a few years ago, but continues to be an important area where members can struggle to find affordable independent advice if not provided by the scheme;

  - There is growing interest in 'partial' DB transfers, which may be of particular interest to long-serving workers who have most or all of their DB rights in a single scheme;

The growing interest in member options, supported by in-house financial advice support, is driven by a mix of motives:

- There is an increasing recognition that the rigid structure of standard DB benefits does not suit an increasing number of members in a world where people no longer want a 'one-stop' retirement; not offering that flexibility in the scheme can drive inappropriate transfers in some cases.

- Trustees and sponsors are also recognising the challenges for members in choosing between different benefit options. They increasingly recognise that there are increased risks for both members and trustees if trustees do not provide access to good advice, especially in light of recent high-profile cases where members who sourced their own advice were poorly advised.

- And there is no doubt that the increased maturity of DB schemes is an increasing consideration, with both trustees and sponsors looking to the 'endgame' for their scheme. Giving members options to reshape their benefits, with appropriate advice, can help members secure an outcome which works better for them whilst simultaneously improving the underlying funding position of the scheme.

At their best, these options offer the potential for a 'win-win' for members, trustees and sponsors.

Contents

01. Introduction 4

02. Scheme-appointed Financial Advisers – market trends 6

- a) Free or subsidised? 7
- b) Business as usual or time-limited exercise? 9
- c) Advice v. Guidance 10
- d) Getting closer to buyout 11
- e) A capacity crunch? 12
- f) DC advice 12
- g) Led by trustee or sponsor? 12

03. Member options considered 14

- a) Pension Increase Exchange (PIE) 15
- b) Bridging Pension Option (BPO) 17
- c) Partial DB transfer 19
- d) Full DB transfer 19
- e) 'Enhanced' Transfer Value (ETV) 21
- f) Flexible Retirement Options (FRO) 21

04. Conclusions 23

01 Introduction

In 2015, the Chancellor introduced the concept of 'freedom and choice' for Defined Contribution pensions. This allowed people with DC pension pots much more flexibility about how they used their pension and, in particular, removed the expectation that in most cases the DC pot would be used for an annuity or income for life.

However, it is not just in DC pensions where flexibility is increasing. In recent years, the range of options offered by Defined Benefit schemes has also increased, providing a degree of flexibility which did not previously exist for DB scheme members. These flexibilities are generally very welcome, but the choices can appear daunting for members approaching retirement and they need help and support to make the choice which is right for them.

This paper is about the wide variety of choices now being offered to many members of Defined Benefit (DB) pension schemes. Rather than simply take a standard scheme pension at normal retirement age, members are increasingly being offered a range of choices including:

- The option to transfer some or all of their DB benefits out into a Defined Contribution (DC) arrangement, sometimes on particularly favourable terms, so as to access the greater flexibilities available in the DC environment;
- A higher scheme pension payable for the period up to state pension age, in order to 'bridge' the gap between the member's preferred retirement age and the age at which state pension age cuts in (when the member's scheme pension then steps down);
- The opportunity to reshape their pension by sacrificing some future inflation-linked pension increases in exchange for a higher starting pension;
- A range of other 'flexible retirement options', which can include varying the proportion of pension taken in the form of a tax-free lump sum on retirement or taking a pension at a different age from the normal retirement age;

The combination of these different choices led one financial adviser who contributed to this research to observe that 'we are seeing the end of 'one-stop' retirement'.

At their best, these 'member options' can be a 'win-win' for the scheme member and for the scheme itself. The member has the option to re-work the standard scheme offering into

a shape which is right for them and their family, based on their own individual needs and preferences. And the scheme may be able to reduce its level of risk and improve its overall funding position if a significant number of members take up these options.

Whilst members can (and do) source their own financial advice to support with their decisions, DB schemes are increasingly supporting members through the appointment of one or more financial advice firms to help members make the best choice for them. LCP's recent 'Chart your Own Course' survey[1] found that around 3 in 10 DB schemes had either already appointed an IFA to help members or was in the process of doing so. Such advice firms are carefully vetted by schemes before being appointed and should be able to help members to make the best of their pension wealth, with the costs of advice often subsidised by the scheme[2].

Over recent weeks, we have interviewed seven major firms who are key players in the scheme-appointed IFA market. Between them they have appointments with around 300 DB schemes, including many of the largest schemes in the UK, on an ongoing or 'business-as-usual' basis, as well as providing additional advice where schemes are running one-off 'member option exercises'.

All of the firms took part in a 45 minute qualitative interview as well as providing statistical information on their work with DB schemes. We are grateful to each of them for their time.

The first section of this report explains in more detail how the scheme-appointed IFA market works and the market trends which each of these providers is observing. We then move on to talk about the individual 'member options' which schemes are presenting to members and report back on what the advisers had to say about each one.

The final section offers some concluding thoughts.

[1] See: Chart Your Own Course 2022 (adobe.com)

[2] The Pensions Ombudsman has produced helpful guidance for trustees considering appointing a financial advice firm to help members which can be found at: Panels and Independent Financial Advisers March 2021.pdf (pensions-ombudsman.org.uk)

02 Scheme-appointed Financial Advisers – market trends

The one "member option" where financial advice is mandatory by law is where a member is considering transferring DB rights worth more than £30,000 into a DC arrangement. In the past, members would generally have had to source their own transfer advice, but we are now seeing many more schemes supporting their members in sourcing affordable, high quality advice on pension transfers.

In the period immediately following the implementation of DC 'freedom and choice' in 2015, there was a surge in demand for advice on DB transfers, but in some cases the advice which members received was not of high quality, with recommendations to transfer at a much higher rate than regulators judged to be in the interests of members. As a result, the FCA has clamped down on the DB transfer advice process, whilst the costs of providing such advice has risen, notably driven by the increasing cost of obtaining Professional Indemnity Insurance for DB transfer advice.

This experience has led many pension scheme trustees and sponsors to ask whether they should be doing more to help members make good choices about DB transfers and about member options more generally. Growing numbers have therefore taken the step of appointing one (or occasionally more than one) IFA firm to be available to members for the provision of advice at retirement[3].

