All change for DB transfers

LCP's quarterly review of the transfer experience of the schemes we administer

Issue 27, June 2022

Average transfer values drop by more than 25% as gilt yields rise

The average transfer value quoted in Q1 2022 was £293,000, down 28% from £408,000 in Q4 2021. This is the lowest figure since Q3 2019 and coincides with a substantial rise in government bond yields, a key consideration in most transfer value calculations.

The 28% drop was the largest between any two successive quarters since we started our analysis in 2014. With this volatility in transfer amounts, transferring members with similar benefits could have materially different outcomes depending on the date their transfer values are calculated.

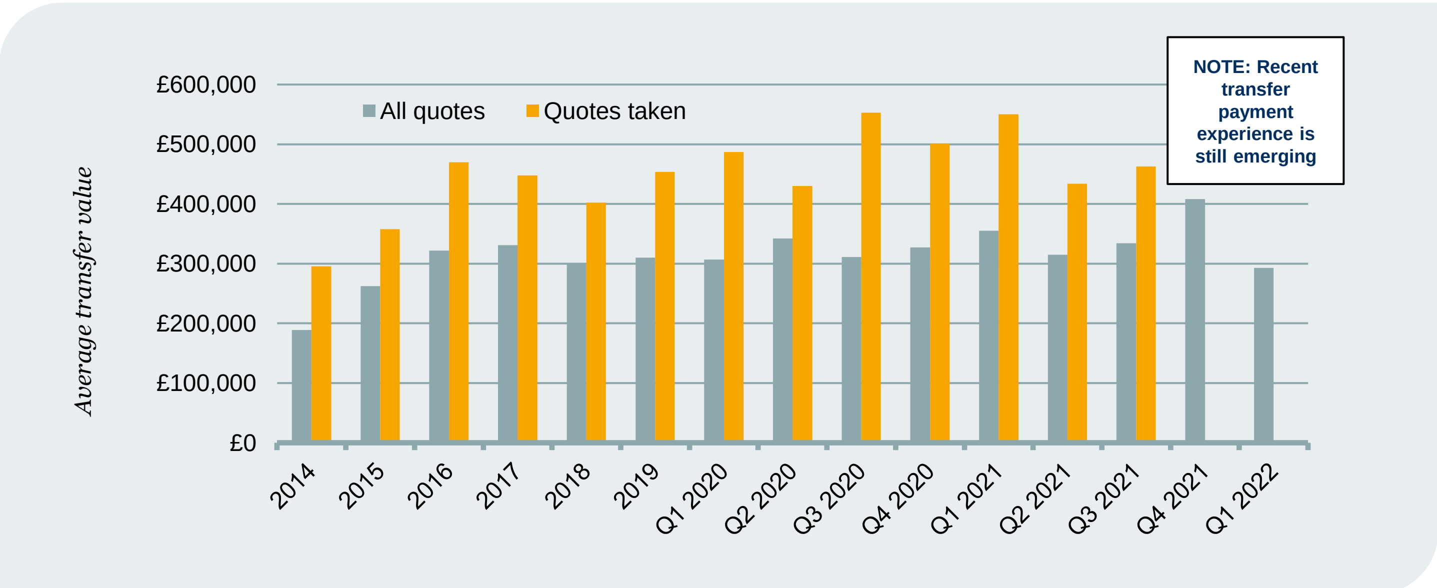
As demand for quotations remained stable over the two most recent quarters – at a rate slightly above the average for the last 2-3 years – the total value of all transfers quoted also fell by 28%, from £151m in Q4 2021 to £109m in Q1 2022.

The take-up rate (percentage of quotations ultimately paid out) for quotations issued in Q3 2021 – the latest quarter with complete payment data – was only 15% (the second lowest rate since 2015), but partial data for Q4 2021 suggests a potential bounce-back in the take-up rate, possibly as members look to take advantage of the higher average amounts quoted in that quarter.

Volatile transfer values could lead to disparities between members

In Q4 2021 the average quotation size jumped above £400,000, only the second time this had happened since we started our analysis in 2014 – the other being Q1 2017. In our previous issue of this report, we speculated that this could be linked to rising inflation expectations and knock-on effects of the 2020 ban on contingent charging.

