Willis Towers Watson

DB member choice survey 2018

The continued rise of pension flexibility

Foreword

For many years, and not without good reason, defined benefit (DB) pension schemes have been recognised as a valuable benefit which provides scheme members with a retirement income for life. This is still the case, but increasingly over the last decade there has been a trend towards providing these members with more choice about how they receive their retirement income, recognising that each member is an individual and may have different income needs. 'Pension freedoms', introduced by the UK Government in April 2015, has been a catalyst to raise awareness of more flexible ways of accessing pension savings.

This survey looks at the recent experience of members of UK DB pension schemes who have been given options relating to their DB benefits and have been provided with access to financial advice to help them make the right decision. The survey captures the experience of over 200,000 members across 400 different UK pension schemes since April 2015, and is based on data from the leading firms of financial advisers appointed to help guide members through the process. This makes the survey the most comprehensive study of the appetite of members of DB pension schemes to explore the flexibility made available by their scheme.

We have split the results into two key areas, reflecting the main types of options UK DB schemes have offered their members in recent years: a retirement transfer option (RTO) and a pension increase exchange (PIE).

An RTO gives individuals over the age of 55 who have not yet started to receive their retirement income, the ability to take advantage of the pension freedoms introduced by the government in 2015. Retired members who are already receiving their DB pension can't access this full flexibility, but schemes can offer these members a PIE to allow them to have higher income in their early years of retirement, in exchange for a lower expected pension in later years.

These options can help manage the costs and risk of running a DB scheme, but can also appeal to a significant proportion of DB scheme members. 33% of pensioners offered a PIE in the last year decided to accept, and in most cases between 20% and 30% of retiring members over the age of 55 chose to take the RTO route. However, there are schemes that experienced very different outcomes amongst their population, particularly in relation to RTO. This highlights the importance for DB scheme trustees and sponsors of understanding the context of their scheme, communicating in an engaging way with their members, and understanding how and where members can receive the financial advice they need if they wish to consider their options.

At the end of this publication, we focus in more detail on some of the issues surrounding members transferring out of DB schemes. This is an area that has attracted much press attention and is a key discussion point for many DB scheme sponsors and trustee boards. Transfers are certainly far more common than they were a few years ago, and not just through the RTO route for those beyond the age of 55. Transfers can be positive for the members, scheme sponsors and trustees, but the landscape is not without risk.

We hope you enjoy reading this publication. If you would like to know more about the options discussed here, or other member options, and how these could form a key part of your scheme's pensions strategy, please speak to your usual Willis Towers Watson consultant or one of the specialists named on page 19.

Abigail Currie
Head of Member Options

Retirement transfer options: the statistics

Now that pension freedoms have been a reality for three years, we are able to see the variability of experience between some schemes as well as the trends. Willis Towers Watson's third annual survey of the leading firms of financial advisers brings together data from UK DB pension schemes that have sought to make members aware of new and existing transfer options which can allow them to access their retirement income flexibly.

Tom Wilton looks at the headline figures relating to members transferring out of DB schemes, and also digs beneath the surface to highlight some of the variation that is becoming evident.

Stop press: different schemes are different!

The most apparent feature in this year's survey is the range of experience shown in the data across schemes. One may have assumed that, after three years of pension freedoms being available, a clear trend would have emerged allowing trustees and sponsors to gauge what proportion of their scheme's membership would likely favour the flexibility of the benefits available by transferring to a new arrangement, as opposed to a pension for life from the DB scheme. Whilst statistics can produce an 'average' figure, the data shows that the range of outcomes is very broad. In some schemes, only single-figure percentages of members elected to transfer out of their DB scheme when given the option, but elsewhere the figure was above 80%.

Figure 1. **Characteristics of schemes with vastly different RTO take-up rates**

Proportion of members transferring...	In a scheme with...
c. 8% or 1 in 12	▪ Weak transfer value basis ▪ Favourable commutation and early retirement terms
c. 80% or 10 in 12	▪ Strong transfer value basis ▪ Financially sophisticated and wealthy population ▪ Engaging communications

Even before anyone draws a line in the sand to say whether they personally think higher or lower incidence of transferring is good (depending on whether you perceive it as active engagement and informed decision-making or misguided and short-sighted judgement), the fact there is such a range creates a challenge for everyone. There's a need to understand what drives this variation.

