



**HELPING DB MEMBERS MAKE BETTER RETIREMENT DECISIONS:
THE ROLE OF SCHEMES, ADVISERS, REGULATORS AND GOVERNMENT**

A Joint Policy Paper from LCP and Royal London

August 2017

EXECUTIVE SUMMARY

In a world of pension freedoms, people with Defined Benefit (DB) pension rights have many options to reshape their retirement incomes. These can include:

- ‘commuting’ part of their pension rights to a lump sum;
- taking their pension earlier or later than normal scheme pension age;
- transferring some or all of their rights out of the scheme into a Defined Contribution (DC) arrangement;
- reshaping their benefits within the scheme, for example by exchanging future pension increases for a higher starting pension, or taking a higher pension for the period between their retirement age and state pension age;
- accessing any supplementary DC element of their pension (eg as purchased by additional voluntary contributions).

Whereas a transfer out of DB rights worth £30,000 or more carries a requirement to take financial advice, there may be no advice required or available with other options, despite the complexity of choosing between them.

This paper therefore asks whether more could be done to help DB members make the right choices as they approach retirement. It brings together the results of specially commissioned surveys of occupational pension schemes and of financial advisers to answer key questions about the role of schemes, advisers, regulators and government in the process of reshaping pension benefits for members of DB schemes.

The key findings of our scheme survey are:

- the large majority of schemes contact members for the first time only as they approach their normal pension age (typically 60 or 65); very few write to members well before pension age about their options;
- growing numbers of schemes are now routinely quoting transfer values in retirement communications but the majority do not do so;
- whilst more than 90% of schemes stress the importance of seeking financial advice to members, only 5% provide access to a named financial advisor that has been selected by the trustees or employer;
- only around 1 in 6 schemes offer a partial DB transfer option;
- nearly all schemes have an option for deferred pensioners to take early retirement, but the large majority of schemes do not highlight this option to members, and retirement

communications often arrive too late for members to make full use of early retirement options.

The main findings of our adviser survey are:

- advisers report a large increase in the numbers wanting to transfer their DB pension rights into a DC arrangement; typical transfer values lie in the range £250,000 to £500,000, a finding consistent with the results of our scheme survey; the transfer value is typically a multiple of 25 to 30 times the size of the annual pension foregone;
- amongst those advised to transfer, the biggest three attractions are:
 - the greater flexibility available in a DC arrangement;
 - the historically large transfer values currently on offer;
 - the potential to pass on a lump sum balance on death to heirs;
- amongst those advised not to transfer, the main reasons are:
 - the loss of a guaranteed income;
 - the ability of the client to handle risk;
 - where the DB pension is the only or main income available;
- clear support for a right to ‘partial’ transfers of DB rights – roughly three in five advisers said they ‘strongly supported’ this option for clients;
- strong support for comprehensive and standardised information about DB rights to routinely accompany transfer value quotes so as to streamline the advice process.

To ensure that DB scheme members are enabled to get the best outcomes and to navigate the choices available to them, we recommend:

- a) that occupational pension schemes should provide more comprehensive information to scheme members about their options regarding their DB pension rights, especially in light of the ‘pension freedom’ reforms of April 2015; this information needs to be supplied earlier, communicated clearly and supported by access to high quality advice and guidance;
- b) that all individuals should have the option to transfer part of their DB rights rather than face an all-or-nothing choice about whether or not to transfer rights which may be worth more than the value of their home;
- c) that transfer value quotations should be accompanied by standardised information that will enable financial advisers to evaluate the pros and cons of a transfer in an efficient manner;
- d) that the FCA proceed with plans to update the advice framework around DB to DC transfers to reflect the post pensions freedom environment;
- e) that more focus be given to advice and guidance post retirement; in particular, where individuals have transferred large capital sums, policy makers need to ensure that they have the ongoing advice and guidance that they need to manage this money effectively.

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1. Options for scheme members approaching retirement

Most members of DB pension schemes, including those with deferred pension rights from periods of past service, are not obliged to take scheme benefits at scheme pension age. In many cases they have options to reshape their benefits either by remaining within the scheme or by transferring out some or all of their rights. Some of the most common options available include:

Taking pension early or late

Pension schemes have a standard “scheme pension age” at which benefits are assumed to be taken, which is often age 60 or 65. However, many schemes offer an option to draw pension earlier (with a reduction for early payment) or later (with an increase for late payment), and these options may be suitable to members to help them through changing working and spending patterns during their 50s and 60s.

