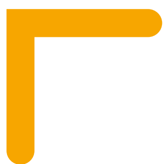
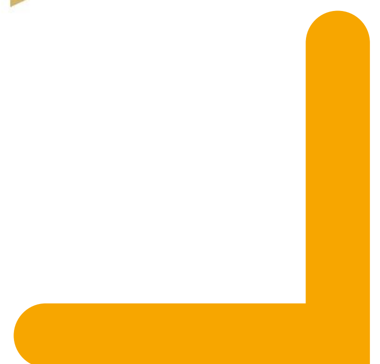
LCP INSIGHT CLARITY ADVICE

Live and let PIE?

Making the most of the flexibility <u>within</u> your Defined Benefit pension scheme

August 2021





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Introduction

When members of traditional Defined Benefit (DB) pension schemes are surveyed as to why they are considering transferring to a Defined Contribution (DC) or 'pot-of-money' arrangement instead, the word 'flexibility' is often heard. People say that although a guaranteed income for life (as offered by the DB scheme) offers security, it can also appear rigid. By contrast, transferring out your DB rights into a DC pension can give you a pot of money which, beyond normal minimum pension age (currently age 55), you can use how you want. Options for using that pot could include funding an earlier retirement, paying for a large one-off item or drawing more heavily earlier in retirement instead of steadily throughout retirement.

But one thing which is often missed – and which a good financial adviser will point out – is that similar flexibilities may be available within the DB pension scheme. Some of these are standard options built into the vast majority of schemes, such as the option to take early or late retirement and the option to vary the amount of tax free cash taken. Other schemes may offer members the chance to take a higher pension in exchange for lower inflation increases, or to take a higher early pension for a limited time period up to state pension age in order to facilitate early retirement.

The right choice for each individual will depend on their specific circumstances and goals. But it is important that DB scheme members understand that if 'flexibility' is what they seek then moving some or all of their money out of the DB scheme is not their only option. There may be flexibilities within the scheme which would allow them to re-profile their pension in a way that works better for them and which avoids the risks associated with a full pension transfer[1].

In this paper we aim to explain the main flexibilities which may be offered within a DB pension scheme and some of the pros and cons of each which members will need to consider when deciding to accept such an offer.

[1] Another way of achieving greater flexibility whilst retaining some of the benefits of a DB pension is through a partial transfer. We discuss this in more detail in this paper: LCP Royal London 2019_Partial Transfers of DB Benefits.pdf

1 Pension Increase Exchanges (PIEs)

In a world where retirement can last for decades, a pension which is not protected against inflation can lose a lot of value. Even with an apparently modest inflation rate of 2.5%, a pension with no inflation protection could be worth barely one half of its starting value twenty five years into retirement. As a result, the law places obligations on providers of Defined Benefit pensions to offer some minimum measure of protection against inflation in certain circumstances. These requirements are set out in more detail in the next section.

However, in practice, many pension schemes may offer something better than minimum inflation protection. For example, they may offer protection which covers longer periods of service, or they may use a higher measure of inflation or have higher limits than required by law.

This additional inflation protection is of great value to the member and can often come at considerable cost to the scheme. But if the scheme is spending money to go beyond the legal minimum of inflation protection, what if the member would prefer this money to be spent in some other way? In particular, what if the member would be willing to forego this additional inflation protection in exchange for a higher pension?

This is the basic idea which underpins the concept of a Pension Increase Exchange or PIE.

Essentially, the scheme will offer a member a higher pension in exchange for lower future inflation protection in the future. This typically can be done as a routine part of the retirement process (an ‘at-retirement’ PIE) or as a one-off offer to those already in retirement (a ‘pensioner PIE’). For simplicity, in this section we will mainly be referring to at-retirement PIEs, but most of the same issues arise with pensioner PIEs.

The PIE is attractive to the scheme because it is less exposed to future inflation increases which can be expensive to ‘hedge’ against, and also because the terms of the offer may provide less than 100% of the value that the average member is giving up. But in some circumstances, it can also be attractive to the member, for example if they are keen to ‘front load’ their retirement income to have more money to spend when they are younger and possibly more able to get out and about.

