PROFESSIONAL PENSIONS

A Guide to Member Options

Produced in association with

AON
Empower Results®

Welcome

Since the introduction of 'Freedom and Choice' for defined contribution (DC) pensions from April 2015, DC members no longer have to buy an annuity at retirement. This has opened up a range of possibilities for members in the world of pensions.

As a result, many schemes are seeing a high number of transfers from defined benefit (DB) schemes. But why would a member want to transfer from the relative 'safety' of a DB scheme?

Reasons include:

- Wanting a different pattern of retirement income than the DB scheme is able to offer;
- Poor health/no spouse, such that purchasing an annuity may represent better value; and
- Tax planning (whether income tax or inheritance tax) as accessing drawdown may provide greater flexibility.

Opinion remains divided over whether a high number of transfers is good for pension schemes, and how members can be supported in making the right decisions at retirement.

The articles in this guide, produced by *Professional Pensions* in association with Aon, offer an insight into how companies and trustees are reacting to the range of options that are now available and how they can get the right outcomes for scheme members.

Ben Roe
Senior Partner and Head of Member Options team, Aon

CHAPTER 1

How are schemes responding to 'Freedom and Choice'?

By **Kelly Hurren**, Senior Consultant, Aon

Sponsors and trustees have an important role to play in deciding what options to make available to members and how much member support should be in place. This chapter sets out the results of Aon's 2018 Member Options Survey covering 300 DB schemes and the actions they have been taking in response to pensions flexibilities.

Significant increase in cash equivalent transfer values (CETVs)

The survey told us that 90% of schemes have seen an increase in requests from their members for transfer values over the last 18 months, with around 40% seeing a significant increase.

This has led to around 30% of the schemes questioned taking action to automate a greater proportion of the transfer value calculations that are carried out by scheme administrators.

Change in trustee attitude

For many years, proactively talking to members about the transfer value options was considered to fall under the remit of the sponsor, with trustees much more likely to take a reactive response to requests.

However, we are increasingly seeing trustee boards being more proactive in this area, potentially driven by an increased interest from members and a desire to ensure that members have all the information they need to make informed decisions about their retirements.

In fact, some lawyers are openly offering the view that it could be considered to be more risky not to proactively provide members with details of the transfer value option at retirement.

90%
of schemes have seen an increase in CETV requests

30%
increased automation of CETV calculations

There has been an increase in schemes personalising communications and providing members with support to assist decision making at retirement

But what support and information should be provided to members?

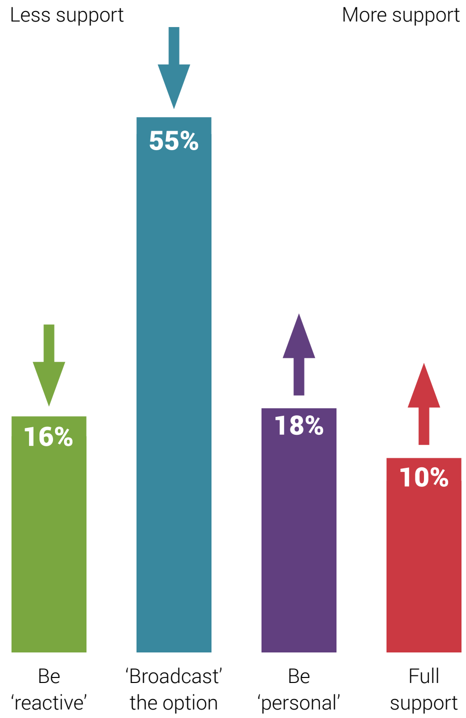
Trustees and sponsors typically have four options:

1. **Be 'reactive'** – allow members to request transfer value quotations in line with the statutory requirements, but no more. This may mean limiting quotes to one per year and not within 12 months of retirement.
2. **'Broadcast' the option** – advertise the option from time to time, perhaps in newsletters, benefit statements or retirement packs, but without quoting numbers unless specifically asked.
3. **Be 'personal'** – provide actual quotes to members, in benefit statements and / or retirement quotes, so that they are aware of the amounts involved. Point members towards where they can obtain financial advice, but without paying towards it.
4. **Full support** – provide members with personalised quotes and access to online tools and /or financial advice, paid for (in whole or part) by the scheme or sponsor particularly in the run up to retirement.