Figure 2. **Key factors influencing member engagement and take-up rates for a typical RTO exercise**

Controllable	Environmental	Member specific
Strength of transfer value basis	Strength of sponsor	Income needs
Scheme factors (commutation, early retirement)	Word of mouth	Other pension savings
Communications strategy	Press coverage	Risk appetite
Timing of offer	Scheme funding	Size of benefits
Size of enhancement	Scheme history	Tax
Paid for financial advice	Population size	Health
Choice of financial adviser	Random variation	Understanding

Figure 2 lists some of the factors that our research shows influence the outcomes for any given scheme. We've split these into three groups: factors within the control of the scheme, factors relating to the environment in which members face their choice, and factors relating to the members themselves. It does not seem wise to try to assign weights to all of these factors so actuaries and decision makers can claim to predict scheme level outcomes with great certainty, as too many of the factors can only be measured subjectively, and indeed it's not possible to assess each factor in isolation. In all cases though, there are at least some members who have decided, having spoken to an impartial financial adviser, that income patterns available outside the DB scheme are the right thing for them.

Does the variation in the data mean that no conclusions can be drawn? Fortunately, the answer is no. Whilst there are a notable number of outliers, the bulk of schemes experience an outcome that sits within a more narrow range. This is perhaps an indication that when some of the 'noise' is removed from the survey data around environmental and scheme or member-specific factors, general trends can be identified of the appeal of pension flexibility to members currently set to draw their retirement income from a DB scheme.

In over half of cases, the proportion of members over the age of 55 who were written to about their option to transfer out of their DB scheme and chose to do so was between 20% and 30% (see *Figure 3*). This captures schemes where all non-pensioners over the age of 55 were pro-actively contacted by the scheme (often called a bulk exercise), and those members who naturally reached their own point of retirement and received their options from the scheme administrator (often called 'business-as-usual' activity). This compares to an average of 31% in 2016-17 and 18% in 2015-16. This statistic is the proportion of members who chose to transfer out at that point. However, some members that were written to as part of a bulk exercise will have considered their options and decided to defer their decision, in the knowledge that a transfer might be suitable for them at a later date. Others may have not yet engaged in the bulk process this year, but will be more likely to explore a transfer option when they reach the point where they wish to access their retirement income, particularly where advice is paid-for only once by the scheme or sponsor at any point up to retirement. It is therefore reasonable to expect the long-term level of transfers, beyond the age of 55 in schemes that support members in exploring their options, to be at the top end of this range or even higher.

What do members chose to do?

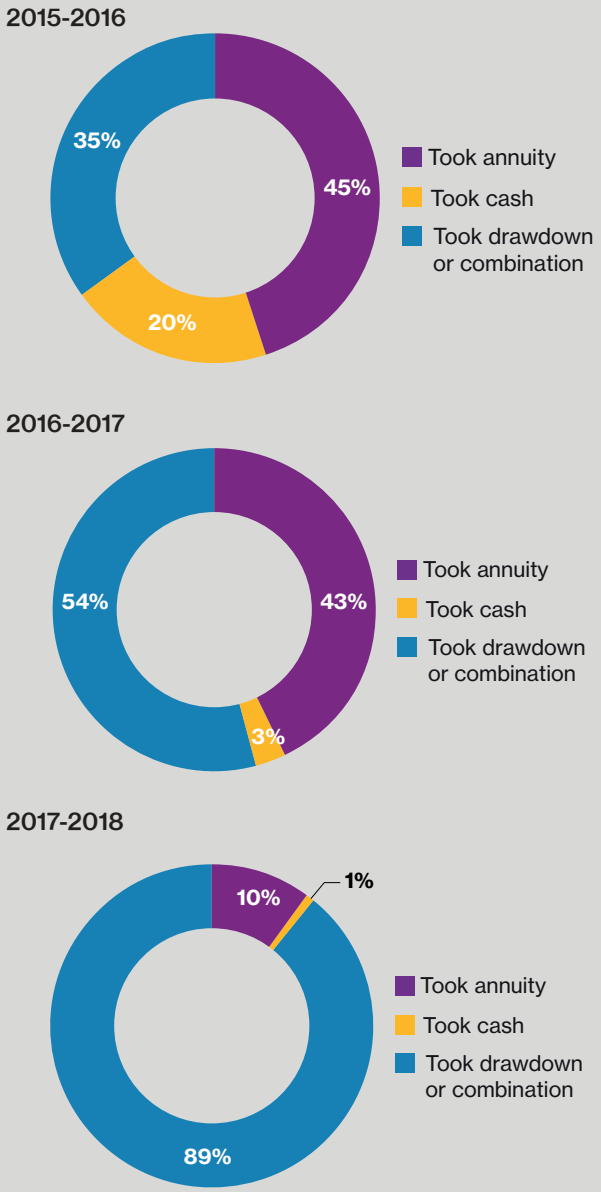
Figure 4 shows the choices that members, who opted for a transfer as part of their retirement decision, have made since April 2015. Over the last 18 months we have seen an increase in the number of members electing for a mix of retirement solutions. This may involve the member immediately accessing a tax-free lump sum element from their transfer but deferring a decision on the remainder, or using some to purchase an annuity to secure a guaranteed minimum level of income and investing the rest. Our expectation is that these mixed approaches will continue to grow in popularity in the future.