In Q1 2022 this figure moved in the opposite direction, falling below £300,000 for the first time since Q3 2019.



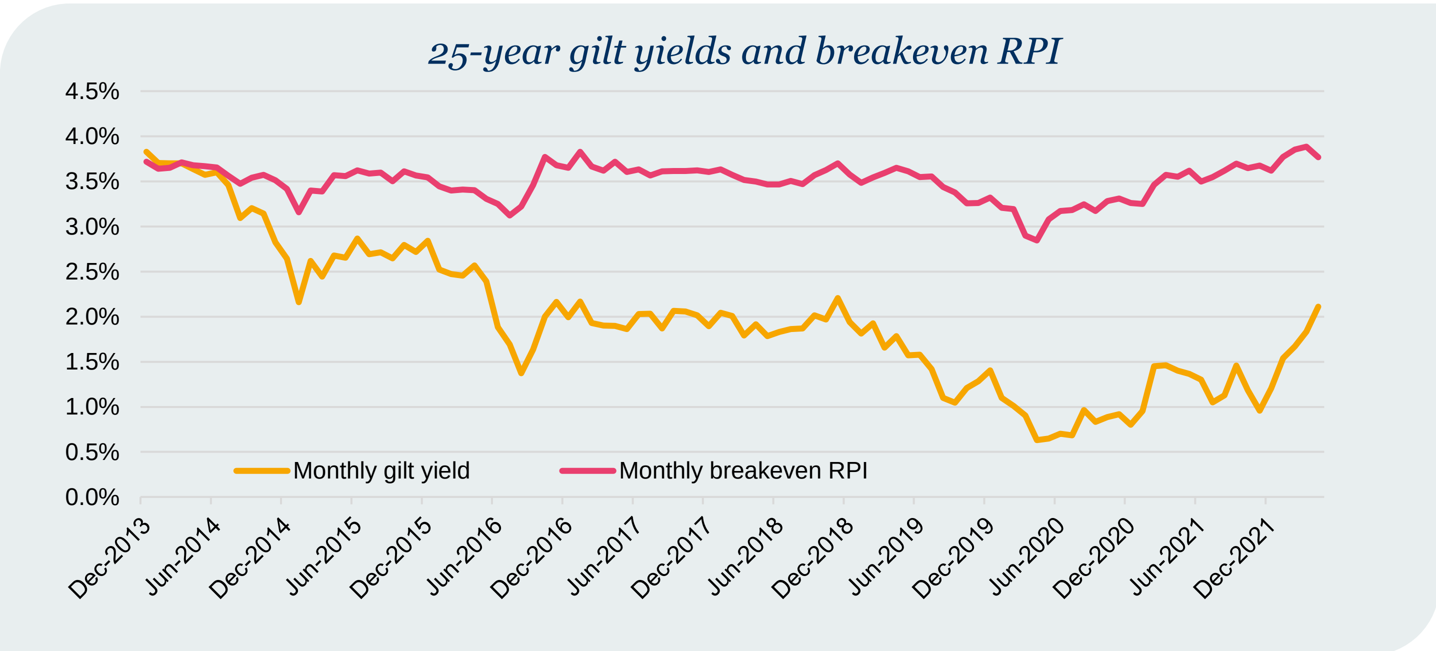
Why did transfer values drop so much in Q1 2022?

The key actuarial assumptions affecting the size of a transfer value are the inflation assumption, the discount rate and the post-retirement mortality assumption. Over the course of 2021, a combination of increasing aggregate demand as lockdowns were lifted, supply-side strains as the economy restructured itself, and increases in the price of certain commodities such as oil, created an environment of high inflation and, importantly for pension schemes, higher expectations of future inflation. With typical discount rates and long-term mortality assumptions not changing markedly, it is likely that rising inflation expectations played a part in the unusually high average transfer values quoted in Q4 2021.

Since the start of 2022, while inflation expectations have continued to rise, this has been outstripped by a rise in government bond (gilt) yields: as shown in the chart below, a typical 25-year gilt yield rose from 0.96% pa on 30 November 2021 to 1.67% pa on 28 February 2022, with a further rise to 2.11% pa on 30 April 2022. Possible reasons for this increase are:

- Investors expecting higher yields as protection against higher expected inflation.
- Increased supply of government bonds to fund increased government borrowing during and after the Covid-19 pandemic.
- Actual and expected increases to the Bank of England's base lending rate against a backdrop of rising inflation leading to higher interest rates throughout the economy.