A survey of our clients showed that, while just over half of schemes had taken the decision to 'broadcast' the option to members, this was a reduction of around 10% compared to the equivalent survey carried out in 2016.

However there has been an increase in schemes personalising communications by quoting details of the transfer value option in retirement packs – around 18% of schemes are currently taking this approach.

What approach do pension schemes currently take?*



Source: Aon

Increase in providing members with full support

The biggest change in the results between the 2016 and 2018 surveys is the proportion of schemes choosing the 'full support' option and providing members with access to online guidance tools and / or paid for financial advice to assist members with their decision making at retirement. Our latest survey showed that 10% of schemes have already made this level of support available to members, with a further 10% of schemes considering making this option available in the next 12-18 months.

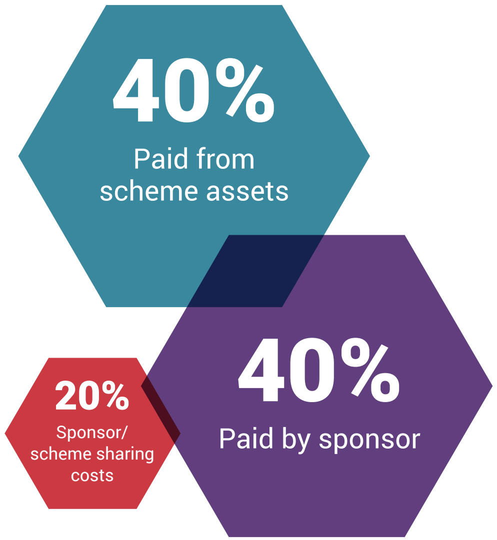
Given the industry concerns around the quality (and cost) of advice provided in some recent high profile cases, trustees and sponsors are increasingly putting in place preferred independent financial advisers (IFAs) - either financed by the member, or financed directly by the sponsor or trustees.

For those schemes who do decide to go down this route, there are clear benefits for members:

- They get access to a reputable, high quality adviser who has been trained in the details of the DB scheme that they are currently a member of; and
- Advice costs that can be substantially lower, even when the trustees or sponsor are not actively subsidising the cost.

Where financial advice has been made available to members at no cost to them, the costs of that advice are either paid directly by the sponsor, paid for by the trustees from the scheme assets or, in some cases, the costs are shared between the sponsor and the trustees. The results of our survey showed that, where paid for financial advice is made available to members, there is a fairly even split of arrangements in place for meeting the cost of this advice.

When provided, how do schemes meet the cost of IFA advice?*



Ensuring members can make the right decisions for them at retirement

While it can be debated how far trustees and sponsors should go in terms of supporting members at retirement, what is clear is that reducing the barriers for members to engage once there and streamlining the process to help members reach the advice stage will help ensure members make the most appropriate decision for them at retirement. Our survey results show that this is an area that has received increasing attention since the new pensions flexibilities were introduced in 2015, and we expect this trend to continue.

*Source: Aon

CHAPTER 2

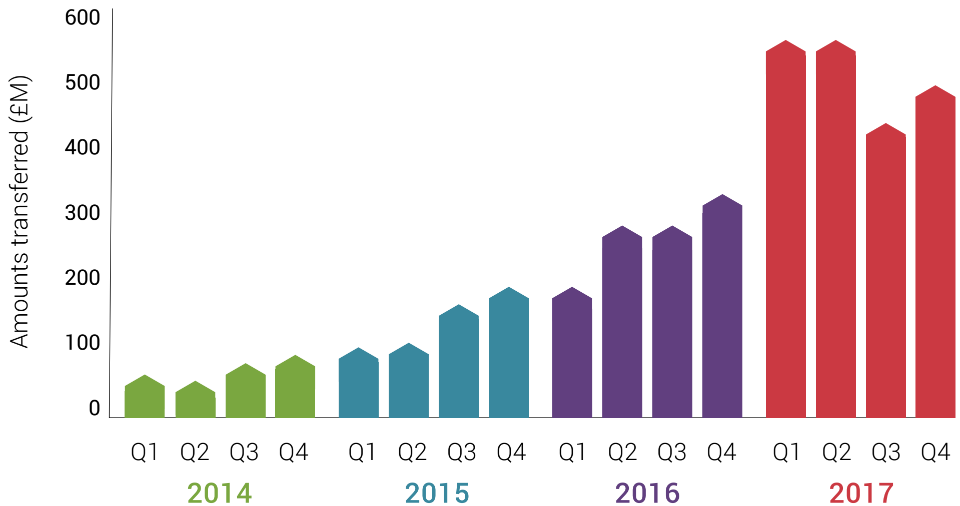
How can members be supported to make the right decision at retirement?

