

HYMANS # ROBERTSON

The Evolution of Member Options

Part one – supply & demand



Supply & demand – what does the future hold?

c£80 billion has already been transferred from DB schemes since the pension freedoms were introduced over four years ago. Despite recent headlines around demand slowing down, the opportunity to transfer has clearly continued to resonate with members, with a staggering £30 billion being moved in the last twelve months alone.

This matches what we've seen across our own clients, where the proportion of members transferring out of their DB pension scheme is now four times higher than before the pension freedoms were introduced.

The full spectrum of member retirement options is complex, and there are a range of factors that will influence how members will engage in these options now and in the future.

What do we mean by member options?

Members potentially have a range of options when it comes to accessing their retirement benefits, including:

- **Full or partial transfers** - Taking all or some of their benefits out of the scheme. A variation of this would be where a higher transfer value is offered for a limited time-period (enhanced transfer value).
- **Early retirement** - Taking their pension before normal retirement age, in some cases on a phased basis.
- **Pension Increase Exchange (PIE)** - The choice of a higher pension today in exchange for lower future pension increases.
- **Bridging or levelling pension** - Choosing to have a higher scheme pension now to bridge the gap to state pension age. The scheme pension then reduces once the state pension comes into payment.
- **Trivial or small pot lump sum** - Exchanging a small pension for a one-off lump sum.

Through providing valuable choice and support over how and when members can take their DB benefits, members can access them in a way that best suits their personal circumstances.

So what could the future hold? What are the main drivers that will impact the supply and demand for member options? And what actions should trustees be taking in response?

In this paper we aim to answer these questions by exploring the key influences on the future of member options, and the role of you as a trustee in providing adequate support. We'll cover:

- 1 The role of trustees
- 2 Influences on the future of member options:
 - I. The maturing market
 - II. Regulation and innovation
- 3 Actions for trustees



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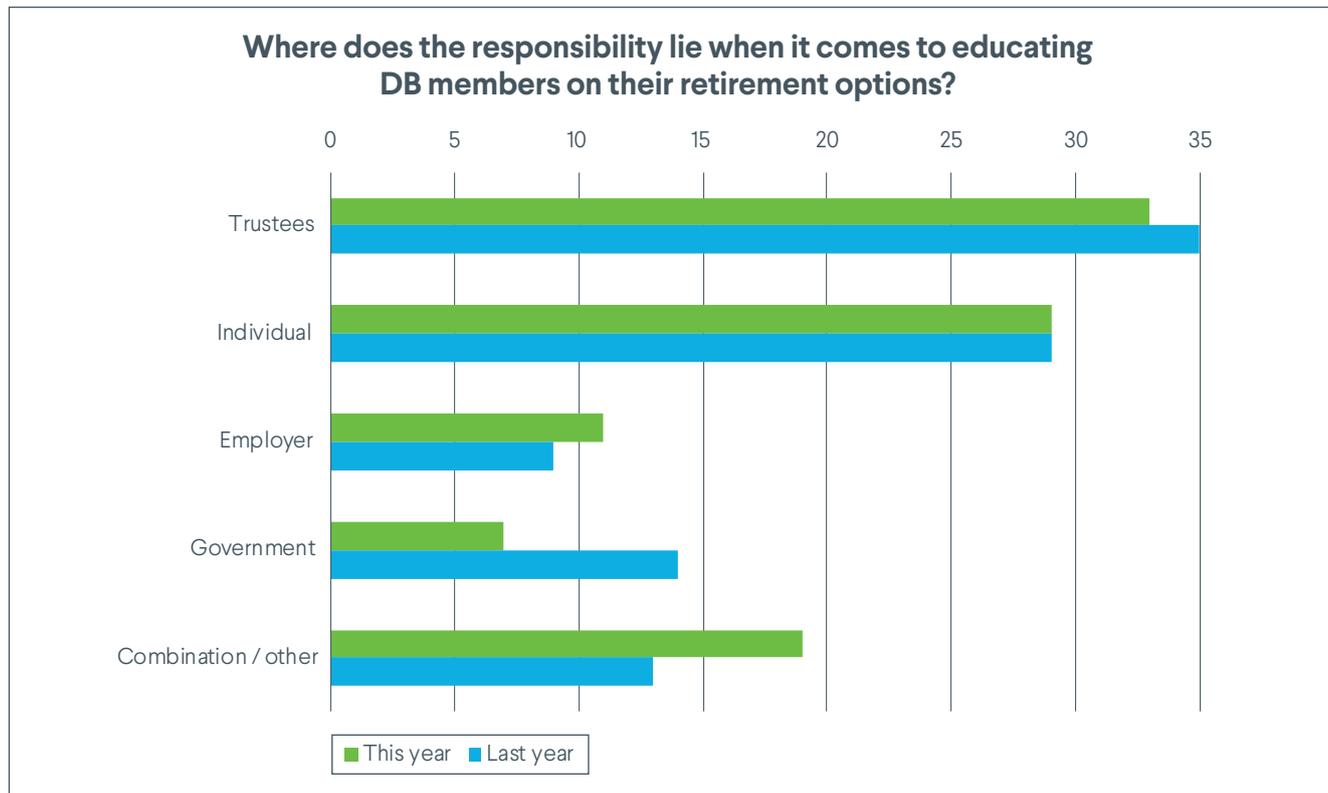
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This is the first in a three-part series exploring the evolution of member options. Part two will look at the ever evolving financial advice market, and what the FCA is doing to help increase confidence in this area. Part three will explore the continued innovation in the insurance market, and the valuable role insurers have to play in member options.