In this section we begin by setting out the current rules on inflation protection and how and why some schemes may go beyond this. We then give an example of how a PIE might work in practice before considering the pros and cons for the member.

1a Statutory minimum inflation protection v. inflation protection in the scheme rules

As noted above, in recognition of the impact of inflation on living standards in retirement, legislation requires that DB pension schemes provide a measure of inflation protection on pensions in payment.

Pension rights earned from service from April 1997 onwards have to be increased each year by inflation as measured by the Consumer Prices Index (CPI). There is a cap on this requirement which is 5% for service from April 1997 to April 2005, and 2.5% on service from April 2005 onwards. Schemes are not allowed to offer a lower level of inflation protection than this. In addition, in a contracted-out DB scheme where members built up a Guaranteed Minimum Pension (GMP) from April 1988 onwards, this has to be increased in line with CPI up to 3%.

However, many schemes will have more generous levels of inflation protection built into their scheme rules. Examples of where inflation protection might be more generous include:

- Many schemes measure inflation using the (generally higher) Retail Prices Index (RPI) rather than the CPI. Reform of the RPI means that from the 2030 the gap between RPI and CPI will largely disappear, but RPI indexation is still of value until that point
- Many schemes will offer inflation protection for service before April 1997
- Some schemes will have a higher cap on the amount of inflation protection which they provide or have no cap at all or provide a minimum or guaranteed level of increase each year eg 3%

Under a PIE, members will be invited to forego some or all of these additional protections. In return they will be offered a higher starting pension. In the next section we give an example of how this could work.

1b *An example of a PIE*

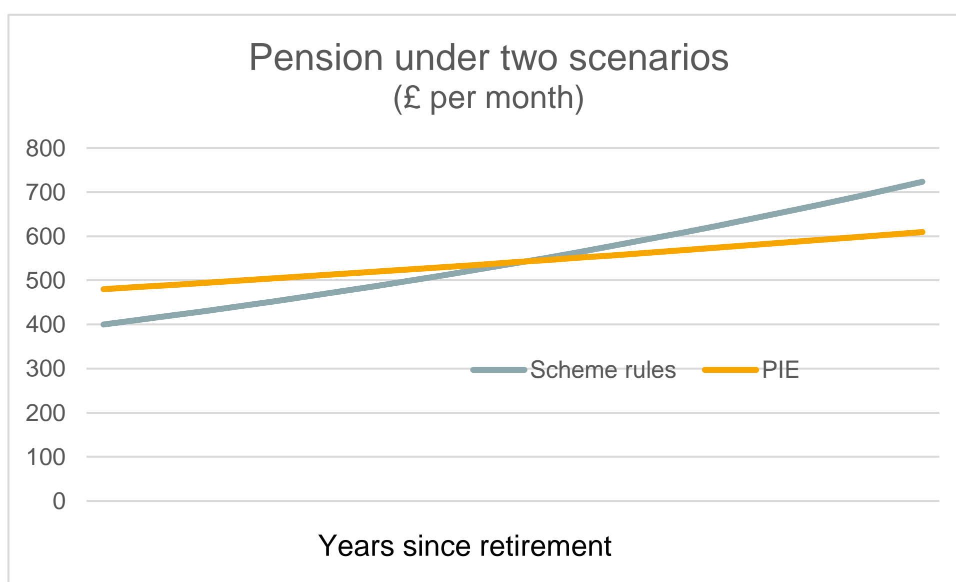
Consider the case of a member entitled to a pension of £400 per month from a DB pension scheme at the scheme's normal pension age. Suppose that the member has a mix of 'pre 97' and 'post 97' service in the scheme and that the scheme offers protection against inflation as measured by the RPI and with respect to all service.

There are two elements of inflation protection which go beyond the legal minimum:

- Indexation is provided on all service, not just the part since 1997;
- Indexation is linked to the generally higher RPI measure of inflation;

The scheme could offer the member a much lower level of inflation protection in line with the legal minimum – possibly less than half the amount that would normally be provided by the scheme – in exchange for a higher starting pension. For purposes of illustration we will assume that the starting pension which is offered instead will be £120 per week.