As most schemes use gilt yields as a reference rate to set the discount rates they use in transfer value calculations, this trend will have resulted in greater discounting and hence lower transfer values among many schemes. Moreover, as it is common for schemes to cap the total pension increase that can be awarded in a given year, eg at 2.5% or 5%, the continued rise in inflation expectations will have had a limited impact on many calculations.



Another possible downward driver of transfer values might be some schemes adjusting their mortality assumptions to reflect an increasingly widespread view that the knock-on effects of the Covid-19 pandemic will lead to some reduction in future longevity improvements. That said, most schemes tend to update their demographic assumptions, including the mortality assumption, much less frequently than their financial assumptions and the impact of any update is likely to be less significant than that of the sharp increase in gilt yields.

In addition to changes in transfer value bases, some of the drop in average transfer values might also be attributable to random variation, or possibly a shift in the profile of members requesting quotations. For example, there may have been an increase in the number of small transfer values quoted as more members with smaller benefits consider accessing their pension savings to help alleviate the rising cost of living.

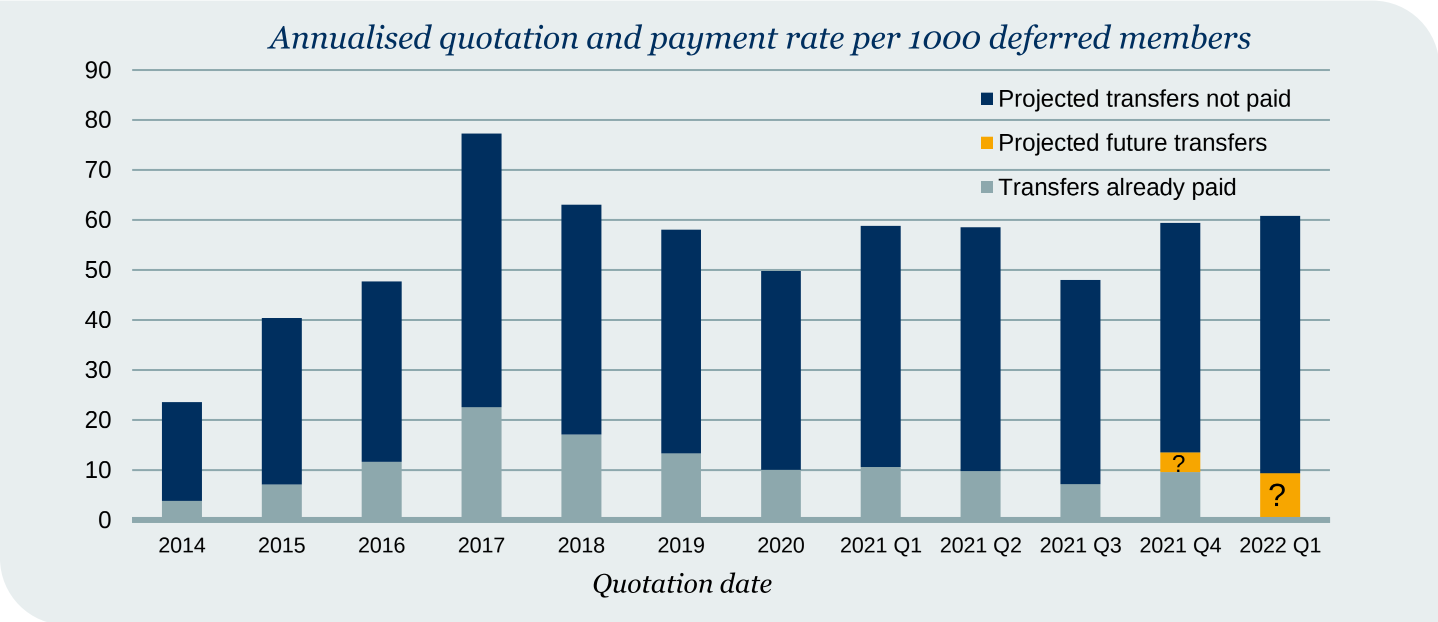
What impact might this have on members?