If you would like to discuss anything in more detail, please don't hesitate to get in touch.

The role of trustees

Despite some movement over the last year, there is still a lot of uncertainty when it comes to whose responsibility it is to educate and better equip members to make good retirement choices.



Confusion over whose responsibility this is is putting member outcomes unnecessarily at risk. In our view, trustees are ideally placed to support their members through the complex options they're faced with, and those who acknowledge this have taken positive steps to act on it.

While we're pleased to see a third of trustees agree the responsibility does lie with them, we've not seen a significant shift in this figure since last year. More trustees now need to follow suit.

The risks to members

A lack of proactivity when it comes to engaging and supporting members with their options will put members' retirements outcomes at risk. Cases like British Steel, where thousands of members suffered at the hands of introducers and unscrupulous advisers really highlights the need for trustees to act. Without positive intervention, there is a real risk of a miss-selling scandal brewing.

The FCA and TPR recently reported that 42% of pension savers are likely to fall for at least one of six tactics used by pension scammers. Victims of pension fraud reported in 2018 that they had lost an average of £82,000, with an estimated £4bn at risk each year across the pensions market. This simply isn't good enough. Trustees have a moral duty to protect their members' benefits in the lead up to, and through retirement.

Influences on the future of member options

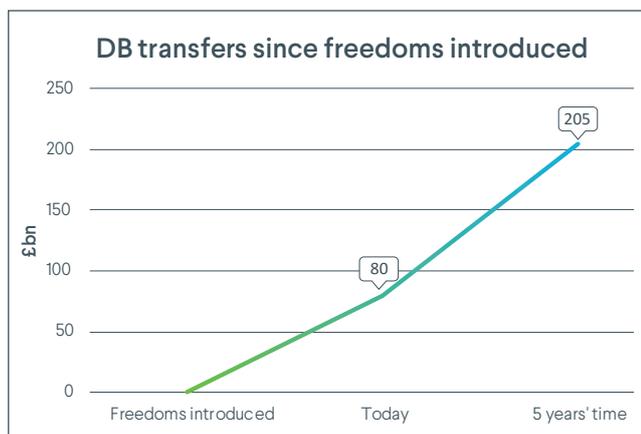
1 The maturing market

There are currently around 5 million deferred members in private sector DB schemes. Given 90% of DB schemes are now closed to new hires and over 50% are closed to future benefit accrual, schemes are maturing rapidly.¹

Future demand

Over the next 5 years or so we'll see the significant majority of DB members reach age 55 and therefore become eligible to access their benefits and the pension freedoms. This will lead to unprecedented demand from members for quality choice and support.

If 1 in 5 of these members ultimately decide to transfer their pension, it could lead to a further £125bn of DB transfers over the next 5 years.



Future supply

Member options are increasingly being used by trustees and sponsors as a lever to settle liabilities sooner and more cost effectively – accelerating schemes' journeys to their long term objective. Proactively providing access to a full suite of member options could reduce the end goal across UK DB pensions by as much as £100bn compared to the cost on the long term objective.

With increased TPR guidance on long term strategic planning, we expect more schemes to build member options into their strategy, no matter where they are on their journey:

- **For less mature schemes**, the focus is likely to be on ensuring members have access to the right options and quality support on a business as usual basis.
- **As schemes mature**, the approach to offering member options will change. Focus may shift from business as usual options to more focused and targeted approaches.
- **For schemes within striking distance of their long-term target**, with all risks largely locked down, we expect to see member options being used to help bridge this final gap. In particular, we expect to see sponsor-led enhanced and time restricted transfer value exercises once again growing in popularity.

How is the market responding?

A potential 5 million individuals will need to be guided through the complex maze of options they'll be faced with.

In our recent survey, almost a third of trustees confessed that 'adapting to Freedom and Choice' is one of the biggest challenges they'll face over the next 12 months. In our view this is too late – four years on since the freedoms were introduced, member options should by now be fully embedded in schemes' strategies. Failing to do so puts members at risk of falling victim to scams, or making irreversible decisions with life-long impact.

The market needs to play catch up and provide members with more support when it comes to educating and engaging them in their retirement options.