The trend that emerged over recent years about the size of a members' transfer value still holds, with those who have higher transfer pots (over £500,000) more likely to be the ones who elect for drawdown or one of the mixed approaches, and those with lower pots (under £100,000) being more likely to stay in their DB scheme.

Figure 3. **The variation of RTO take-up rate outcomes across different schemes**

Take-up rate	Proportion of schemes
Lower end	15%
Average (20-30%)	**55%**
Higher end	30%

Figure 4. **Choices made by those who transferred as part of an RTO**



"There's a marked increase in the number of schemes who are prepared to be on the front foot... and treat their members as individuals who should be made aware of their options and entitled to make their own choices."

Expectations for the future?

Pension freedoms is no longer a new feature of the UK pensions landscape, and members of DB schemes are increasingly aware that there are options available to them as well as choices for them to make. Some schemes make it easy for members to be aware of their options and consider them, whilst in others it is down to the member to know what questions they need to ask and when. There's a marked increase in the number of schemes who are prepared to be on the front foot in this regard and treat their members as individuals who should be made aware of their options and entitled to make their own choices. This is something of a shift from the early period of pension freedoms, when many schemes were reluctant to communicate with members about their options for fear of being judged to be trying to influence the outcome. However, the consensus view amongst industry practitioners is that informing is not the same as influencing, and in fact, failure to inform members of their options is more likely to be judged as influencing the outcome. If trustees or sponsors think that a DB pension is always the right outcome for each individual then that may be fine – but we know the world is not that simple, people are all different and we can't know everyone's individual circumstances.

Over the course of the coming years and as we move into the early 2020s, we expect most DB schemes in the UK to adopt the practices evidenced by those in our survey: actively communicating with members and providing them with a support framework to make the right decision for themselves about how to access their retirement income. The challenge this puts in front of scheme sponsors and trustees is to navigate the successful implementation of the change in member communication, administration practice and the interaction with financial advisers.

Pension increase exchange: the statistics

Much of the industry's attention relating to member choices in DB schemes over the past couple of years has been focused on transfers. Transfers are not the only member option that schemes have contacted members about; giving pensioner members the choice to swap some of their increasing pension for a higher, non-increasing annual income – a PIE – is an established, common option that has a more predictable outcome than the transfer choice.

Jenny Neale looks at the evidence of industry experience of PIE, and explores why many schemes as well as members are considering PIE as a way to provide flexible retirement income.

The myth of PIE

In spite of all the talk about transfers, DB pension scheme members being offered a PIE is by far a more common exercise for schemes to run. Our survey reveals that, across the industry over the last three years, for every DB pension scheme member who has been contacted by their scheme about a transfer option, three others have been written to and given a PIE option.

A PIE can be offered where a scheme pays annual increases that are higher than the statutory rate. This generally means that schemes which offer some form of increase on pensions built up before April 1997 – where there is no statutory requirement to provide any increase – are the ones that can offer their members a PIE option. PIE options first came to the fore as a way to help de-risk DB schemes and offer members flexibility and a framework to establish best practice was introduced when the Code of Good Practice on Incentive Exercises was published in 2012.

Some industry commentators may have assumed that with PIE having been around for a decade, any scheme that may want to explore the option would have done so by now. The evidence however shows that this is not true. Over the last two years, many schemes wrote to their members currently receiving a pension and provided them with the PIE option, whilst many other schemes are planning to explore the feasibility of doing so. A PIE can be a legitimate way for DB schemes to provide flexibility to this group of retired members, for whom a transfer is not permitted under legislation.

What does the PIE experience show?