Interviewees said that there were several reasons why trustees and sponsors are increasingly likely to consider appointing an IFA:

- In response to demand from members who are finding it increasingly hard to source their own affordable and high quality financial advice, particularly for DB transfer advice;
- In recognition that such appointments are now widespread amongst larger schemes and that schemes who do not make such appointments risk becoming 'outliers', and possibly at risk of future challenge by members;
- Growing numbers of trustee boards now include one or more professional trustees who in turn may serve on multiple schemes; such trustees will often have

[3] The issues around scheme appointed IFAs are discussed more fully in a joint paper between LCP and Royal London published in 2020: On point paper: Helping members access DB transfer advice – time for schemes and regulators to do more? | Lane Clark & Peacock LLP (lcp.uk.com)

experience of how to carry out a scheme appointment, and may spread good practice from one scheme appointment to another;

- To avoid a repeat of previous scandals where members of a DB scheme were taken advantage of by unscrupulous financial advisers and introducers;
- The growing role of trustees in protecting members against the risk of scams, such as the duty to operate a system of 'red flags' and 'amber flags' where potential transfers raise issues of concern.

The provision of financial advice / support varies from scheme to scheme, but the main features are:

- 'Due diligence' is undertaken to ensure that the IFA firm has good processes in place, is experienced in the services required and has a good reputation;
- In general, the advice firm should be 'independent', in the sense that they are not restricted to advising only on a limited range of funds as the destination for any DB transfer;[4]
- The cost of the advice is free or subsidised for the member (with the costs typically being funded for in part or in whole from Scheme assets or by the employer);
- Some process of ongoing due diligence is built, to ensure that the advice firm maintains high standards.

For the purposes of this research, we interviewed seven major IFA firms who are active in this market. We asked for facts and figures about the numbers of schemes and members that they advise, as well as discussing with them the trends they are seeing in this section of the market.

From our conversations, several key themes and issues emerged:

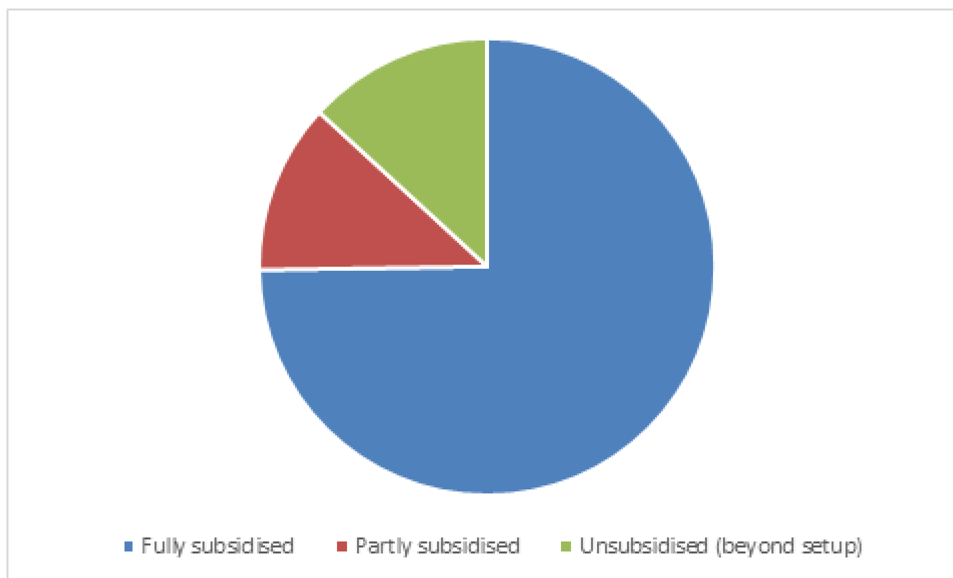
a) Free or subsidised?

In the vast majority of cases, advice provided by a scheme-appointed IFA will be fully paid-for or at a reduced cost compared with sourcing the same advice from a 'high street' IFA. For example, even where members are paying the full 'marginal' cost of advice from a scheme-appointed IFA, a typical cost might be around £1,000 for DB transfer advice, whereas high-street IFAs would be unlikely to charge less than £4,000-£5,000 with some charging substantially more, especially on high value transfers.

The chart below provides a summary of the responses we received from our interviews, weighted by the number of schemes that each IFA firm works with.

[4] The FCA provides guidance to employers who are considering paying for an IFA to help DB scheme members, and warns of the risks of appointing a 'restricted' adviser. The latest guidelines say: "Where an employer wishes to avoid straying into arranging activities when appointing a financial advice firm, they should consider whether a restricted advice firm's range of products would be broad enough to allow that firm to provide advice on investments generally, including non-insurance products". (See: FG21/3: Advising on pension transfers (fca.org.uk)).

Figure 1. Extent of subsidy of advice costs in schemes with an IFA appointment



Source: LCP survey of scheme-appointed IFAs – data weighted by number of schemes served by each IFA firm

As Figure 1 shows, in around three quarters of cases the member is able to access advice on a fully subsidised basis, though there may be restrictions on the timing of advice (eg only at retirement) or the frequency (eg only one free advice session). In remainder of cases, the member may pay a reduced fee (partly subsidised) or the full marginal cost of the advice.

However, even where the member is paying the full marginal costs, the scheme will usually meet all of the set-up costs involved in getting the IFA firm familiar with the details of the DB scheme, in connecting up IT systems, in preparing communications to members etc. Members may then at most pay only the 'marginal' cost of providing advice, which can save thousands of pounds for the member compared with standard advice costs, especially for DB transfers.

What was striking from the data that we collected was that simply providing an IFA is not enough to drive high take-up. For example, one IFA firm told us that they provided advice to just five members per year per scheme on average across all the schemes where they had a standing appointment.

When we probed further, two key factors emerged as affecting take-up.