¹ PPF's Purple Book 2018

<https://www.ftadviser.com/pensions/2019/08/07/half-of-savers-at-risk-of-being-scammed-despite-govt-action/>

2 Regulation and innovation

The broader DB market has changed beyond all recognition over the last ten years. It's impossible to predict exactly where we'll be in the next 10 years. However there are two key areas which will undoubtedly have an impact on member options - GMP equalisation / conversion and the likely requirement for schemes to set and navigate to a long term objective.

Guaranteed Minimum Pension (GMP) equalisation and conversion

We'll all be familiar with the outcome of the Lloyds case and the long-anticipated conclusion that pension schemes need to equalise benefits for inequalities in GMP.

There are several synergies between GMP equalisation and member options, making it a natural opportunity to build member options into your strategy.

- **Removing GMP's through conversion will remove administrative complexity.** We expect this will materially increase the number of schemes who offer partial transfer values to members. For some schemes, particularly those with lots of long serving members, partial transfers could be a really attractive option for both members and schemes.
- **Bringing post 88 GMP into the scope of a pension increase exchange exercise.** For some schemes with higher proportions of GMP, this could make pension increase exchange even more attractive to members.
- **Providing greater choice around benefit conversion.** GMP conversion presents an opportunity to provide valuable choice to members over the shape of their converted benefits. Offering choice to members may be particularly attractive for schemes that have complex and expensive pension increases to insure.
- **A chance to remind those with small pensions of the option to take a lump sum.** Whilst writing to members on GMP equalisation and conversion, it might not take much extra effort to remind members of this option. This will help tidy benefits up whilst giving valuable choice to members.

GMP equalisation and conversion doesn't need to be a compliance exercise. We are working with our clients to use it as an opportunity to better engage with members and add real value to your overall strategy.

Long term objectives

DWP is consulting on the requirement for schemes to set a long-term objective for their scheme. The intention of this is to move the focus away from shorter term cash and balance sheet management to longer term strategic thinking which we continue to be highly supportive of.

Trustees and sponsors having to define a long-term objective will in our view put greater emphasis on developing a sound member options strategy. When assessed against the ultimate long term objective (whatever that is for your scheme), member options will contribute greater value to achieving that objective sooner. We therefore fully expect it to become the norm for trustees to drive overall long term strategy and to embed member options within that.

One potential long term objective is consolidation, including through a master trust or non-insurance based consolidator (for example Clara Pensions or the Pensions Superfund). This is an evolving area, however, for those schemes who choose to go down this route, member options could be used to help bridge the gap to consolidation. This could ultimately help improve benefit security for all members sooner than otherwise would have been possible.

It will be interesting to see if consolidator vehicles are willing to give some advance credit for member options in pricing - either with the trustee/ sponsor running the exercise within the scheme prior to transfer or the consolidator running the exercise post bulk transfer. This is an approach we are increasingly seeing from insurance companies. We will discuss this more in the third paper in our 'evolution of member options' series.

Given the member demand for these options and the potential risks to trustees of not offering well-communicated good choice, it will be vital for consolidator vehicles to provide members with access to their options in a supported environment. From our discussions with some consolidators, we understand that they are keen to offer a wide range of options to members, with high quality communications and member support. However, as trustees continue to do more to support members in this space, there will be a strong expectation that any consolidator is able to offer a similarly supported environment. We therefore expect this area to become a key criteria for trustees in selecting a consolidation vehicle.

Actions for trustees

We expect, and hope, to see more trustees improve the way they engage with members and support them around their options. This can only be a good thing for all parties. We've identified three key priorities for trustees:

1 Provide valuable choice to members

This should be broader than just offering full transfers. Implemented effectively, providing members with a range of options gives valuable choice over how members take their benefits. It also presents an opportunity for schemes to remove or change the shape of benefits that are expensive to administer and insure.

2 Communicate these options effectively

The education process with members should be started as early as possible, and form part of your overall long term strategy. Engaging effectively with members through a variety of media will be key in building trust and confidence with members – this will form the bedrock of sound retirement decisions. Proactively putting building blocks in place now will save you time and money in the long run.

See our 6 top tips for building strategy in our **Redefining Member Communications guide.**

hymans.co.uk/redefiningcommunications

like minds

3 Support your members in making the right choice

There is currently an undersupply of quality, affordable financial advice in the market. This must be resolved in order to meet the demand from members to understand and choose an appropriate retirement option and sleep well at night. With only c50% of transfer advice deemed suitable by the FCA, we would like to see trustees take a more active role in facilitating quality financial advice to their members. This is clearly an opportunity for advisers, and it will be interesting to see how the market evolves. This will be the focus of the next paper in our series.

The future of member options

With demand for member options showing no signs of slowing down, we urge trustees to ensure their members are receiving adequate support.

A more trustee-driven approach to supporting members with their retirement options will improve member outcomes while driving efficiencies for trustees and sponsors over time. A win:win for all parties.



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Please get in touch if you would like to discuss how we can help you develop and deliver your own member options and engagement strategy.

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