Figure 5. **PIE engagement and take-up rates over the last three years**

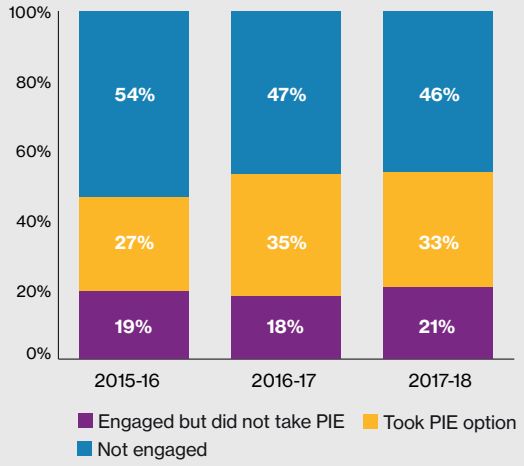


Figure 5 shows the experience, revealed in our survey, of schemes who have introduced a PIE since April 2015. There's a trend of increased levels of engagement (the proportion of members speaking to the appointed financial adviser) and a stable level of take-up (the proportion of members accepting the PIE option).

The average level of PIE take-up over the last year is 33%, compared to 35% and 27% in the previous two years respectively. The variation between schemes is nowhere near as stark as evidenced in the transfer experience. Almost all exercises in the last year experienced take-up within the range of 25% to 45%. This suggests that member appetite for PIE is relatively predictable and also that the financial outcome for the pension scheme's deficit and the sponsor's profit and loss (P&L) are more certain.

Comparing different PIE exercises

Although the range of PIE take-up levels is relatively narrow, the data does suggest that the way in which a scheme implements an exercise can have an impact on the outcome in two areas.

Firstly, the generosity of the offer. The Code of Good Practice determines a way of measuring the generosity of a PIE, described as the balanced deal percentage (BDP). This represents the value of the uplift offered to members as a proportion of the value of the pension increases being given up. As you may expect, more generous offers can appeal to a higher proportion of members and vice versa. That said, *Figure 6* shows that there is not a significant variation in overall take-up rate where schemes offer a PIE with a BDP between 70% and 90%.

Figure 6. **The sweet spot of PIE BDPs**

Secondly, the way a scheme communicates with members appears to influence both the level of engagement and the take-up. It makes sense that where a scheme spends more time ensuring that the channels of communication used in an exercise are best suited to the target population, they will have the most impact. For some individuals, clear, clean and simple written documents will work best. Others will find more glossy, consumer-grade letters and brochures easier to digest. Increasingly, complementing written communications with online content provides a way to deliver messages that works for more of the target audience. Online content can utilise explanatory videos as well as interactive features to deliver the messages via more communication channels, meaning individuals can receive the information and digest it via the medium that best suits them. Guidance seminars delivered at locations accessible to the target population also prove to be hugely impactful for an exercise.

Higher levels of engagement and tailored content, which is crafted to help a broader range of members understand their options, helps to ensure that more members make the decision which is right for them. If the PIE offer itself is well designed to be attractive to members, then this higher level of engagement will feed through to higher take-up rates.

Figure 7. **Lines of communication for member options**

Written communication	Online content	Guidance seminars
Clear and simple	Interactive and engaging	Personal approach
Initial point of contact	Members can explore the detail	Can provide comfort and clarity

The benefits of a PIE

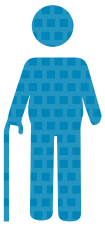
A PIE is often talked about as being a win-win-win scenario, something that can manage to find a sweet spot of being good for the members, the scheme's overall level of risk, and the scheme sponsor. So what are these good outcomes?

For the members, a PIE provides them with the option of having higher income in their early years of retirement. This gives individuals more flexibility around managing their income in a way that may suit their needs or preferred patterns of spending. *Figure 8* illustrates some examples of the typical uplift to an annual pension that a member being offered a PIE may be given. Even though these offers may be calculated in a way that ascribes lower value to the uplifted pension (a BDP below 100%), that calculation is done on a given set of actuarial assumptions and does not consider the preference of the individual and what they want to do with their income. The PIE offers the member a guarantee of a higher income in their early years, and for many this is worth more to them than the expectation of increases in the future.

Figure 8. **Typical one-off uplifts to current pension under a PIE option**

At age **60** a **59%** uplift to current pension

At age **70** a **37%** uplift to current pension



At age **80** a **22%** uplift to current pension

For the scheme, a PIE exercise tends to improve the funding position. Whilst exercises have a variety of designs, profiles and take-up rates, a useful rule of thumb is that a scheme with £100 million worth of pensioner liability will tend to see its funding position improve by around £1 million to £2 million by implementing a PIE exercise. Even for schemes with less than £100 million of pensioner liability, the savings can more than offset the costs for introducing PIE flexibility; for larger schemes, the return on investment can be very compelling as the fixed costs of implementation are spread over a larger population of members.