The chart below shows the member's pension at retirement under the existing scheme rules and under the PIE and in each year thereafter. For purposes of illustration, we assume inflation increases of 1% under the PIE (because only the post 97 service gets protection and only in line with CPI) and 2.5% under the scheme rules (because all service gets protection and in line with the RPI). The gradient of each line and the starting points will, of course, vary from individual to individual and scheme to scheme.



The key points are:

- If the member accepts the PIE they have a higher starting pension;
- Annual increases are lower under the PIE option than under the original scheme rules
- At some point it is likely that the weekly pension will eventually be greater under the scheme's rules option than under the PIE option – but this depends critically on what subsequently happens to actual inflation
- Whether the member gets more pension overall will depend primarily on how long they live, what happens to inflation and on how much increased pension is on offer in exchange for the inflation protection given up.

In some cases PIEs are offered at retirement as a routine feature of the scheme, whilst in others a one-off 'exercise' will be undertaken where members (including pensioners) are actively encouraged to consider a PIE offer. In both cases, members should seek financial advice or guidance to help make the right choice, and in some cases this will be funded in part or in whole by the scheme or the sponsor.

At present, many schemes are involved in a separate exercise relating to the 'Guaranteed Minimum Pensions' (GMPs) which certain DB pension schemes are required to provide. Some schemes are tackling this issue by reshaping benefits in a process known as 'GMP conversion'. In some cases members may be offered a PIE option in combination with seeing their pension benefits reshaped as part of the GMP conversion process, and this could mean that the potential uplift from the PIE is different than would otherwise have been the case.

1c Pros and Cons for the member

At first sight, a PIE can be very attractive. The concrete offer of an immediate increased 'headline' pension is hard to resist, especially compared with the uncertainty and complexity of the inflation protection which is being given up[2]. However, there is a risk of behavioural biases leading members to make poor choices by placing 'too much' weight on income in the present, even if it could cost them in the long run. So in this section we seek to set out in a balanced way the pros and cons of accepting a PIE and the questions which a member should consider.

i) When do I want to be able to use my pension?

There are many reasons why having access to more of your pension wealth earlier in retirement could be attractive. A higher starting pension – and potentially a larger tax free cash sum – could enable you to clear debts, including any outstanding mortgage, more quickly. It could also make earlier retirement a possibility, though a 'Bridging Pension Option' (see next section) might be more relevant if this is a priority.

There is also evidence that spending patterns in retirement can follow a 'U' shape, with people spending more in early retirement when they are perhaps more active, followed by a period of lower consumption, but then in some cases increased costs in later life as care needs increase. Those who take up a PIE get more money to spend at the start of retirement when they may be more fit and well to enjoy it. But the flip side is that they are likely to have less coming in later in retirement, if and when care costs have to be met.

ii) Will I get more or less pension overall?

A PIE is an exchange of value – you give up your non-statutory inflation protection and you gain a higher starting pension. In some cases, this exchange will result in you getting more pension overall, particularly if you have a shorter lifespan than average or if inflation turns out to be low in the future. In this scenario, decades of comprehensive inflation protection will in hindsight be shown to be of less value to you than frontloading your pension. On the other hand, those who are in good health and expect to live a long retirement, and those particularly concerned about the risks of future inflation (for example because of their expected future expenditure patterns), might do better through decades of larger annual increases.

One key factor in whether you are likely to get more pension overall is the generosity or otherwise of the uplift offered by the scheme. In some cases the scheme will make its 'best estimate' of the cost of the inflation protection you are giving up and will convert this in a broadly neutral way into a pension uplift. If this is regarded as giving '100%' value, then there is a broadly evens chance that you will get more overall assuming your health is similar to other scheme members of your age.[3] However, even in this case, accepting a PIE offer will leave you more exposed to inflation risk than

[2] A similar choice faces those who are thinking about using a DC pension pot to buy an annuity where there is an option between a higher starting amount with no inflation protection (a 'level' annuity) or a lower starting amount with some inflation protection (an 'index-linked' or 'escalating' annuity). In practice, the large majority of people opt for the former.