Commuting pension rights to a lump sum

Most pension schemes offer members the right to give up a proportion (generally 25% or in some cases more) of their pension, and convert it into a tax-free lump sum. This is the one option that is usually highlighted to members as they approach retirement, and many members are aware of it and most members take it up. However, whilst the offer of cash along with the tax treatment often appears attractive, the terms of conversion are not always good value, and commuting pension to cash may not in fact be in a member’s best interests.

Transferring some or all of the benefits out of the scheme into a DC arrangement

Prior to April 2015, in most cases at least 75% of any transferred amount had to be used to purchase an expensive annuity, which meant that a transfer was generally assumed to not be in a member’s best interests. But the world has now changed, and the much greater flexibility provided by a DC arrangement, coupled with the attraction of creating a large pot of money that is a personal asset, can be very attractive for many members.

Reshaping benefits within the scheme

Some schemes offer members options to give up future pension increases in return for a higher starting pension (a “pension increase exchange” or “PIE”). Other schemes offer members options to take a higher pension at the point of retirement, payable until state pension age (currently age 65, but rising soon), and then a lower pension from that time, once their state pension kicks in (often called a “bridging pension” or a “levelling pension”). Both options can be attractive to members, as it gives them a higher income at a time of life when they have a need for it. This can also be attractive for an employer as it may enable employees to retire who would otherwise not be able to afford to do so, and typically also reduces an employer’s longer-term pension risk.

Accessing a DC element of pension (eg as purchased by additional voluntary contributions)

Many members of DB schemes have additional DC benefits that have been earned in the scheme, perhaps from paying additional voluntary contributions in the past, or from more recent contributions made by both themselves and their employer. Schemes usually offer various options relating to these benefits - from taking as cash, transferring elsewhere, converting to DB pension or purchasing an annuity. The relative attractions of the various options may not always be obvious to members.

Most of the above options usually result in cost savings for the pension scheme, because the assumptions which underlie the calculations tend to be more favourable to the scheme than the funding outcome if the pension rights continued unamended¹.

Given the range of choices on offer and the complexity of choosing between them, it is important that scheme members get the right information, advice and guidance to help them make those choices. But in many cases it is far from clear that they are getting this help from their schemes or getting the financial advice that would help them to make good choices. We are also concerned that the rules and processes around transferring money out of a DB pension scheme are not always working in the member's interests as well as they might. In this paper we therefore ask a range of questions of schemes, advisers and of government in order to understand the current situation and to recommend reform.

For pension schemes

- Have pension schemes changed the way they communicate with their members post pension freedoms?
- Are schemes communicating with deferred members far enough in advance of retirement?
- Are pension schemes offering appropriate options to members that will meet their needs?
- Are members who stop short of a full transfer out of their pension rights getting access to advice and guidance to help them make good choices?
- Are trustees and employers taking a risk by helping scheme members to access advice or guidance? Or are they taking more of a risk by failing to help scheme members make good choices?

¹ To be more precise, the terms offered to members are usually based on "best estimate" assumptions rather than "prudent" assumptions. Schemes also benefit in terms of risk reduction because the result of the option is usually to bring payments forward, and thereby reduce future uncertainty (the exceptions are late retirement and some options associated with any DC benefits in the scheme).

For financial advisers

- What is happening to the scale of demand for DB to DC transfers and to transfer values?
- Who is the typical person considering a transfer and how much are they considering transferring?
- What are the main reasons why individuals may be advised to go ahead with a transfer, and what are the main reasons why advisers may recommend someone not to transfer?
- How are advisers dealing with ‘insistent clients’?

For regulators and government

- Does the current regulatory regime around DB to DC transfers work in a ‘pensions freedoms world’? If not, how could it be changed to be a better fit?
- Do consumers need new rights – for example, to a partial transfer of their DB pension rights?
- Could the transfer process be streamlined, for example, by requiring schemes to provide standardised information alongside transfer quotations in order to speed up the advice process and reduce the need for fresh quotations to be given?