Finally, for scheme sponsors there is an equivalent impact to the deficit reduction which flows through to the sponsor's P&L account as a one-off gain. This can be an important piece in the jigsaw for a scheme building a business case to run a PIE exercise, and the attractive P&L impact can help secure support from the corporate sponsor.

So although PIE has been around for a number of years, there are still plenty of opportunities for UK DB schemes to implement an exercise to provide this flexibility to retired members. Schemes that have not previously implemented a PIE can explore the option, take on board the learnings from those who have gone before and run what is now a tried and tested process with a good degree of certainty of the outcome. Even schemes that have run a PIE in the past can explore running a subsequent tranche to capture new retirees since the initial PIE, and give those who may have previously declined the option, a second chance to consider if it is right for them now.

There are few things in life or pensions that appear to be a confident bet of a win-win-win outcome, but PIE may be one.

What next for transfers?

The trend of members transferring out of UK DB pension schemes over the past few years is certainly one of the headline stories that has gathered press and industry attention. A trigger for this activity was the introduction of pension freedoms in April 2015, which provides more flexibility to access retirement savings for individuals who elect to transfer from their DB scheme.

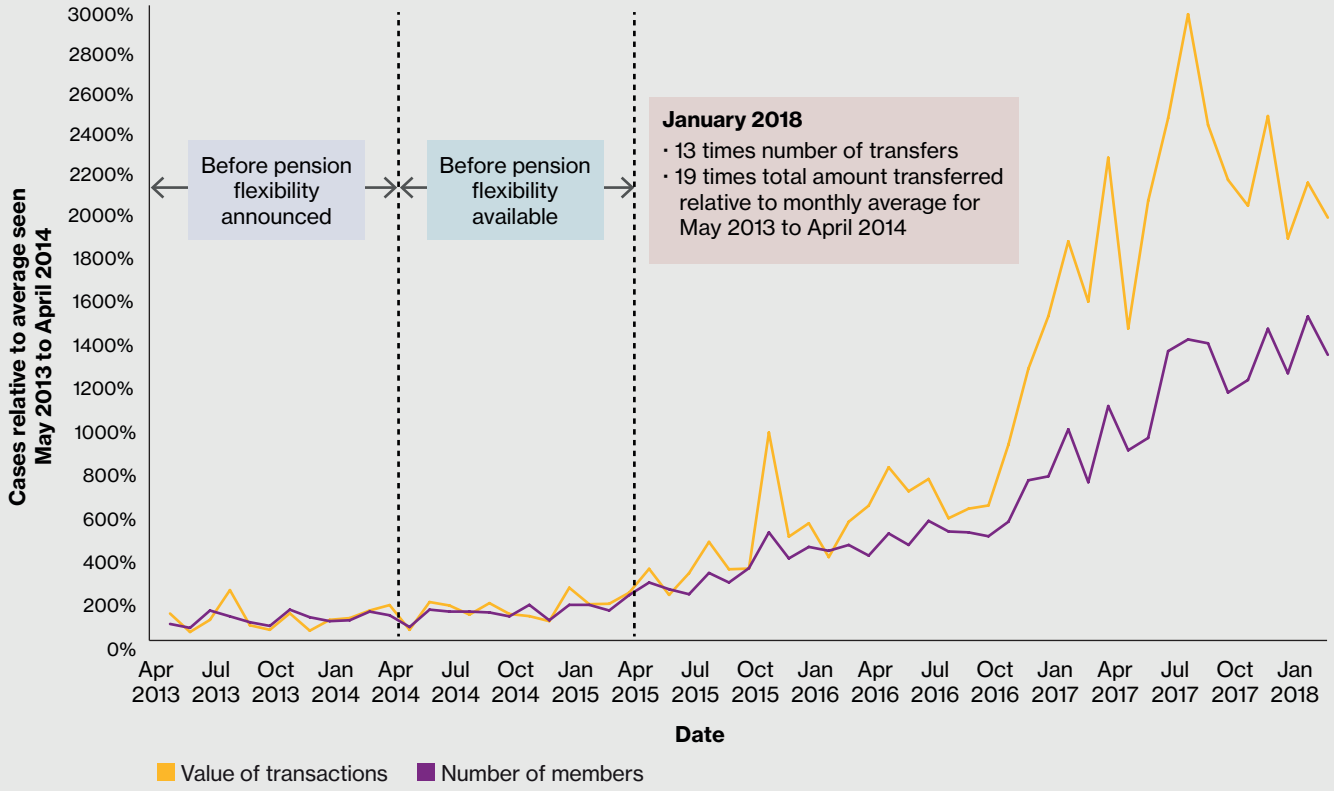
Stewart Patterson considers how pension scheme trustees and sponsors can, and perhaps should respond to this changed landscape. He also considers whether the new freedoms could be the source of a future mis-selling scandal.