[3] This percentage is described in the Code of Practice (see later) as the 'Balanced Deal Percentage'.

you were before, and this could be particularly painful for a pensioner if future inflation were to be high.

However, it is important to be aware that some schemes may offer you less than 100% value – typically because the scheme sponsor may wish to use the opportunity to try to reduce their costs. If this is the case in the PIE you are offered – and you should always check – then it is more likely you will get less pension overall if you take up the offer. You may have other reasons for going ahead, but it is important to understand whether the basic terms you are being offered are neutral or not. In this case, as we explain below, if you are already in receipt of your pension the scheme should normally offer you access to *guidance* for PIEs offering 100% value and free and impartial *financial advice* for PIEs offering less than 100%, to help you make the choice which is right for you.

It is also worth being aware of the potential knock-on effect of the decision that you make as a member on any pension payable to a surviving spouse or other qualifying dependant after your death. For example, if you give up some inflation protection and live a long retirement, your pension at time of death may be lower than it would have been if you had not accepted the PIE. Of course, your spouse may have shared in the benefit of the uplift in the pension at the start of your retirement so may still be content overall that you accepted the deal, but this is a reminder to think through all of the consequences of a PIE. The potential knock-on on any pension payable to a surviving spouse does vary so you need to check the details of the offer.

iii) How valuable is this extra inflation protection?

As we have pointed out, given that typical retirements today run into decades, protecting the value of your pension against inflation can be very important. We have got used to very low (and sometimes negative) inflation rates, but this is relatively unusual. At time of writing, inflation is rising and some commentators believe that the economic stimulus of recent years is likely to lead to a return of much higher inflation. If this were to be the case then those who had given up some of their inflation protection through accepting a PIE might end up regretting it.

More generally, as noted above, it is those who live for the longest who benefit most from inflation protection. An apparently modest inflation rate of 2.5% will compound to reduce the value of a starting pension by around one half in 25 years. Those who are in good health and have a good prospect of a long retirement risk ending up with less pension overall if they trade reduced annual increases for a higher starting pension, especially if we see a resurgence of inflation.

iv) Can I achieve my objectives in a different way?

A PIE may be just one of a number of ways in which an individual can achieve the goal of having more money to spend earlier at the expense of having less money to spend later. For example, the DB member may also have DC pensions or other investments and they could simply choose to run those down more quickly if they wished. Or they could consider some post-retirement part-time work to top up their income.

Alternatively, the member may be planning to use the larger up-front income (and possibly larger lump sum) as a means of tackling debts, but it is possible that with suitable debt advice a different strategy might be preferable.

It is important therefore that the PIE is evaluated not in isolation but in the context of the member's wider financial circumstances, goals and attitudes, and by comparison with other strategies which might be available.

v) Will the transaction affect my tax and benefit position?

A PIE offered at retirement may well involve not just a higher starting pension but a higher tax free lump sum.

For individuals in receipt of means-tested benefits such as Pension Credit, Housing Benefit or Universal Credit, considerable care needs to be taken when considering a PIE.

Broadly speaking, any increase in regular income is deducted pound-for-pound in the case of benefits such as Pension Credit or Universal Credit, meaning that the recipient may not actually be better off as a result. In addition, if a PIE is combined with taking a larger lump sum and goes unspent, this is likely to be treated as 'capital' for benefit purposes. Universal Credit and local authority council tax assistance schemes have stringent capital cut-offs so that those with capital above specified levels can lose all entitlement to benefit.

In these sorts of cases it is hard to see the benefit in giving up future pension increases for the sake of a larger current pension or lump sum, if the larger pension or lump sum has a substantial negative effect on benefit entitlement.

On income tax, because occupational pensions are taxable, any increase in your starting pension is likely to be subject to tax. In addition, those who take a PIE at retirement will use up more of their pensions Annual Allowance for that year so are at greater risk of an Annual Allowance tax charge, though generally only for those with the largest pensions. Similarly, an increased pension might jeopardise protections which an individual has secured against pension Lifetime Allowance charges, so advice should always be taken if you are affected by this issue.

vi) Are there any other things to consider?