The first of these was price. Most (though not all) of the firms we spoke to said that there was a huge difference in take-up between advice that was completely free and advice where there was a charge levied on the member, no matter how heavily subsidised. In part this may be because the value of financial advice is only really apparent after you have taken it, and some members may simply under-estimate the worth of financial advice. In addition, although the price of advice may be very modest relative to the worth of a

member's DB pension rights, the advice fee is – in most cases – coming out of the member's current account and even a subsidised advice cost of (say) £1,000 is a very large absolute amount to pay. In a world where the advice fee for transfer advice has to be paid whether or not the recommendation is made to go ahead with a transfer, people may be especially unwilling to risk paying a large sum only to be told not to do anything. For all of these reasons, there is likely to be a big difference in take-up between schemes which offer fully subsidised advice and those which offer partly subsidised advice.

The second key factor affecting take-up is engagement, which in turn is heavily dependent on member communications. A number of schemes told us that there was a huge difference in take-up between schemes where the trustees actively embraced the advice offer and communicated it to members at every opportunity, and those who simply put in place an IFA and left things at that. The very clear message from our research for trustees and sponsors is that appointing an IFA on its own is not enough. There also needs to be a communications strategy for making members aware of the offer and of the value of advice, whilst at the same time making it clear that members can use their own IFA if they so choose. A number of respondents told us that they were planning to do more with their 'business as usual' appointments to encourage greater take-up of the advice offer, usually via working with the scheme to improve awareness through an improved communications strategy.

b) Business As Usual ('BAU') or Time Limited Exercise?

Given the ongoing statutory requirement for financial advice around DB transfers over £30k, many larger schemes have appointed an IFA firm primarily to ensure that members have access to high quality and affordable transfer advice. But where schemes routinely offer members other options as part of the standard rules of the scheme, members may benefit from broader financial advice on a 'business-as-usual' basis, and this can also be provided by the appointed advice firm.

However, in some cases, a scheme will decide to run a member option 'exercise' where special terms or flexibilities are offered on a time-limited basis and sometimes just for a particular group of members. Where the scheme does not already have a scheme-appointed IFA (or even if it does) it may seek to appoint an IFA firm to provide advice purely on the exercise. In such cases, it is good practice for the cost of providing advice to fall on the employer[5].

Opinions varied considerably about the role of 'exercises' and the willingness of IFA firms to engage with them. Several advisers expressed concerns about the risks associated with exercises, with one telling us that they 'don't like anything with a time limit attached'. Others said that they preferred to concentrate on BAU advice and on the potential added value to members of more rounded advice and longer-term engagement rather than 'ring-fenced' advice on a specific option or exercise.

[5] See the Code of Practice on Incentive Exercises at: https://www.thepensionsregulator.gov.uk/-/media/thepensionsregulator/files/import/pdf/incentive-exercises-industry-code-of-practice.ashx

One firm said that they would prefer to advise on a 'big bang' introduction of a range of member options as part of 'business as usual', rather than on time-limited or ad hoc exercises.

These responses demonstrate the very long way that these IFA firms have come in the last decade, when BAU appointments were scarce and their revenue was dominated by one-off exercises.

On the other hand, other advice firms remain happy to advise on one-off exercises. Probably the most common example cited was offering members chance to swap inflation protection for a higher starting pension (a so-called 'pension increase exchange' or PIE, discussed in more detail below). This in turn was often being offered as part of the wider process of equalising Guaranteed Minimum Pensions (GMPs).

c) Advice or guidance?

Regulated financial advice refers to a situation where an adviser provides a personalised recommendation to an individual about the best course of action for them individually. Guidance refers to the provision of generic information and personalised explanations which helps members to be better informed but does not seek to recommend a particular course of action.

Several of the firms who took part in our research reported an increased demand from members arising from the Covid pandemic and the cost of living crisis, both for regulated financial advice and also for more general financial guidance.

On the one hand, some scheme members had clearly concluded that they were ready for early retirement and needed advice on how best to manage that and to use the flexibilities on offer within and beyond their DB scheme. On the other, some members were now more financially vulnerable and needed to talk to someone about their finances, perhaps with a greater focus on managing short-term financial pressures.

Regulated financial advice is mandatory for DB transfers over £30,000, as noted above, whereas the rules are less clear cut for other member options. The Code of Good Practice on Incentive Exercises indicates that it is good practice to offer advice for time limited exercises such as ones offering an enhanced transfer value out of the DB scheme, or in cases where the value of the pension rights being given up (eg future inflation increases) is less than 100% of the enhancement being offered (eg a higher starting pension).

However, the Code of Good Practice (now under the stewardship of the Pensions Regulator) does not have statutory force, and some advice firms were concerned that some of the bad practice which first led to the Code being created was being seen in the level of support being given on other member options.

A number of respondents said that schemes were sometimes seeking to run member option exercises, such as PIEs or BPOs, based on only on (generic) guidance rather than personalised financial advice with a recommendation. Given the complexity of the choices

involved in such exercises, there may be some concern that members may not always get the best outcome if they are not supported with tailored financial advice.

d) The impact of getting nearer to Buy-out?

Under the terms of the Pension Schemes Act 2021, all DB pension schemes are expected to have a 'long-term objective' for their scheme. In many cases this will be to build up sufficient funds to enable the scheme to ultimately 'buy out' all of their liabilities with an insurance company and wind up the scheme. Offering 'member options' can be part of a scheme's 'strategic journey plan' to reach a funding level where benefits can be bought out[6].

With DB scheme funding generally improving and DB schemes steadily maturing, growing numbers of members could find that their rights end up being secured by an insurance company in the short to medium term rather than being paid out by their scheme.

An issue which is likely to grow in importance is the potential interaction between member options and the scheme's plans to target buy out. This could be in two areas:

i. Member options exercises

As well as providing greater flexibility to members, member options exercises (or the introduction of member options as BAU) are increasingly seen as being part of the 'journey plan' of the scheme. When members restructure their benefits in response to a member option (either within the scheme or by transferring out), this will generally improve funding on a low risk or 'buyout' measure, as well as reducing longevity, inflation and interest rate exposure and so also contribute to the goal of 'de-risking' the scheme. We may well see an increased number of member options being offered in order to help schemes reach their buyout objective, now that buyout is starting to appear on the medium term horizon for many schemes.

ii. Terms for transfers out

Under existing law, most non-retired members of a DB scheme have a statutory right to transfer their rights out of the DB scheme and into a DC arrangement. However, if the scheme enters into a full buy-out with an insurer, the position becomes less clear cut. The terms on which a transfer can be taken may vary from insurer to insurer and may not be the same as those that would have been offered under the scheme before being secured with the insurer. An insurer may also offer a narrower range of other options than the original DB scheme. One IFA firm suggested to us that if members are thinking about a potential DB transfer at some point, they would be more likely to recommend a transfer now if it looks as though their scheme is approaching buyout, though other firms felt this was not an important consideration.