2. The Current Rules around Advice and Guidance for scheme members

There are two main sets of regulations which govern the help and advice to which scheme members are entitled when choosing between different options around their DB pension. A voluntary Code of Good Practice also applies in some circumstances.

a) Disclosure

Under existing ‘disclosure’ regulations, occupational pension schemes are required to provide information to DB members about their benefits at two points in time: when they leave service, and as they approach the scheme’s normal pension age. This means that many members will not hear any more from their pension scheme about their benefits until they reach age 60 or 65. Furthermore, disclosure regulations do not require members to be informed of all their options at retirement, and in effect only the standard retirement benefits are required to be quantified.

Whilst the current UK disclosure requirements are arguably inadequate to assist members in making retirement decisions, this may be set to change as a result of new European legislation on pensions known as IORPII. IORPII is currently set to come into force just a few months before article 50 ultimately triggers Brexit, so it is reasonable to assume that it will become UK law.

One of the requirements of IORPII is for deferred members to be sent annual statements setting out their benefits. This would seem a sensible opportunity for UK pension schemes to review their communications and include more detail on member options, including on transfers and early retirement. We can therefore only expect increased requirements on schemes, and increased interest from members, as the law evolves in this area.

b) Advice on DB to DC transfers

Individuals considering transferring DB pension rights with a transfer value in excess of £30,000 into a DC arrangement are required to take financial advice before undertaking the transfer, though they are not required to act in line with that advice. Individuals who press ahead with a transfer against the recommendation of their adviser are known as ‘insistent’ clients. In the adviser poll reported later in this paper, we found that four fifths of advisers were sufficiently concerned about the unsuitability of some transfers that they would refuse to transact a transfer where a client ‘insisted’ that they wanted to proceed against the recommendation of their adviser.

Advice around DB to DC transfers is overseen by the FCA and under current rules advisers are expected to start from the assumption that the transfer is not in the best interests of the client.

However, the FCA has recently published a consultation paper² which suggests a number of ways in which the advice framework might be updated. The key changes which are proposed are:

- Whilst the FCA still believes that in most cases a transfer would be a bad idea, the adviser would start with a ‘neutral’ approach to the individual client and look to make a personal recommendation based on their specific needs and objectives;
- Rather than focus too much on the ‘critical yield’ which would need to be obtained from investing the transferred lump sum in order to match benefits given up, advisers would have to present a simple comparison to clients of the lump sum value of benefits given up compared with the transfer value.

Any changes arising from this consultation are expected to be implemented in early 2018.

c) Code of Good Practice

A voluntary pensions industry Code of Good Practice was first published in 2012, which applies when an employer (or trustees) is making a one-off special communication to members about their benefits with an aim of reducing employer pension costs. The code sets out generally recognised good practice on the provision of balanced communication and other support for members through the provision of financial advice and guidance. The code encourages a similar approach to be adopted for normal day-to-day member choices such as retirements and transfers.

Despite these regulations and good practice guides, it is clear that there is currently an ‘advice and guidance’ gap for many scheme members. For some members, they may not be aware of options until it is too late – for example, hearing about an option to retire early once you are age 65 is not very helpful, and for some schemes the option to transfer out of the scheme lapses as a member approaches normal retirement age. For other members, options that are attractive to them may not be highlighted or quantified. And for those reviewing their options to reshape their benefits within the scheme (rather than transfer out) there may be little or no guidance and many members may make choices without being fully aware of the options available to them and the relative merits of each. In the next section, we look at what information different schemes provide to members at different stages.

² CP17/16 “Advising on Pension Transfers”, Financial Conduct Authority, June 2017