Most DB pensions are paid in full but there is always a risk of a sponsoring employer becoming insolvent at a time when there is a shortfall in the fund. In this case the scheme may end up transferring to the Pension Protection Fund. If this were to happen then there could be some advantage if you had accepted a PIE because any PPF compensation is likely to be based on a higher pension figure.

2 *Bridging Pension Options (BPOs)*

In previous generations, retirement at or around state pension age would have been regarded as the norm. Those with generous company pensions may have been able to afford to retire early, but for most people it was only once they were able to draw both their state and occupational pensions that it was affordable to stop work.

In more recent years, and particularly since the advent of ‘pension freedoms’, individuals now have much more choice over when they retire and whether this is a one-off event or a phased process over a period of months or years. For example, an individual (or two members of a couple) might have:

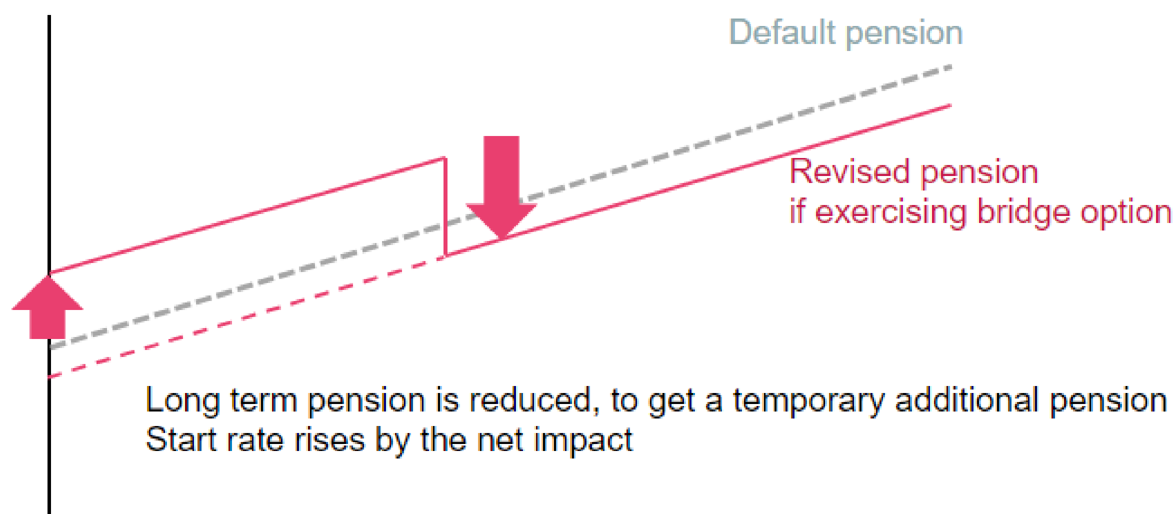
- A state pension payable at 66, rising to 67 from 2028;
- A DB pension with a normal pension age of 60 or 65, but with options for early or late retirement;
- One or more DC pension pots which can be taken in part or in full from normal minimum pension age – currently 55 and rising to 57 in 2028;

Particularly where there are two adults each with multiple pension rights, the decision over when and how to retire is much more complex than in the past. One of the reasons why people may choose to transfer out of their DB pension into a DC arrangement is the flexibility to draw more of your pension earlier, and thereby potentially finance an earlier retirement.

But, increasingly, there may be no need to transfer out of your DB scheme to access this flexibility. Bridging pension options allow people to take a larger pension below normal scheme pension age but then accept a reduction in pension when the state pension starts to be payable. For those with larger DB entitlements this enhanced early pension may be enough to support early retirement or a move to part-time work, ahead of retiring fully once state pension becomes available.

2a An example of a BPO

The basic idea of a Bridging Pension Option (BPO)[4] is that the member initially receives a larger pension than they would have done under normal circumstances, and that this enhanced pension 'bridges' the gap in time between drawing a scheme pension and state pension age. On reaching state pension age, the pension is then reduced to a figure below the pension the member would otherwise have received. This is illustrated in the chart below:



A typical BPO would involve a reduction in scheme pension at state pension age with the intention to avoid any significant drop in total income at state pension age. However, individual entitlements to state pension can vary, so it is important that members understand how much their scheme pension will drop at state pension age and how this compares with the state pension that will come into payment at that point.