6 See Chart Your Own Course 2022 (adobe.com) for more discussion of issues around strategic journey planning and the role of member options.

e) A capacity crunch?

A minority of the advisers that we spoke to suggested that there could be fast approaching a 'capacity crunch' in the market for scheme appointed advice. The ability of members to source affordable advice for themselves is clearly in decline, not least as evidenced by the slump in the number of IFAs with permissions to provide DB transfer advice[7]. This in turn could lead to growing pressure on schemes to assist their members by making available a scheme-appointed adviser and could increase take-up by members where such an offering is already in place.

At the same time, at-retirement advice is a specialist area (and particularly so with DB transfer advice) and it is not straightforward for advice firms to ramp up capacity at short notice. As a result, some advice firms said that they were already allocating blocks of adviser time well into next year and suggested that capacity might limit their willingness to take part in tenders.

Much clearly depended on the adviser's business model however, and some foresaw no problems in expanding their offering as required. This was particularly the case where experienced advisers could be switched from other areas of the firm's business if the need arose.

f) DC advice?

The focus of this paper is primarily on DB pensions and the ability of members to reshape or transfer DB benefits. But growing numbers of members will also have Defined Contribution (DC) rights and 'holistic' advice at retirement would mean helping members to make the best use of those pots as well. This can sometimes create a problem if the trustees of the DB scheme do not regard advice on a member's DC rights as being within their remit. On the other hand, a sponsoring employer may be far more interested in DC advice being provided, not least as this may well be more relevant to the current workforce than DB advice. We are likely to see more appointments where advising on all of a member's pension rights, not just the DB ones, becomes the norm.

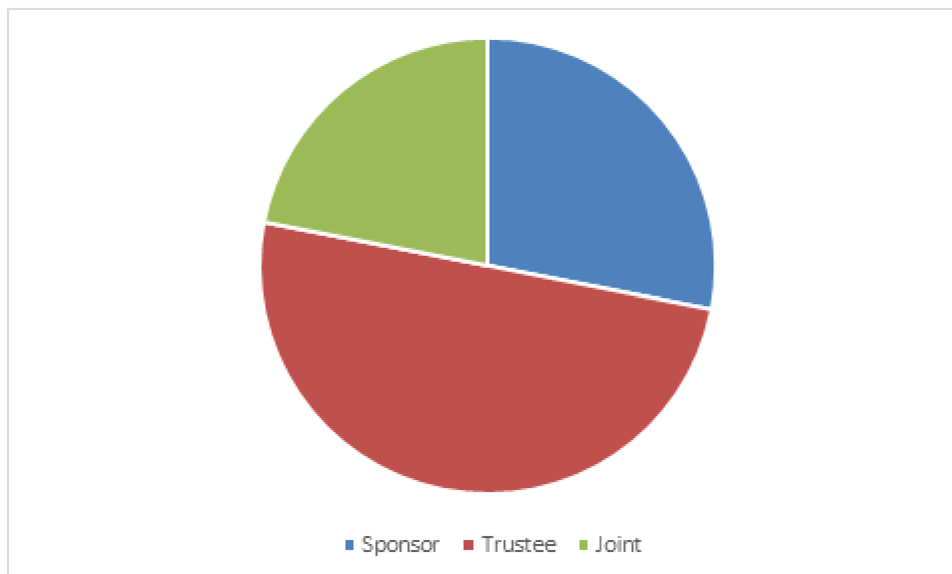
g) Led by trustee or sponsor?

In many cases the appointment of an IFA firm or firms to help members will be driven primarily by the trustees of the scheme. However, in some cases a sponsoring employer will be the driving force and will directly fund the provision of advice. Sponsor appointments can be for a mix of 'paternalistic' reasons, wanting good outcomes for past and present employees, but can also reflect a recognition that provision of advice is likely to increase take-up of member options which in turn can improve the funding position of the scheme.

[7] See our joint paper with Aviva, published in 2021: [On point paper: Mind the transfer advice gap | Lane Clark & Peacock LLP (lcp.uk.com)]

Based on the c 300 schemes covered by the IFA firms who we interviewed, the chart below gives an indication of whether appointments were typically trustee led, sponsor led or jointly led.

Figure 2. DB Scheme appointment – sponsor / trustee / joint



Source: As Figure 1

As the chart, shows, roughly half of all appointments are predominantly trustee led, with just under a quarter being driven by the sponsor and the remainder being a joint project between both parties. Even where the initiative (and funding) comes from the sponsor, trustees would typically expect to be heavily involved in the whole process.

03 Member options considered

As noted earlier, since 2015 DC members have enjoyed considerable new freedoms over how they use their pension pot.

But it is not only in the space of DC pensions that retirees are exercising 'freedom and choice'. Members of traditional Defined Benefit (DB) schemes are now also increasingly likely to have the opportunity to re-shape the way in which they take their benefits so as to better fit their retirement plans, rather than simply take a standard pension at a standard age with a standard structure.

Indeed, for the current cohort of retirees, who may have a mixture of a state pension, one or more DB pensions and one or more DC pots, the options to phase and stage retirement are considerable. For example, this could involve early retirement (before state pension age), funded by rapid drawdown of a DC pot or through a reshaped DB pension with a higher starting scheme pension to 'bridge the gap' to state pension age, with a subsequent step down in scheme pension. Or it could involve a move to part-time work with a reduced wage supplemented by partial pension access.