An undeniable change

Since pension freedoms came into effect, the level of transfers out of DB schemes has increased dramatically. *Figure 9* shows the volume of assets as well as number of transfers out of a representative sample of Willis Towers Watson clients over the last several years and the trend is clear.

Within these figures there will be a whole range of background stories. Some schemes may have seen very little change so far, whilst others will have taken active steps to ensure members are aware of their options and be supporting them to explore what is the right decision for them. Another group may have taken little or no action, but nevertheless are experiencing a marked step-up in the level of transfers out. Is this group taking an active decision not to act, or are these schemes planning how to support their members to ensure that they are all able to make an informed decision?

Figure 9. **Activity in DB to defined contribution transfers for members aged 55 or older from a representative sample of Willis Towers Watson clients**

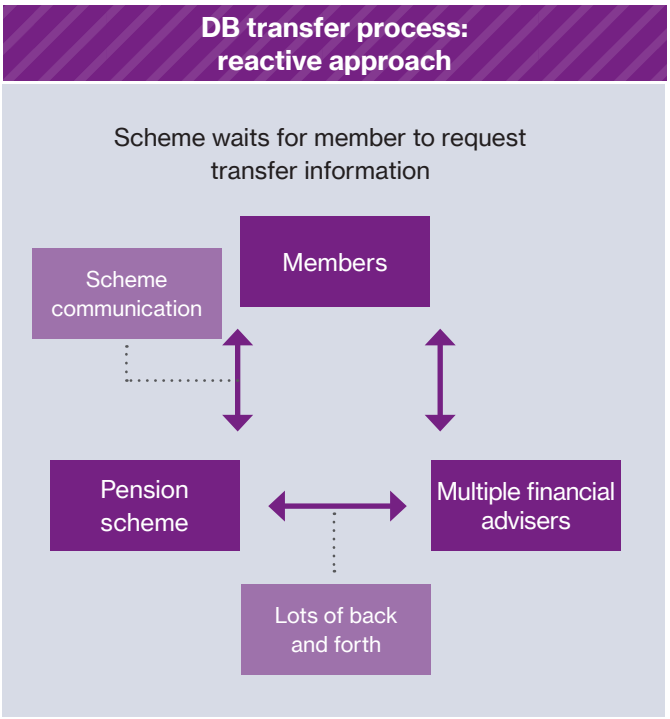


What does a 'good' process look like?

If we accept that pension freedoms is now here to stay, then trustees and scheme sponsors should consider what processes they should put in place to be comfortable with the level of awareness their members have about the choices available to them. Schemes need to consider the way they communicate with members, the administration processes that will help deliver this and the interaction between the scheme and the financial advisers that members, who wish to explore a transfer, will need to engage with.

"Giving members the option to work with an appointed financial adviser is another way schemes can significantly improve the member experience and manage costs."

Figure 10. **How efficiencies can be achieved by appointing a financial adviser**



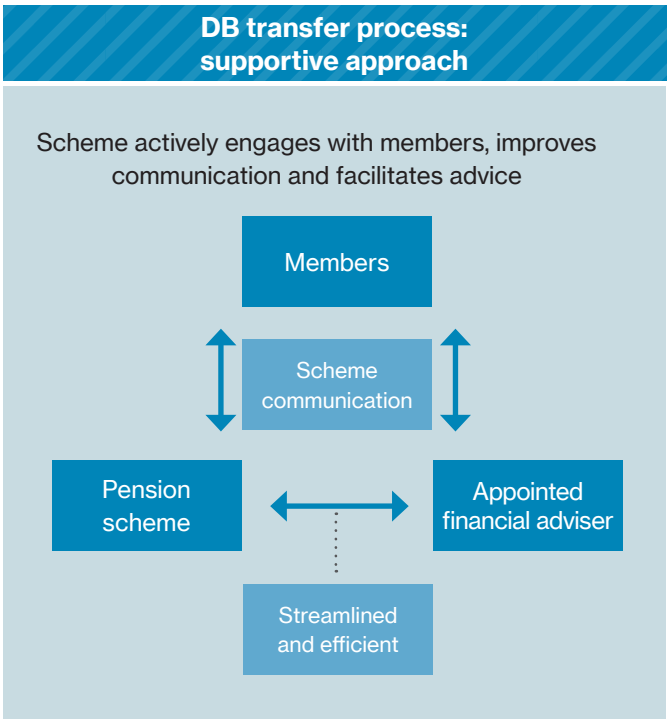


Figure 10 shows some of the new interactions that DB schemes now need to manage. Whilst these new interactions carry a potential upfront cost, they also provide the opportunity for schemes to run more efficiently in the long term, shorten its journey to reach its target of self-sufficiency or buyout and finally, enable members to be better informed as well as engaged.