[4] Note that in some schemes a Bridging Pension Option may be described as a "temporary pension option" or a "levelling pension option". We are talking here specifically of options which members may choose to take. We are not referring to schemes where a pension reduction at state pension age is built in to the benefit structure.

2b *Pros and Cons*

As with a Pension Increase Exchange, whether or not a Bridging Pension Option is right for the member will depend very much on the circumstances of the individual and the terms of the offer.

Again, as with a PIE, there is a risk that people place too much weight on 'money now', and too little weight on money later in retirement – a process known as 'hyperbolic discounting'. Whilst the money early in retirement – and the earlier retirement – is obviously welcome, they may come to regret the choice later in retirement when they are living on a lower pension than would otherwise have been the case. It is important that people are able to make a balanced choice when faced with options of this sort, and good advice will be important.

For some people, a BPO will make the difference between being able to afford to retire early and having to carry on working, possibly in a physically demanding job or one from which the worker would otherwise wish to retire. In this case, the upside of early retirement may be worth the lower long-term scheme pension. This would be particularly true of someone who had below-average life expectancy who could be a net beneficiary from the transaction over-and-above the attractions of early retirement.

A further significant attraction of a BPO is that it may well involve not just a higher starting pension but a higher tax free lump sum. But there is no 'free money' in this transaction. Even if the BPO is at 100% value, a larger payout upfront will mean less money from the scheme in later retirement, and if the BPO is at less than 100% value, the deal may be expected to result in less pension in total.

However, the member will need to consider their long-term position. If they only have a modest company pension and perhaps little or no other income, they may find that the reduced company pension (plus state pension) which they get post state pension age in this model gives them a rather modest standard of living. For this group it is possible that working longer – and building up further pension rights in a workplace pension – could give them a much better standard of living in retirement, albeit for a shorter period of time.

Another factor to consider is the tax implications of restructuring pensions in this way. An immediate higher pension may attract more income tax. In addition, an increase in starting pension normally counts towards the Annual Allowance for pension tax relief. It could also mean an increase in the amount of Lifetime Allowance eaten up by the DB pension or the loss of a Lifetime Allowance protection. Whilst the majority of savers are probably well within these limits, this is certainly an area where taking careful advice could avoid an unexpected tax bill, and a large tax charge could alter whether accepting the deal is attractive or not.

A further issue is any potential mismatch between the step down at state pension age and the actual amount of state pension which an individual is entitled to receive. Because actual state pension amounts can vary, the step down in company pension may not exactly match the amount of state pension which kicks in. Whilst an overall boost to income at this point would be welcome, a drop in total income at state pension age would not be. Members considering a BPO should therefore find out how much their pension will fall at state pension age and compare this with an up-to-date forecast of their own state pension entitlement, taking account of any planned changes to their own state pension age.

Furthermore, with state pension ages moving, it is important to ensure that the age at which the company pension will be reduced is consistent with the age at which the individual can draw their state pension, taking account of any increases in state pension age.

3a Other flexibilities – Early/late retirement

It is common to think of DB pension schemes as having a set pension age which would often be the age at which active members of the scheme would retire and start drawing their pension. However, with many DB pension memberships now being 'deferred' – that is, relating to a previous job or to a now-closed scheme - the connection between taking a pension and retiring from work is now much weaker. And, more importantly, most schemes have much more flexibility than is commonly appreciated when it comes to the age at which you can draw your pension[5].

In brief, most DB pension schemes will offer the member the opportunity to take a pension before or after normal pension age. Those who take a pension early will get a lower starting pension than if they had waited until normal pension age whilst those who take a pension late may get a higher starting pension. The extent of the pension reduction for early retirement (or increase for late retirement) will vary from scheme to scheme but in most cases it will be calculated on an actuarially neutral basis. In simple terms, the scheme does not seek to gain or lose when members take early retirement – it adjusts the pension so that the expected cost to the scheme of providing a pension for the individual member remains broadly the same.