The average transfer value quoted in Q1 2022 was 28% lower than in Q4 2021. This is the largest quarter-on-quarter drop in this figure since 2014, when we started tracking statistics on transfers, and bucks the general trend of steadily increasing transfer values since 2014. Due to the rise in gilt yields discussed above, two members of a similar age and with similar benefits requesting transfer values three months apart – one in Q4 2021 and the other in Q1 2022 – may have been quoted very different figures.

From the members' perspectives, this disparity might appear unwarranted: while pension schemes typically invest in gilts – and other assets whose return might be expected to move in line with gilt yields – for an individual the nominal cash amount transferred is likely to be more important than its value relative to a metric such as gilt yields. This is especially likely to be the case for members over 55 whose aim in transferring might include accessing the greater flexibilities (cash sum, drawdown etc) available in a defined contribution arrangement at retirement.

Members generally find it difficult to understand why their transfer value might differ so significantly over a small period of time, especially when the change in value is downwards.

Transferring out is likely to appear more attractive when transfer values are higher than normal, and vice versa. Quotations issued in Q3 2021 – the latest quarter with complete payment experience – had an average size of £334,000 (in line with recent averages), and only 15% of these were paid out. This is the second lowest rate since Q3 2015, and continues a general trend of low take-up rates since the contingent charging ban was implemented on 1 October 2020. However, of the quotations issued in Q4 2021 (when the average size was £408,000), 16% had already been paid out as of early April 2022. With more of these quotations expected to be paid out over Q2 2022, we expect the ultimate take-up rate for this quarter to be much higher than that seen in Q3 2021.



Too early to see the effects of new transfer scams legislation

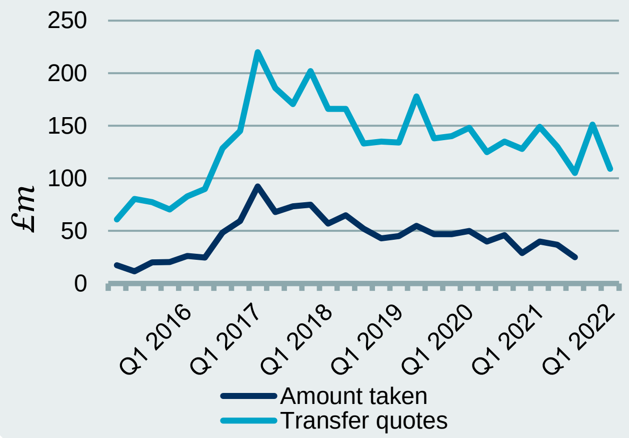
New legislation came into effect on 30 November 2021, requiring trustees to carry out due diligence on transfer payment requests received with the aim of protecting members from pension transfer scams. The Pensions Regulator (tPR) issued new guidance to trustees and scheme managers alongside the legislation. Under the new legislation, if a transfer payment request raises an "amber flag", the member will need to attend a guidance session with the Money and Pensions Service (MaPS) before the transfer can proceed. If a "red flag" is raised, the trustees will be required to block the member's statutory right to transfer. There are seven possible amber flags and six possible red flags, as set out in tPR's guidance.

One of the amber flags is "a sharp, unusual rise in transfers involving the same scheme or adviser". Alongside our main quarterly analysis, we are continuing to centrally monitor individual schemes' transfer request activity to help LCP administration teams spot any concerning rises in requests. This involves comparing each scheme's request activity in a given month against the average for other LCP clients in that month and against that scheme's recent historic activity. If activity is flagged as being higher than expected, we notify the client team so that they can check for a concentration of requests involving the same adviser or members looking to transfer into the same receiving arrangement. So far, we have not seen any significant change in quotation or take-up rates at an aggregate level as a result of the new legislation.

Long-term trends in transfer activity

In the 12 months to 31 March 2022 our administration teams provided transfer value quotations to almost 6% of deferred members, with a value of £495m in total. This compares to just under 5% and £537m in the 12 months to 31 March 2021. While there has been a slight uptick in demand for quotations as the Covid-19 pandemic has eased, overall transfer quotation activity remains significantly lower than the peak in activity seen in 2017 when almost 8% of deferred members requested transfer quotations with a total value of £778m.