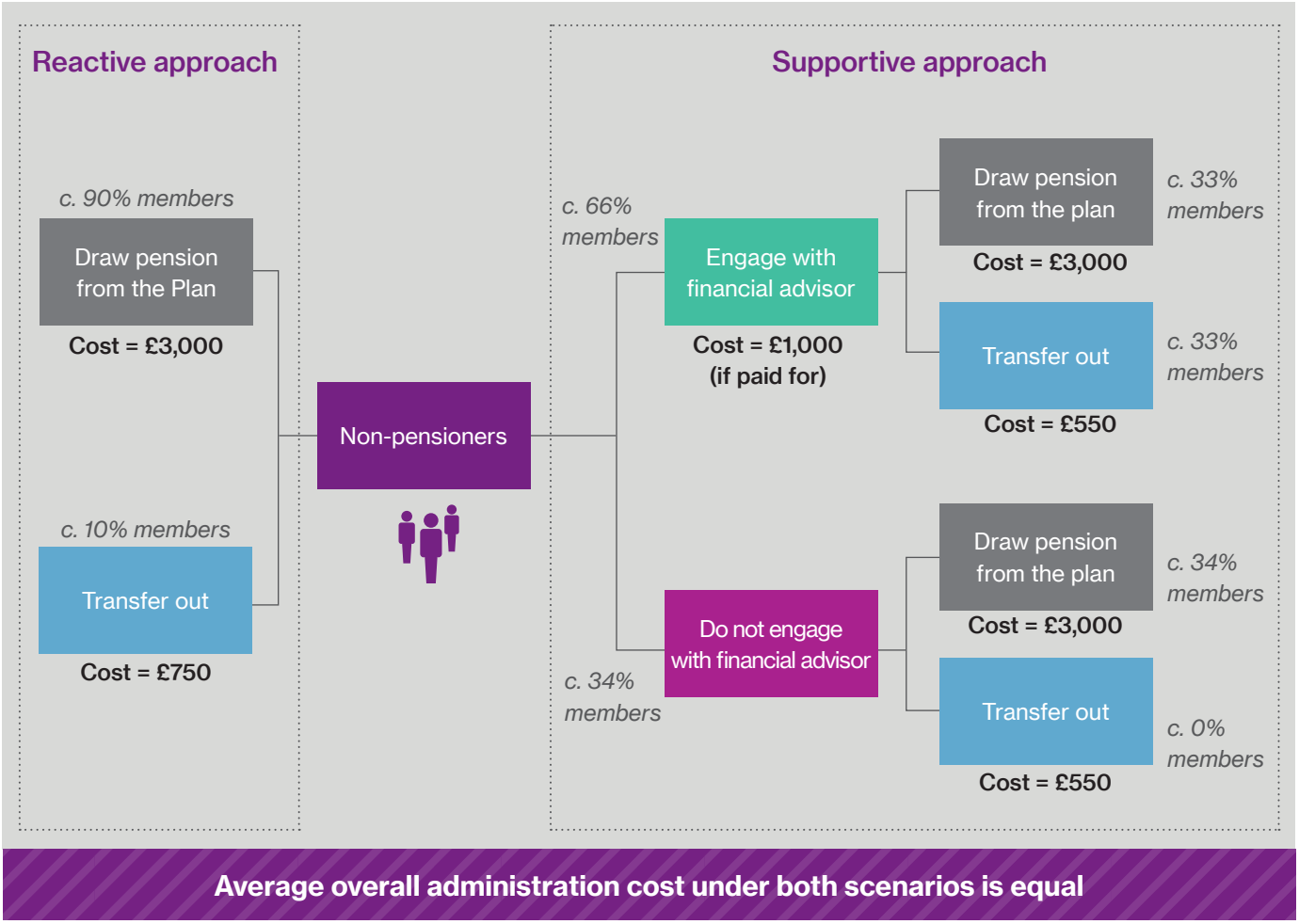
To help minimise the frictional costs of the various interactions, schemes can strive to automate calculations and communications processes as much as possible. Giving members the option to work with an appointed financial adviser is another way schemes can significantly improve the member experience and manage costs, as the appointed adviser will have a better understanding of the member's default DB option as well as access to some of the core data they will need to carry out their advice. This means less time and expense is used up with interactions between the financial adviser and scheme administrator on a case-by-case basis.