By **Gemma Cowan**, Senior Consultant, Aon

For many members, their DB pension can be the largest single asset they own – often worth more than their house. The decision whether to leave it in the DB scheme or take a transfer value to a DC arrangement to take advantage of the new flexibilities is probably the biggest financial decision they will ever make. But unlike buying a house, this decision is not reversible.

Data from over 200 DB schemes administered by Aon shows that the amount being transferred from DB schemes has increased six-fold since 2014, as shown by the graph below.

Amounts transferred from DB schemes administered by Aon by quarter*



*Source: Aon

With such high volumes of transfers, who should provide members with the support they need and what should this support look like?

Independent financial advice

Alongside the 'Freedom and Choice' provisions was a requirement that members who have a transfer value over £30,000 must take independent financial advice from a suitably qualified individual before they are able to transfer their benefits out of a DB scheme.

Historically, many independent financial advisers (IFAs) looking at DB-to-DC transfers focused on the 'critical yield' test – whether the return that a member would need to achieve in the DC arrangement to replicate their DB benefits with an annuity, was an acceptable risk.

More recently (and recognising that the reason many members are considering a transfer is to access their benefits in a different form, rather than an attempt to replicate their DB pension) IFAs now need to take a far more holistic view when giving advice.

As well as financial factors such as other pension entitlements and other assets, IFAs will consider issues such as the ability to manage investments and risk, health and life expectancy, the likely needs of dependants, and other lifestyle factors.

The availability of quality advice on pension transfers has no doubt increased in recent years. But for every IFA out there with expertise in pension transfers (and there are plenty), there are others who do not have the necessary experience.

It therefore pays to do your research – whether as an individual or as a trustee or sponsor looking to facilitate access to good advice for your members.

In order to give an insight into what the IFA process looks like, we spoke to three different IFAs that Aon have worked with in the last year.

> It pays to do your research – whether as an individual or as a trustee or sponsor looking to facilitate access to good advice for your members

HOW CAN MEMBERS BE SUPPORTED TO MAKE THE RIGHT DECISION AT RETIREMENT?

THE ADVISER VIEW

What do you take into account when advising a member?

"When advising a member on DB pensions, we really need to understand their assets, liabilities, property values, taxation position, family, health and longevity – the list is almost endless.

We also need some softer details – what are they going to do in retirement, what are their plans, – so that we can try and put together a plan that suits them from the options that are available."

Nick Flynn, LEBC, The Retirement Adviser

Have members made their decision before they speak to you?

"We find that the members that approach us for advice already have a good idea of what they want to achieve for their retirement. However, these individuals might be seeing the capital value of the pension plan for the first time and it is our job to make sure they are making decisions on an informed, rather than emotional, basis.

For example, drawdown might look very attractive; however we might find that the member has no capacity for loss or capability to manage the risk that their funds may go down in value."

Maxine McIntyre, WPS Advisory

How long do you typically spend advising someone?

"Typically the fact finding appointment is going to last for an hour. This will give us enough time to get most of the information that we need from the member.

There will then usually be a series of phone calls and emails just clarifying certain points. It is not unusual though that we will get a further phone call from the member telling us something that they had forgotten about the first time.

We then book a further hour appointment with the member to go through the report and the recommendations. This is really important – the purpose of this is to ensure that the member understands the report that we have sent them and importantly why we have made the recommendations.