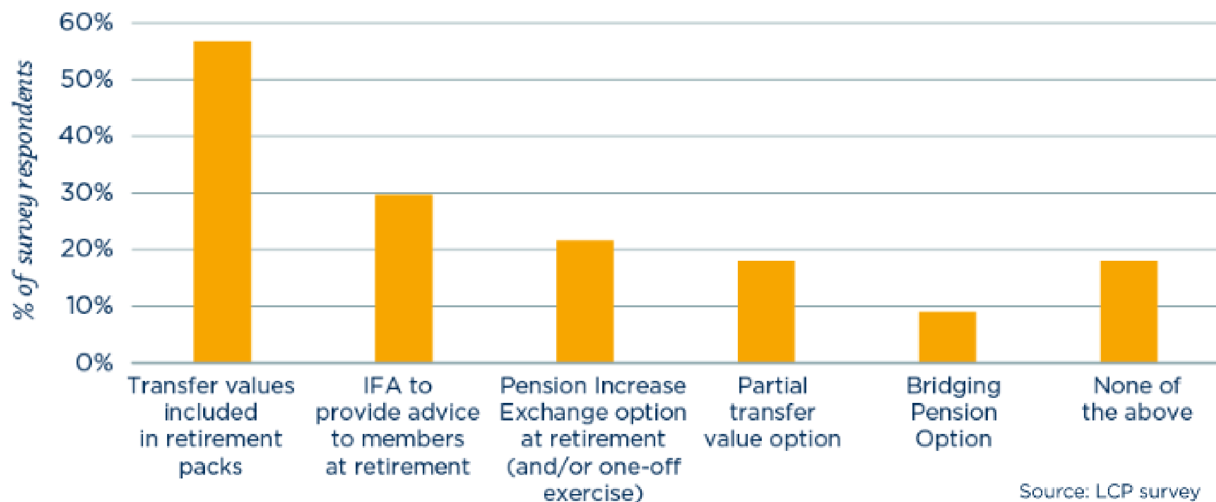
And our research also found that the recent Covid pandemic and cost of living crisis has caused many people to revisit their retirement plans and have a growing interest in financial advice and guidance to help them navigate their choices.

In this section we therefore focus on some of the main member options on offer in the DB world – in addition to the transfer value option (which is a statutory requirement of all schemes to offer to members meeting certain criteria) - and how these were seen by the advice firms which we interviewed[8].

The chart below is from the 'Chart your own course' research cited earlier and gives an overview, based on a sample of DB schemes who replied to that survey, of which of the various member options are most widely in use at present.

[8] We describe some of these options in more detail in our August 2021 policy paper 'Live and Let PIE'. On point paper: Live and let PIE?– making the most of the flexibilities within your Defined Benefit pension scheme | Lane Clark & Peacock LLP (lcp.uk.com)

Figure 3. Member options chosen by DB schemes



A notable feature of this chart is that fewer than one in five of the schemes which responded to the survey said that they offered none of the member options listed. The most common was to include a transfer value figure as standard in retirement packs (that is, even if the member had not previously requested information about transfer values), and appointing an IFA to help members. But growing numbers are offering other options such as a 'Pension Increase Exchange' or a 'Bridging Pension' option. We now move on to consider each in turn, explaining what they involve and what our IFA firms told us they observed when discussing them with clients.

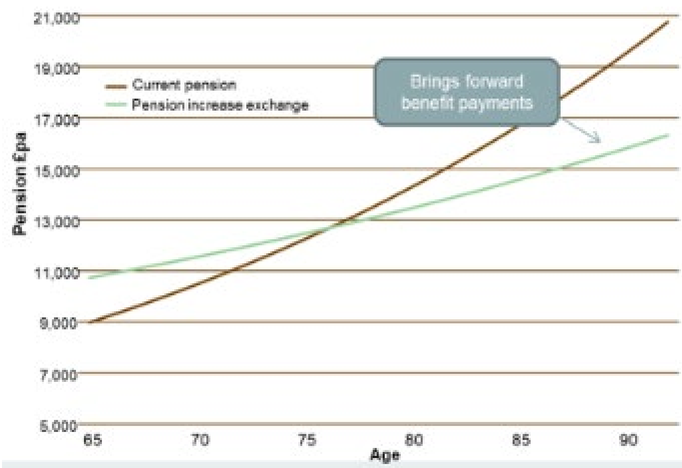
a) Pension Increase Exchange (PIE)

Pension legislation sets out minimum levels of inflation protection which DB pension schemes are required to offer. The rules can be different for different periods of service (eg service from April 1997 onwards has to be protected against inflation up to a cap) or for different slices of benefit (eg GMP benefits accrued between 1988 and 1997 have to be indexed up to a cap).

But many DB schemes will offer more generous indexation than the minimum required by law. For example, the scheme rules may link increases to the Retail Prices Index (RPI) measure of inflation rather than the generally lower Consumer Prices Index (CPI) measure used in statute. Similarly, a scheme may offer inflation protection on the whole pension in payment and not just that built up since April 1997.

The idea of a Pension Increase Exchange (PIE) is to allow the member to sacrifice some of this non-statutory inflation protection for a higher starting pension. This is illustrated in the chart below which shows how a PIE leads to a higher pension in the earlier phase of retirement but a lower one later on.

Figure 4. Structure of Pension Increase Exchange



Offering a PIE has a number of attractions:

- For the member, a higher starting pension which then increases less rapidly in retirement may be more attractive; for example, the member may want to spend money on travel and may want to do so when they are in the earlier part of their retirement and perhaps in better health; they may be willing to sacrifice (some of) their future inflation increases in exchange for more money earlier in retirement;

- For the scheme, the terms on which the PIE is offered may improve its funding position when a member exchanges benefits in this way; removing inflation protection also potentially reduces the scheme's inflation and longevity risk.

In the current high inflation environment, it might be expected that members would start to value their built-in inflation protection rather more than in the past and that this in turn might reduce demand for PIEs. But the advisers that we surveyed suggested that the situation is much less clear cut.

Several advisers said that current higher inflation may have led to slightly greater caution around taking PIEs. This could be because the 'crossover' age beyond which the member has received the same value of their pension benefits as they would have done had they not taken the PIE may now be slightly higher as long-term inflation expectations have increased. There was also some suggestion that some members might be inclined to delay taking a PIE (where offered as part of BAU) in order to maximise increases during the current period of high inflation before taking up the option when inflation subsides.