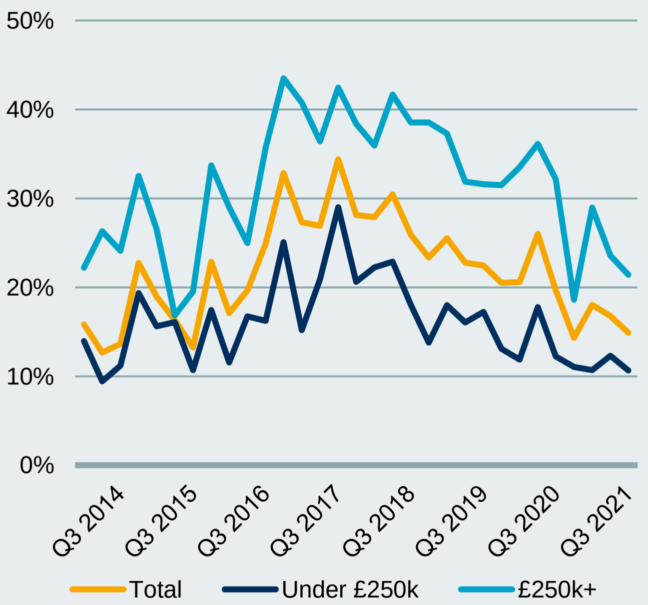
The total value of payments in respect of quotations provided in Q3 2021 decreased to £25m with an average size of £463,000; this compares to the peak for quotations provided in Q1 2017 (£92m paid out with an average size of £627,000).



Have take-up rates changed?

The take-up rate for quotations made in Q3 2021 was 15%; this represents a decrease from the previous quarter (17%).

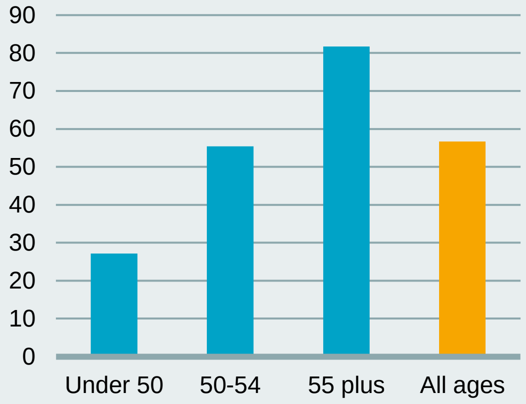
Proportion of transfers taken over and under £250k



Transfer value quotations in year to 31 March 2022

Quotation rates continue to be highest for those aged 55 and over. Just over 8% of members aged 55 and over requested a transfer quotation in the 12 months to 31 March 2022, compared to less than 3% of members under 50.

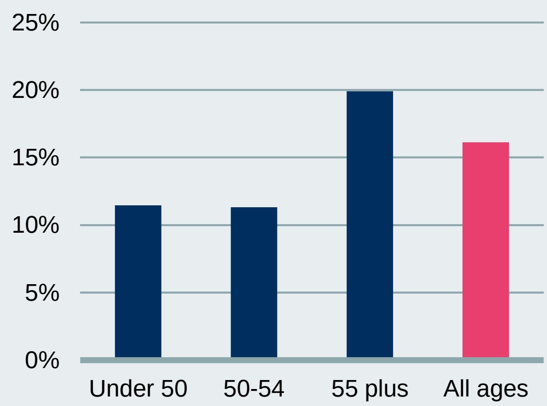
Number of quotations per 1,000 deferred members in each age group



Transfer values taken in year to 30 September 2021

Around 20% of quoted transfer values proceeded to payment for those members aged 55 and over, compared to 16% of all transfer values quoted in the 12 months to 30 September 2021. Only 11% of transfers quoted to members under 50 were taken over the same period. As a proportion of all quotations in the year which were then paid, 68% were paid to members aged 55 and over and 13% were paid to members under 50.

Proportion of quotations that proceed to payment in each age group



The average transfer value taken in respect of quotations in the 12 months to 30 September 2021 was £487,000, just under twice the average price of a house in the UK during this period.

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