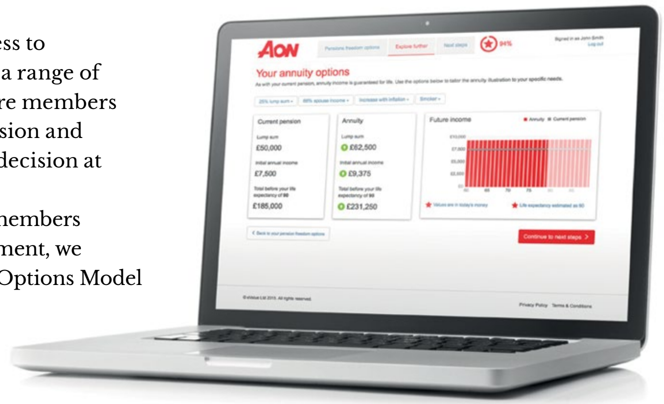
When we add the report writing time and the checking, this usually takes us up to about four hours per member"

Mark Pearson, Origen Financial Services

Use of online tools

Providing members with access to personalised information via a range of channels will help ensure more members engage in this important decision and therefore make an informed decision at retirement.

To help educate and guide members through their options at retirement, we launched the Aon Retirement Options Model (AROM) in November 2016 which has since been used by 6,000 members.



This tool enables members to view their retirement options side by side and tailor the outcomes to their personal circumstances. Where IFA support is also provided to members, experience suggests that members who decide the transfer option is not for them make this decision before contacting the IFA – reducing IFA costs by around 10%. Conversely, those who do approach the IFA are already educated on the basics of the options and can then focus the advice session on their individual circumstances.

While the level of support that should be made available to members could be debated, it is widely believed that for a decision of this importance, the more support that is available to members the better.

Furthermore, for trustees, sponsors and the wider pension industry, more support reduces the risk of members receiving poor advice and making decisions that they later regret.

> “I used the modeller when looking at my pension options. I thought it was very clear and I liked how it encouraged me to look at every option. It nicely balances what could be too many possible permutations, with simplicity so the main messages get across
>
> **Pension scheme member**

CASE STUDY: Engineering firm

- A large engineering firm was looking for a solution to improve the level of support offered to members of their defined benefit scheme and to streamline the retirement process
- Aon worked with the pensions team, trustees and unions to introduce a new retirement process that included online access to AROM and paid-for IFA advice
- The revamped retirement process saw around 80% of members make use of the online support or paid-for financial advice
- Members are more educated and around 50% of members are electing to transfer their benefits out of the scheme at retirement to access the new flexibilities

> “We are excited to be able to offer our members a high level of guidance and education on their retirement options and feedback from members has been extremely positive
>
> **Head of Pensions**

80% of members make use of the online support or paid-for financial advice

50% of members are electing to transfer their benefits out of the scheme at retirement

CHAPTER 3

Bulk member option exercises: what are the benefits for schemes and members?

By **Oliver Cowan,** Senior Consultant, Aon

Over the past three years, sponsors and trustees have been navigating their way through the pension freedoms and trying to predict what impact they will have on their pension schemes.

Over this time, we have seen a huge increase in demand from sponsors and trustees alike in running bulk member options exercises where members are informed of options available to them – both within and outside of the pension scheme - and given independent financial advice to help them understand those options.

Such exercises typically include bulk transfer value exercises (with or without an enhancement) and pension increase exchange exercises.

Transfer value exercises

Bulk transfer value exercises are aimed at non-pensioner members in a pension scheme. Members are typically presented with details of their transfer value alongside information on the options available if they were to transfer out of the scheme and, for members aged over 55, details of the pension they could take in the DB scheme if they took the retirement option.

These exercises give members a chance to explore the new options available to them well ahead of retirement. They also have the advantage for the scheme sponsor that they can reduce liabilities and the level of risk in the pension scheme.

> We have seen a huge increase in demand from sponsors and trustees alike in running bulk member options exercises

To enhance or not to enhance?

When looking at transfer value exercises in particular, potentially the two most important considerations are:

1. Whether transfer values are sufficiently attractive for members to want to transfer out of the pension scheme; and

2. Whether transfer values are sufficiently attractive for members to want to transfer out of the pension scheme *now*.

If the focus is on maximising risk and liability reduction in the short term, the second point becomes crucial. In this scenario, the decision of whether to offer members an enhancement to their transfer value comes into play.

In the exercises Aon has led since 2015, around half have offered members enhancements, and those exercises have seen more than double the level of transferring members on average.

Our statistics tell us that even a small enhancement can have a noticeable impact on the outcomes of an exercise.

CASE STUDY: Aon's own schemes

We as a firm strongly believe that bulk exercises can have a significant impact on the effectiveness of a pension scheme's long term de-risking plan as well as leading to better outcomes for members – so much so that we have implemented bulk enhanced exercises within our own schemes - the Aon Minet Pension Scheme in 2016 and, more recently, the Aon Retirement Plan.