3. LCP surveys: What help do occupational schemes currently provide, and reporting on current transfer activity

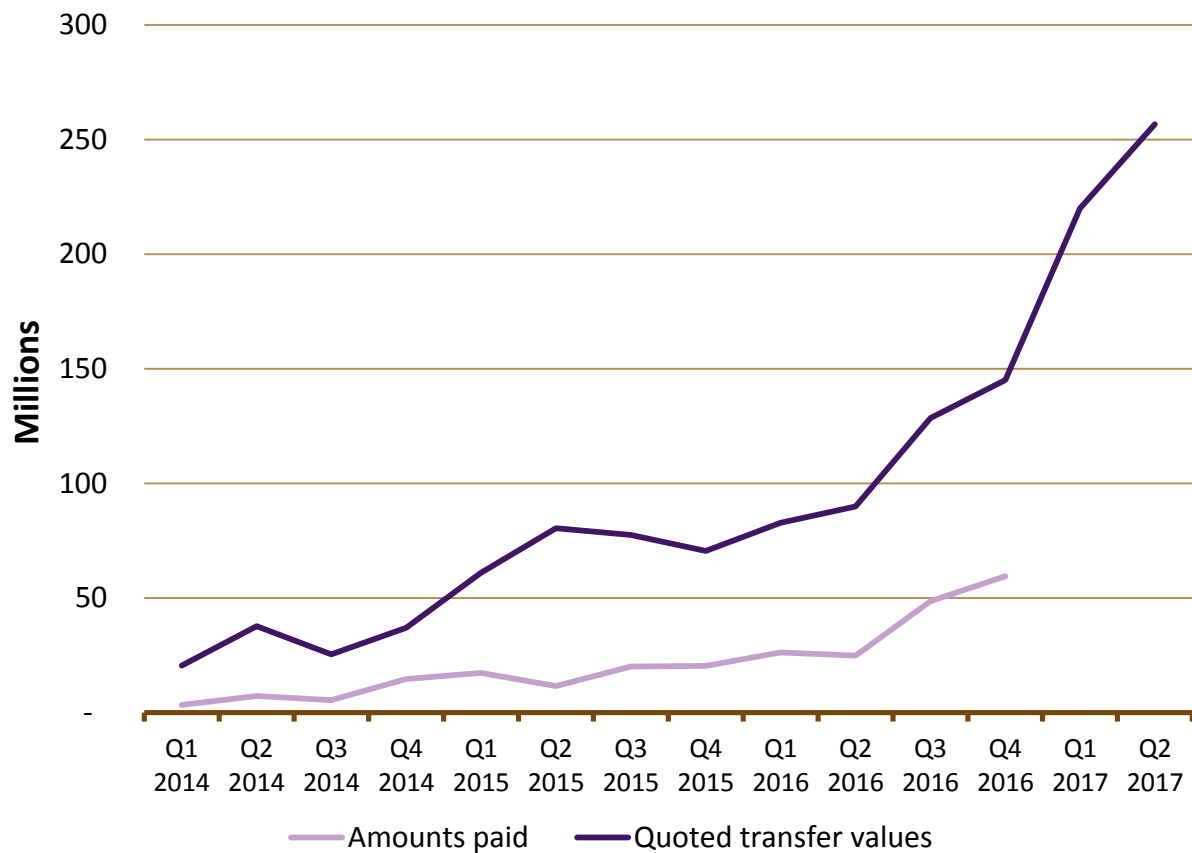
In this section, we report on a specially-commissioned survey of over 100 pension schemes undertaken by LCP in May 2017. The schemes represent a wide cross-section of UK pension schemes, across all industries, with scheme sizes ranging from less than £50m to more than 10 schemes worth more than £1bn. LCP conducted a similar survey in 2015 shortly after the new pension flexibility and freedoms were implemented, and in some cases a trend in market activity can be seen.

Headline findings were:

- 10% of schemes write to members well before their normal pension age (typically from age 55) about their pension options – the remaining 90% contact members for the first time as they approach their normal pension age (typically 60 or 65);
- in 2015, 20% of schemes were quoting transfer values in retirement communications – this has now increased to 30% and anecdotal evidence suggests that this percentage will increase further;
- whilst more than 90% of schemes stress the importance of seeking financial advice to members, only 5% provide access to a named financial advisor that has been selected by the trustees or employer;
- around 15% of schemes offer a partial transfer option – a similar proportion to those schemes identified in 2015 as having made decisions to do so;
- 10% of schemes offer other options at retirement such as levelling pension and PIEs – however, around half of those don't highlight the options to members, so that take-up can be low;
- nearly 100% of schemes have an option for deferred pensioners to take early retirement, but 80% of schemes do not highlight this option to members, and retirement communications generally arrive too late for members to make use of early retirement options;
- back in 2015, one-third of schemes had seen a recent increase in transfer value quotes and transactions – since then, more than 80% of schemes have seen increases in transfer quotations and more than half of schemes have seen the number of transfers increase.

LCP also undertakes a regular survey of transfer activity in the pension schemes the firm administers. Chart 1 shows the total amount of transfer values quoted under this survey each quarter over the last three years, and the increase in the total amount of transfer values actually taken arising from those quotations³.