However, most said that high inflation had not yet put most people off. Reasons given included:

- The offer of an increased pension now, in exchange for lower inflation increases in the future remained very attractive; indeed, cost of living pressures may add to the desire for 'pension now' rather than 'pension later';
- Many people saw the present inflation increase as a 'spike' and therefore not especially relevant to the long-term benefits of retaining maximum inflation protection; an older generation who can still remember previous 'spikes' in inflation may be more relaxed than younger members who have perhaps never experienced double-digit inflation;
- Inflation protection within DB schemes is in any case usually capped, so once inflation is over a cap (eg 5%) the amount of benefit given up by sacrificing inflation protection does not rise any further even if inflation spikes;
- Many pensioners consider themselves to be 'good at budgeting' and consider that they would be able to cope with the gradual erosion in the real value of their pension in later life which would be implied by giving up some of their future inflation protection in exchange for a higher starting pension.

Member take-up of PIE offers (such as one-off exercises targeted at pensioner members) clearly varied from scheme to scheme, but take-up rates of up to 50% were not uncommon. This suggests that schemes which run a PIE exercise could see an improvement in their scheme funding position.

Advisers did however confirm that where the terms of the PIE were deemed 'fair value' (ie a broad equality between the value of the inflation protection given up and the pension uplift received in exchange), schemes were often not offering formal financial advice and members were often acting on the basis of generic guidance alone. This is in line with the minimum standards set out in the industry Code of Good Practice, but may fall short of what is needed to enable members to compare this option with the others available to them.

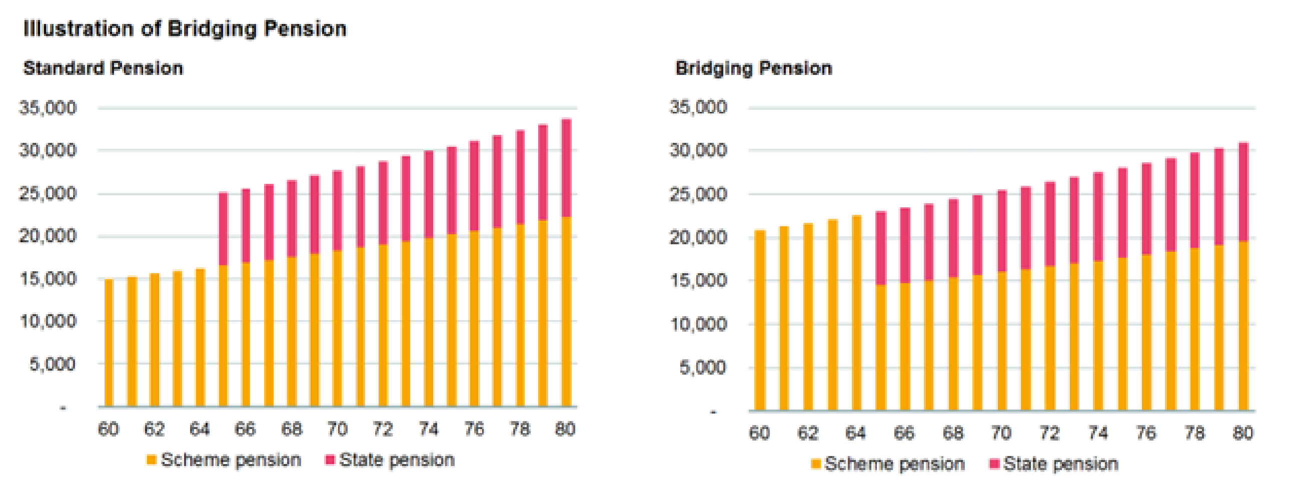
b) Bridging Pension Option (BPO)

The majority of DB pension schemes have a normal retirement age of either 60 or 65. For many decades these ages were well aligned with state pension ages. For example, for a man, state pension was until recently payable at 65 and so he could retire from paid work and draw his state pension and his DB pension at the same time.

However, whereas normal scheme pension ages have mostly stayed the same, state pension ages have increased. State pension age is already 66 for both men and women and will be 67 by April 2028, with further increases planned. This means that someone who takes their DB pension at the scheme's normal retirement age may find themselves short of the amount they need if they want to be able to stop work. This may be particularly true if they plan to retire 'early' – that is, before normal scheme pension age or if the normal retirement age is 60.

The idea of a 'bridging pension option' (BPO) is to help to overcome problems arising from these different pension ages. A typical BPO would involve offering the member a higher scheme pension from their chosen retirement date followed by a lower scheme pension when state pension becomes due. As shown in the chart below, this could result in a 'smoothed' retirement income, and could enable a member to achieve their retirement goals more readily.

Figure 5. How a Bridging Pension works



One adviser estimated that where a BPO was a permanent feature of the scheme, they would expect 15-20% of those who drew a scheme pension to take-up the bridging pension. This take-up rate is somewhat below the typical range which LCP has seen, which has typically been in the range 20-50%, depending on the details of the offer.

Most advisers reported relatively low volumes of Bridging Pension Options at present, though some schemes could have such an option without necessarily appointing an IFA. Advisers thought interest in bridging pensions could increase, especially as state pension ages rise. Most were very positive about BPOs as another way in which members could reshape their benefits to the potential advantage of both member and scheme.

As with PIEs, advisers reported that where BPOs were being offered at 'fair value', schemes were sometimes offering members limited support or guidance rather than personalised advice. Whilst offering 'guidance only' in this situation is allowable under the Code of Good Practice, there is a risk that unadvised members may make poor choices if they do not appreciate, for example, the tax implications of a BPO or how taking a BPO compares with other options such as taking a transfer.

Reported take-up of BPOs varied hugely from scheme to scheme and from exercise to exercise. Some key points made by advisers around BPOs were:

- A BPO can be particularly relevant to someone with more modest pension entitlements, where the state pension is a material part of their retirement planning;

for this group, managing on a scheme pension alone is unlikely to be enough to allow someone to fully retire before state pension age;

- A BPO can be especially attractive for someone considering early retirement, perhaps especially in the wake of the recent experience of Covid and the growth in home working.

c) Partial DB Transfers

Whereas a full DB transfer is a statutory right of members of DB schemes, the right to transfer *part* of their DB rights is not. Yet there are good reasons why this option could be very attractive to members[9] in certain circumstances. An obvious example would be where a member has long service in a single DB scheme. A full DB transfer might involve too great a transfer of risk onto the individual, but a partial transfer could enable the member to secure a core guaranteed income (from state pension plus partial DB pension) and then enjoy the greater flexibility of a DC pension pot via a transfer value in respect of the remainder of the member's benefits.