Should schemes pay for members to receive financial advice?

Amongst trustee groups and corporate decision makers there can be debate as to whether a scheme should appoint and pay for a financial adviser. On the one hand, some argue that it is the only way to make sure all members are fully informed about their options and able to act in their best interests. On the other hand, some stakeholders feel that they may be judged to be, in some way, accountable if a member is subsequently unhappy with the decision they make having spoken to the appointed adviser.

On balance, we feel that the main arguments in favour of appointing an adviser outweigh those against. Added to that, there are strong arguments to support the business rationale around the lower long-term costs of administration (see *Figure 11*) and reduced level of time spent dealing with queries from a range of different financial advisers.

Figure 11. **Illustrative figures show how paying for advice can be cost-neutral**



Alternative 'middle ground' options exist, where schemes may select either one or a panel of financial advisers that have satisfied some level of due diligence, but not fund the actual advice itself. This approach may be right for some schemes, but it can introduce a barrier to members engaging with the adviser, even where the advice cost is materially lower than available on the 'high street'. Schemes taking this route generally absorb the set-up costs, but are less likely to experience all of the benefits (more members making an informed choice and de-risking impacts for the scheme) and are still exposed to the risk of being judged accountable for having recommended a suitable adviser. If a panel of advisers is chosen, these challenges still remain, along with the need to have a higher level of governance to monitor the interactions with more than a single firm of financial advisers.

Figure 12. **Benefits of a fully-supported financial adviser process, providing paid-for financial advice to members**

What are the risks of a 'bad' process?

A process that doesn't see members having suitable awareness of their options is one where we are most likely to see decisions being made that are not in their best interests. From the member perspective, this is a bad process, but as outlined previously it also means that schemes do not benefits from the de-risking impact of some members transferring and the long-term administration costs can be higher.

The main risks relate not only to situations where individuals are not aware of their options, but also to where the route by which they are guided towards making decisions, has little or no oversight by parties acting in their interests (such as regulators and pension scheme trustees). There are tales in the industry of individuals being introduced to an advice process by third parties, whereby the roles, responsibilities and regulation of the introducer as well as adviser are murky at best. This is the type of story that, whilst difficult to entirely eliminate, is certainly in the interest of the industry and pension scheme members to do what we can to avoid.

Those most at risk from poor outcomes will first and foremost be the members themselves. If a member makes a decision to transfer or otherwise and subsequently regrets that decision, they may feel they need to challenge something about the way they made their decision – were they made aware of their options, did an adviser help them make an informed decision and was the process suitably transparent?

Ultimately, any pensions mis-selling scandal damages the reputation of the whole industry and puts a question mark over the trust placed by individuals on any information put in front of them about pensions. That's a bad outcome for everyone, as it increases the likelihood of individuals dis-engaging in active decision-making about their retirement income, which can only mean a decrease in the likelihood that the decisions they make are right for their particular circumstances.

Why work with Willis Towers Watson?

Willis Towers Watson has unrivalled experience in working with both trustees and plan sponsors to develop and implement their member option strategies. We are best placed to work with you to achieve the best outcome for your scheme because of our:

Unrivalled experience

We have been involved in the implementation of over 200 member option exercises covering over 600,000 offers to individuals. These exercises ranged in size from just 100 members to tens of thousands of members. We have a team of 30 dedicated member option experts who are able to anticipate all the issues and pitfalls that can arise.

Project management

Our team includes around 20 qualified project managers. Their experience of planning as well as implementing these exercises means that they are delivered on time and within budget. Interdependencies are identified and all parties involved can focus on their actions rather than managing the project.

Strong relationships with providers

We have an in-depth understanding of the financial advice market and advice models, together with a comprehensive understanding of the regulatory environment. This enables us to navigate the most appropriate solution for our clients. Qualified financial advisers within the team lead financial adviser selection exercises.

Market-leading communications

Our clear member communications explain the options to members in a fair and unbiased manner, resulting in increased member engagement as well as corresponding take-up rates. Our communication specialists have years of experience in explaining complex pension issues to members.

Strategic advice

Our advice aims to find the most appropriate solution for you and ensures implementation is successful. Key to this is helping sponsors and trustees understand the impact of the design of the option at an early stage, avoiding issues arising later in the process. Our experience of advising both sponsors and trustees means we can take account of potential reactions from the other party when providing our advice.

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About Willis Towers Watson

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