Schemes have often not been very good at alerting members to their option under the scheme to take early retirement.[6] So it is well worth members finding out what their options are, and the terms on which they could vary their pension age, when they are thinking ahead to how and when they might retire.

The pros and cons of taking early retirement to some extent mirror those of PIEs and BPOs as discussed earlier. You are, in effect, taking more of your pension wealth earlier and therefore there is less for you to enjoy later in retirement. Those who expect to live long lives in retirement may lose out more in lower long-term pension than they gain by drawing their pension early.

Combining an early-retirement pension with ongoing paid work may also raise tax issues. Someone who is working and paying income tax will have generally used up all of their tax-free personal allowance, so any occupational pension income received on top will be taxed from the first pound, potentially even at higher rates of income tax. By contrast, those who wait to take their occupational pension until they are no longer in paid work are likely to pay less tax on that pension.

But taking a pension before normal pension age could be part of an overall package which allows a member either to retire fully or at least to reduce their hours. The occupational pension, perhaps

[5] Note that this is separate from any provision for 'ill health' early retirement where different rules may apply.
[6] See for example our joint policy paper with Royal London entitled "Helping DB members make better retirement choices" helping-db-members-make-better-retirement-choices.pdf (royallondon.com)

supplemented by part-time work, could be enough to support them until the state pension kicks in, and could therefore facilitate an easing out of paid work which would not be possible otherwise.

3b Other flexibilities – Tax-free cash

In 'pot-of-money' (Defined Contribution) pensions it is possible to take up to 25% of the pot in the form of a tax-free lump sum. In a DB pension it is also possible to take tax-free cash, though the way this is worked out is slightly different. In some cases the benefit is structured to provide a set level of pension combined with a set amount of tax-free cash based on final or average salary. In others, the member is presented with the option of a (higher) pension with no tax-free cash or exchanging (or 'commuting') some of that pension into a lump sum combined with a lower pension. Another potential source of flexibility is in schemes which provide both DB and DC benefits, the member may have some choice about which benefits are used to take their tax-free cash.

What is often not appreciated is that, provided the member stays within overall HMRC limits on tax-free cash, it may be possible for them to vary the balance between the amount of their pension they take as regular income and the amount they take as a lump sum. Whilst the 25% figure is a limit to the proportion of the value of the pension that can be taken as tax-free cash, members are generally free to opt for a lower figure if they wish. Although it might make sense for many people to maximise the amount they can take tax-free, for others a better balance might be to secure more of their regular income in retirement via their scheme in the form of a higher regular pension and a lower amount of tax-free cash. The right answer will clearly vary from individual to individual but the starting point is to know that this may be an option.

One other factor to be aware of is that the rate at which schemes exchange regular pension for a lump sum can vary hugely. In some cases these 'commutation' terms are poor value and amount to a 'profit' for the scheme. For example, in many public sector schemes, a member who gives up £1 per year of pension only gets £12 in lump sum. Given that they are likely to live for twenty years or more on average, this is likely to be a poor deal, even allowing for the tax-free status of the lump sum. But in other schemes the exchange of value is likely to be much more favourable. Again, before making decisions in this area, taking advice as to which options are likely to be most favourable to the individual can be very valuable.

4 Good practice in offering members pension flexibilities

Whilst options such as a PIE can be a potential 'win-win' for both member and scheme, there are also risks of members losing out. This is more likely where the terms of the option are less than 'fair value', for example they may be out of date, or may have been designed primarily to maximise the improvement to the funding position of the scheme. In the past there have also been examples where members have been put under pressure to accept offers or where advisers have been incentivised to maximise the take-up rate of these offers, even where it is not always in the member's interest.