The advisers who took part in our survey were generally very enthusiastic about partial transfers as an option for members and wanted to see more schemes offer them. Indeed, they felt that where partial transfers were offered, it would be good if they could be more flexible than at present. Those schemes who do offer partial transfers may do so on a very limited basis – for example, only at retirement, or only being able to transfer a set proportion of the value of accrued benefits. The IFAs we interviewed suggested that if partial transfers could be customised more, this would be to the benefit of members.

However, advisers also recognised that partial transfers could be an administrative and communications headache for schemes. The complexity of underlying DB rights (eg GMPs, different 'tranches' of benefits with different features), meant that working out 'which part' of the DB rights were being transferred was often not straightforward. If schemes have to pay the cost of setting up a partial transfer option as well as administering the complexity of coming up with individual partial transfer values, this may put them off.

Notwithstanding these challenges, advisers said that they were seeing a gradual increase in the number of schemes either offering partial transfers or considering doing so.

Separate recent analysis of 78 pension schemes administered by LCP suggested that just over 1 in 5 currently offer a partial transfer option. Partial transfer volumes have to-date however been relatively low, and only just over half of the schemes which offered this option had actually completed a partial DB transfer in the last four years.

One notable feature of our data on partial transfers, which is consistent with the point made above in respect to long-serving members, is that partial transfers seem to be more common where the member has a large total pension. Our research found that in the last

[9] Our October 2019 paper on partial transfers covers this topic in more depth: partial-transfers-of-db-benefits-october-2019.pdf (royallondon.com)

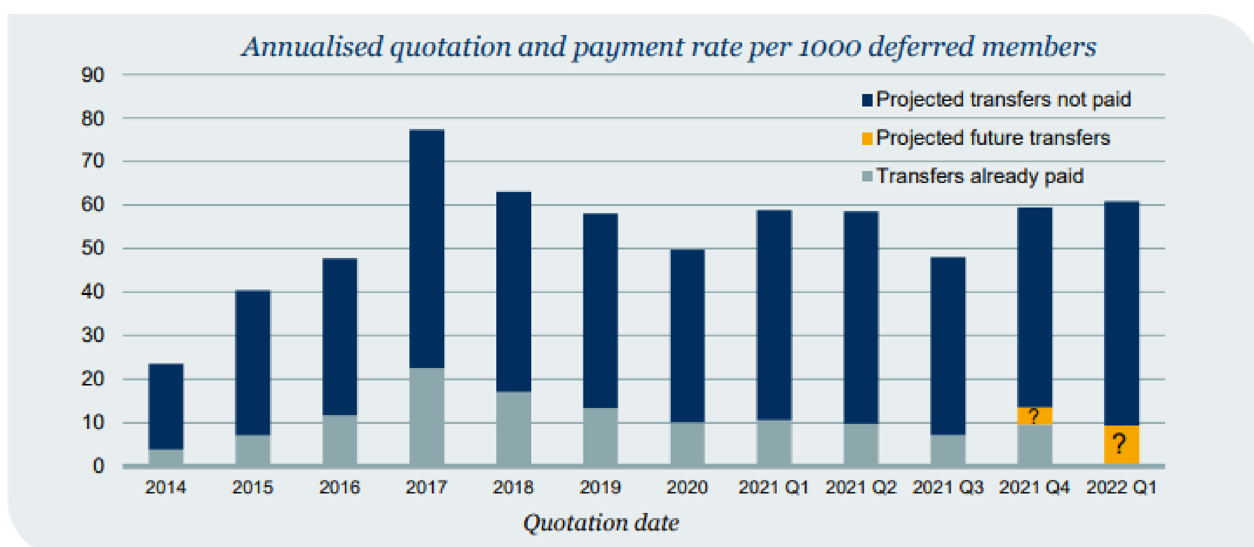
four years the median *partial* transfer taken was around £500,000, typically representing around half of the member's pension rights.

d) Full DB Transfers

In broad terms, a standard transfer value will reflect the expected 'best estimate' cost to the scheme of funding for a member's benefit. However, schemes vary considerably in the relative generosity of the transfer values which they may offer for any given level of scheme benefit. This may in part reflect the expected 'best estimate' returns on the investment strategy being used to underpin the payment of pensions in the Scheme, both now and in the future, as well as assumptions in respect of the scheme members (eg longevity). More analysis of the relative generosity of transfer values across different schemes can be found in the report "New rules for DB transfer advice – how generous are DB transfer values" which can be found at: LCP survey of DB Transfer Value Comparators.pdf. An updated version of that analysis will be published shortly.

On full DB transfers there was a general feeling that the market had cooled somewhat compared with the early years of pension freedoms. Analysis of the schemes administered by LCP[10] shows the surge in interest in DB transfers in the early years after the 2015 reforms, together with the subsequent levelling off of demand. The chart below shows the rate of transfer value requests (per 1,000 deferred members) and the rate of transfers paid out. Activity clearly peaks in 2017, before falling steadily to 2020 and then stabilising, although the most recent figures are likely to be somewhat distorted by the impact of the Covid-19 Pandemic.

Figure 6. Rates of a) DB Transfer Quotations and b) DB Transfers 2014-2022



Source: Data on schemes administered by LCP, reported in: All change for DB transfers - Issue 27 | Lane Clark & Peacock LLP (lcp.uk.com)

[10] See: All change for DB transfers - Issue 27 | Lane Clark & Peacock LLP (lcp.uk.com)

A range of reasons were given by advisers for the recent slowing down of the DB transfer market:

- Transfer values falling back from their previous peaks as interest rates start to rise;
- The rising cost of obtaining transfer advice, especially from 'high street' IFAs, coupled with the need to pay for advice in full regardless of whether that advice was to transfer or not;
- A growing awareness of the risks of DC investing; one adviser pointed out that the drop in markets at the start of the Pandemic, and the separate drop when Russia invaded Ukraine, had reminded members that 'DC pots can go down';
- A reduction in the number of under 55-year-olds transferring, partly in light of the latest regulatory guidance.

e) Enhanced Transfer Value (ETV)

In addition to this BAU ability to transfer out of a DB scheme, members may on occasion be offered more advantageous transfer terms in the form of an 'enhanced' transfer value. This may be on offer for a limited time period, may be focused on particular groups of members and may be accompanied by an increased level of financial adviser support.