The exercises achieved take up rates of 33% and 22%, while offering more choice and increased generosity of transfer terms for transferring members, and greater benefit security for non-transferring members due to a significant reduction in buy-out deficit and an overall shrinking of the size of the schemes.

Since the introduction of pension freedoms, we have seen a noticeable shift in attitudes

Pension Increase Exchange (PIE) exercises

Members who retired before the new pensions freedoms were introduced are not able to take advantage of the new flexibilities and, for many members, this represents a lost opportunity.

As a result, we have seen an increase in demand for PIE exercises, with double the number of exercises taking place since 2015 compared to the two previous years. This gives pensioner members the option to receive a higher pension today in return for giving up future inflationary increases on their pension.

For members who have a desire for a higher level of income earlier on in their retirement and/or have other sources of inflation protected income, the PIE option gives members the flexibility to re-shape their pension to better suit their circumstances.

It also has the advantage for the scheme that it reduces risk and can be set on terms that reduce the scheme's liabilities.

Trustee boards leading the way

Prior to 2015, over 90% of the bulk transfer value and PIE exercises that Aon led were initiated by the pension scheme sponsor. Since the introduction of pension freedoms, we have seen a noticeable shift in attitudes, with around 20% of bulk exercises being initiated by trustees in 2016 and 2017.

The change in attitude is being driven by a desire to offer members attractive new options and to educate members on their existing options. We expect this trend to continue.

CASE STUDY: Chemicals company

In 2017, the trustees of a chemicals company proposed to the sponsor that a PIE exercise should be carried out for their 1,100 pensioners. The trustees were keen to offer pensioners access to some flexibility in their income given the new options that were available to future retirees, and knew that it would also help improve the scheme's funding position.

The trustees commissioned Aon to implement the PIE exercise using Aon's 'implemented consulting' framework. This framework enables trustees and sponsors to agree all key decisions in one initial meeting and to delegate responsibility to Aon to implement the remainder of the steps on their behalf. This efficient approach reduced the overall costs of implementing the exercise.

The exercise was popular, with just under half of the pensioner members accepting the offer resulting in the funding position improving by around £10m.

CHAPTER 4

Can a member options exercise mean that buyout is closer than you think?

By **James Allinson,** Senior Consultant, Aon

So, member options exercise can be a 'win:win' for schemes and members, but how does that fit into the long term strategy for the pension scheme?

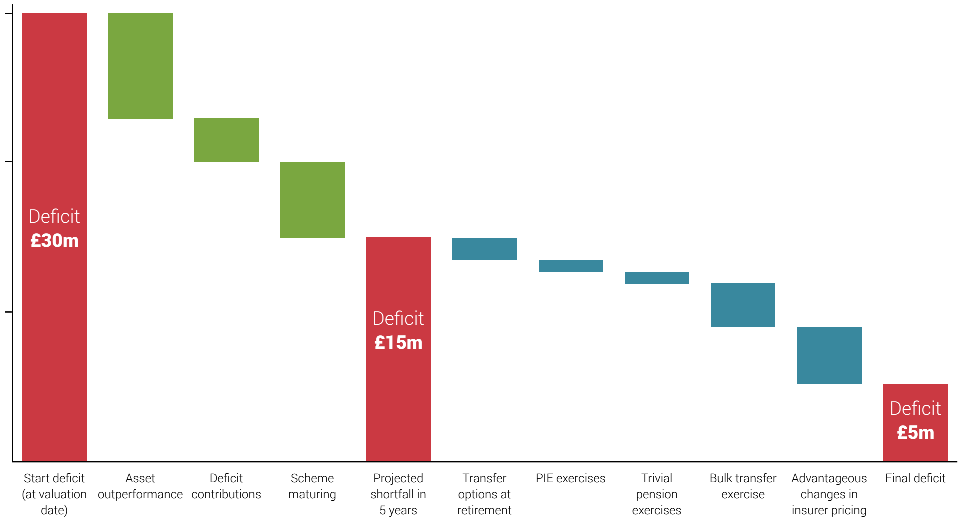
Good question!

The simple answer is that member options exercises can usually be tailored to make sure that they meet a pension scheme's long term objectives.