To help reduce the risks associated with one-off exercises, a voluntary 'code of practice' was established to ensure that a high standard is followed in how the offer is presented and implemented. Although the code does not have statutory force, it is now overseen by the Pensions Regulator and reputable practitioners in the field would be expected to follow its principles. The current version of the code can be found at: Incentive exercises industry code of practice (thepensionsregulator.gov.uk)

Amongst principles set out in the code are:

- That members should receive advice or guidance to help them make the decision that is right for them; for example, the Code specifically says that in PIE exercises where members are on average being offered less than 100% of the value of the inflation protection they are giving up, they should be given access to free and impartial financial advice;[7]

- Communications with members should be clear and unbiased

- Exercises should allow members time to make their choice and should not be put under any pressure

Any member offered a PIE or other adjustment to their benefits as part of an exercise who feels that these principles have not been followed should raise their concerns with the scheme. They may also wish to raise them with the Pensions Regulator and/or the Pensions Ombudsman.

[7] Guidance for financial advisers advising on PIEs can be found at: Incentivised Transfers for Pensions (actuaries.org.uk)

Conclusions

Much has been made in recent years of the added 'flexibility' which can be obtained by transferring rights obtained in a Defined Benefit pension scheme into a Defined Contribution or 'pot of money' arrangement. Whilst regulators warn that members are generally better advised to retain the security and guarantees associated with a DB pension, the lure of 'flexibility' can be a strong one.

What this paper has sought to demonstrate is that there may be far more flexibility available within the DB world than is commonly appreciated. For example, for many years, members have been able to take their pension before or after normal pension age, even though this option has often not been well-communicated. And in many schemes members can vary the balance between regular pension and tax-free lump sum to fit their individual circumstances.

But, more recently, other ways of re-shaping DB benefits have come to the fore. A Pensions Increase Exchange (PIE) allows the member to forego inflation protection above the statutory minimum in exchange for a higher pension. A Bridging Pension Option (BPO) allows the member to take a higher pension before state pension age in return for accepting a drop in pension when state pension age is reached.

Our central message is that 'flexibility' need not be synonymous with 'transferring out'. Many schemes may already offer a range of flexibilities which allow the member to alter their retirement date or the profile of their pension income without leaving the 'safe harbour' of the DB pension scheme. Members should certainly find out from their schemes what flexibilities are available on a 'business-as-usual' basis, but may also wish to approach their trustees to see if a PIE or BPO might be offered to broaden the range of options. Such options, carefully handled, have the potential to offer a 'win-win' for both scheme and member.

Glossary – technical terms explained

Balanced Deal Percentage – this is a way of summarising the generosity of a PIE offer; it compares the expected amount of pension the average member would get if they accept the PIE with their expected pension without the PIE; if the percentage is under 100% and you are offered a PIE as part of a one-off exercise, the code of good practice states that the scheme should appoint and pay for an independent advisor to provide you with financial advice to help make the right choice

BPO – a Bridging Pension Option, where members can take a pension at an enhanced rate but which is then reduced by a pre-determined amount when their state pension age is reached. In some schemes this may go by a different name such as a 'temporary pension option'.

DB – a 'Defined Benefit' pension where the amount of pension you build up is guaranteed and depends on things like your salary and your length of service; 'final salary' pensions are a specific type of DB pension where it is your salary when you leave the scheme (or sometimes an average over the last few years) which determines how much pension you get

DC – a 'Defined Contribution' pension is a pot of money which is invested for you to draw on once you reach normal minimum pension age (currently 55 but rising in 2028 to 57) or later, as you choose; there is no guarantee as to how much pension the pot of money will generate and, following the introduction of 'pension freedoms', there is no obligation to use the fund to buy an annuity (or 'income for life');

PIE – a 'Pension Increase Exchange' where members are offered a higher pension in return for giving up some of the inflation protection they would otherwise get. A PIE can be part of the 'business as usual' activity of the scheme (eg offered at retirement to all members) or can be a one-off exercise where pensioners are offered an uplift

PPF – the Pension Protection Fund provides compensation for members of DB pension schemes if the sponsoring employer becomes insolvent. PPF compensation is likely to be less generous than the pensions that would have been paid if the scheme had continued, but does offer an important 'safety net' in the event of employer insolvency. More details can be found at: Welcome to the PPF | Pension Protection Fund

LCP INSIGHT CLARITY ADVICE

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