One notable feature of our survey was that some advice firms said they did little or no work of this type whereas for others it was a common feature of their member options work. It was also clear that take-up rates of ETVs can vary hugely from scheme to scheme and from exercise to exercise, with one firm citing take-up rates ranging from 8% to c.45% across different exercises, depending on the individual circumstances of the scheme and the nature of the offer. Another firm pointed out that some schemes may simply choose to review their transfer terms and improve them across-the-board, rather than offering a temporary enhancement or an enhancement for particular groups, and this can also lead to a significant increase in take-up of transfers.

One specific concern which was raised related to the members aged under 55. Over-and-above the general regulatory presumption that advisers should assume that transferring out will not be right for most people, there are additional regulatory guidelines that in effect discourage transfers amongst the under 55s. Some advisers felt that this group should not be featuring in one-off enhanced transfer value exercises at all.

f) Flexible Retirement Options (FRO)

Several advisers reported that their main work was in advising scheme members on the suite of 'flexible retirement options' available to members. This could include some of the specific options listed above but could also include:

- Different combinations of regular scheme pension and pension commencement lump sum, up to the HMRC maximum permitted level;
- Early and late retirement options;

One advice firm commented that members were in some cases being presented at retirement with a 'bewildering' range of options, making it very hard for them to judge which would be best for their individual circumstances. The need for advice rather than merely generic guidance in such circumstances would be particularly important, as well as the need to ensure that member communications are in plain language and to avoid steering members in any particular direction.

The attraction of flexible retirement options is likely to be stronger for those who may have multiple pensions or for whom a 'one-stop' retirement no longer fits their plans. Some examples could include:

- being able to take a DB scheme pension early (though at a reduced rate), thereby enabling the member to reduce their working hours, perhaps until state pension age.
- being able to take a larger lump sum which could be used by a member to pay off a mortgage or other debts, reducing the pressure on household finances and making it easier to cut back on working hours.

04 Conclusions

The explosion of 'freedom and choice' seen in DC pensions following the 2015 reforms is also now starting to be seen in DB pensions, albeit at a more measured pace. There are two main reasons for the growth in interest in 'member options' in DB pensions:

- Demand side factors – the various member options described in this paper can be very attractive to a scheme member. Compared with seeing a regular scheme pension quotation, a transfer value quotation can have a much more powerful behavioural effect. Similarly, consumers may be interested in front-loading their pension (via a PIE or BPO) either to make the most of it while they are young enough to enjoy it, in order to help them through current cost of living pressures or even to facilitate early retirement.

- Supply side factors – schemes are increasingly appointing advisers to support members in making the right choice about their retirement options. With schemes becoming more mature, there is a growing focus on 'journey-planning' with member options being seen as an attractive way of improving member outcomes whilst getting the scheme one step nearer to its eventual destination. The legal requirement to equalise GMPs has led to a particular spike in the number of PIEs being offered as part of the reshaping of benefits which would be happening in any case.

There is no doubt that the options being offered to members are complex, especially set alongside the choices they may have to make about how and when to access any separate DC pot, about the timing of their retirement and about when to draw their state pension. The demise, for many people, of the 'one-stop' retirement means that reshaping occupational pension rights can be a key part of retirement planning and can open up choices which would previously not have been viable.

Offering members high quality, impartial financial advice is not only in the interests of members but can also be highly cost-effective for schemes if the result is greater engagement and take-up of the options on offer. There is also a strong case for offering such advice earlier in the retirement journey (eg from age 55) which gives members more time to plan for their retirement in an informed way, and brings in advice before members have firmed up their plans.

LCP INSIGHT CLARITY ADVICE

Contact us

If you would like more information, please contact your usual LCP adviser or one of our specialists below.

Steve Webb
Partner

+44 (0)7875 494184
Steve.Webb@lcp.uk.com

Clive Harrison
Partner

+44 (0)1962 873362
Clive.Harrison@lcp.uk.com

Laura Amin
Partner

+44 (0) 20 3824 7331
laura.amin@lcp.uk.com

At LCP, our experts provide clear, concise advice focused on your needs. We use innovative technology to give you real time insight & control. Our experts work in pensions, investment, insurance, energy and financial wellbeing.

Lane Clark & Peacock LLP
London, UK
Tel: +44 (0)20 7439 2266
enquiries@lcp.uk.com

Lane Clark & Peacock LLP
Winchester, UK
Tel: +44 (0)1962 870060
enquiries@lcp.uk.com

Lane Clark & Peacock Ireland Limited
Dublin, Ireland
Tel: +353 (0)1 614 43 93
enquiries@lcpireland.com

Lane Clark & Peacock Netherlands B.V. (operating under licence)
Utrecht, Netherlands
Tel: +31 (0)30 256 76 30
info@lcpnl.com

All rights to this document are reserved to Lane Clark & Peacock LLP. We accept no liability to anyone to whom this document has been provided (with or without our consent). Nothing in this document constitutes advice. The contents of this document and any questionnaires or supporting material provided as part of this tender submission are confidential.

Lane Clark & Peacock LLP is a limited liability partnership registered in England and Wales with registered number OC301436. All partners are members of Lane Clark & Peacock LLP. A list of members' names is available for inspection at 95 Wigmore Street, London W1U 1DQ, the firm's principal place of business and registered office. The firm is regulated by the Institute and Faculty of Actuaries in respect of a range of investment business activities. The firm is not authorised under the Financial Services and Markets Act 2000 but we are able in certain circumstances to offer a limited range of investment services to clients because we are licensed by the Institute and Faculty of Actuaries. We can provide these investment services if they are an incidental part of the professional services we have been engaged to provide.

© Lane Clark & Peacock LLP 2022