Aon's 2017 Global Pension Risk Survey suggested that around one-third of our clients see buyout as the ultimate destination. But whatever the long-term objective, member options can be designed to deliver savings. This can go hand in hand with an effective insurance strategy, so that for a 'typical scheme' it can get you to buyout quicker and with less risk over the period.

Aon's 2017 Global Pension Risk Survey suggested that around one-third of our clients see buyout as the ultimate destination

Reducing the buyout deficit via liability management and risk settlement*



The chart above shows a typical scheme that might be 70% funded on a buyout basis at the moment. This position would be expected to improve due to the green items above namely:

- Asset returns;
- Contributions being paid into the scheme; and
- The scheme membership getting older and retiring, which makes them cheaper to insure.

Taking no further proactive actions, a typical scheme might then be 85% funded on the buyout basis. But this might still be a way off from 'cheque writing distance'.

A suite of member options exercises could make the difference between getting to cheque writing distance, or having to retain the risk of the scheme for several more years. The blue items in the chart show how member options can help bridge this gap:

- Implementing transfer options at retirement (2%)
- Carrying out a Pension Increase Exchange (PIE) exercise (1%)
- Trivial pensions exercises (1%)
- Bulk enhanced transfer value (ETV) exercises (4%)

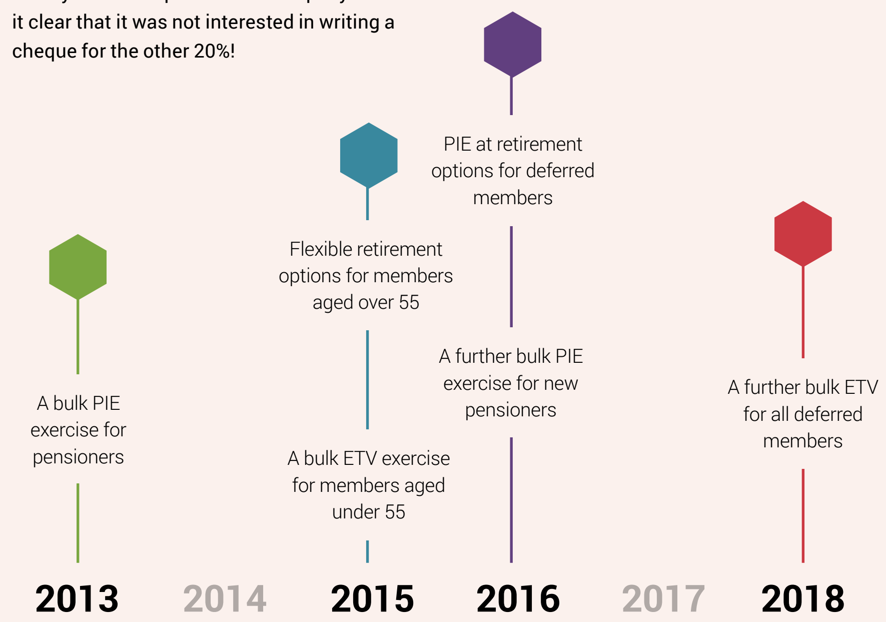
As you can see, none of these exercises on their own deliver sufficiently material buyout reductions but, in combination, could halve the remaining buyout deficit. Furthermore, it may only take a handful of members to take up a transfer option in order to generate sufficient buyout savings to pay for the costs of running the exercises.

*Source: Aon

CASE STUDY: Manufacturing firm

Just over five years ago, the trustees of the pension scheme of a manufacturer with 2,500 members set out a plan very similar to the example above. It was very clear to all parties that buyout was the ultimate destination but at the time the scheme was only 80% funded on buyout assumptions. The company made it clear that it was not interested in writing a cheque for the other 20%!

Rather than relying only on risky assets to narrow this gap, along with the maturing of the scheme, the trustees wanted to take proactive steps to improve the position. They took a number of initiatives over a five year period:



Since 2013, the scheme has gone from 80% to 100% funded on a buyout basis with a significant proportion of the improvements coming from these initiatives. The scheme is now looking at buyout pricing with recent quotes suggesting that, following completion of the latest exercise, the scheme will be able to afford to buyout with no additional support required from the company.

This case is a great example of how a number of small initiatives, when combined, have led to material buyout savings.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