Chart 1. Change in Transfer Activity since 2014



³ Note that cases have been allocated to quarters accordingly to their quotation date for the analysis of both quotation and payment activity. This means that there is a time-lag of up to six months for take-up data. Member ages have been calculated at the quotation date.

Chart 2 shows the significant increase in transfer value quotation requests over the last three years. The results are quoted “per 1,000 deferred members”. Recent take up rates are understated as the data only reflects transfer payments actually made before 30 June 2017 – hence the projected amounts in the chart. The chart shows a dramatic increase over the period in both the number of transfer value quotations being requested and the number of transfer values being transacted.

Chart 2. Number of Transfer Quotations per 1000 deferred members

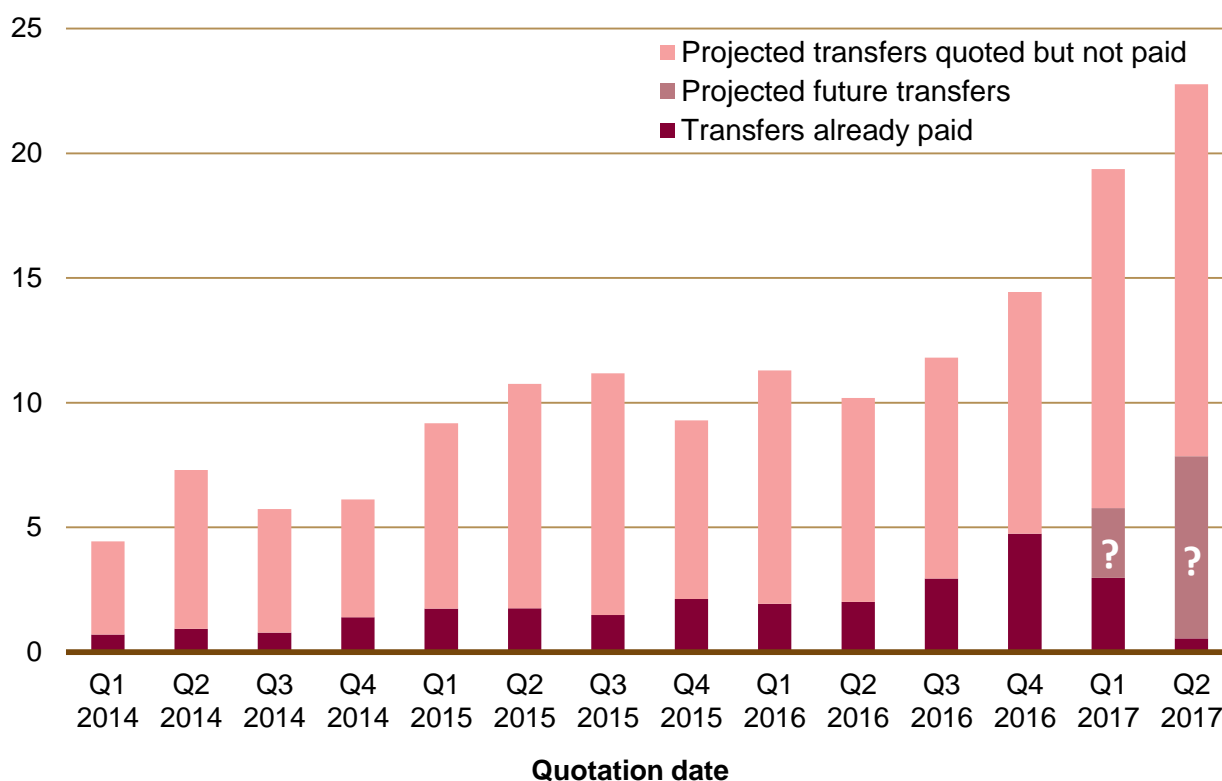


Chart 3 shows the average size of transfer values over the last three years, and shows a steadily increasing average to over £400,000. Some of this increase has been driven by market conditions, as falling yields (particularly post-Brexit) has led to increases in the value of members' pensions. Some is also likely to reflect members closer to retirement with large pensions being increasingly more likely to take a transfer.

Chart 3. Average size of transfer values Q1 2014 – Q1 2017

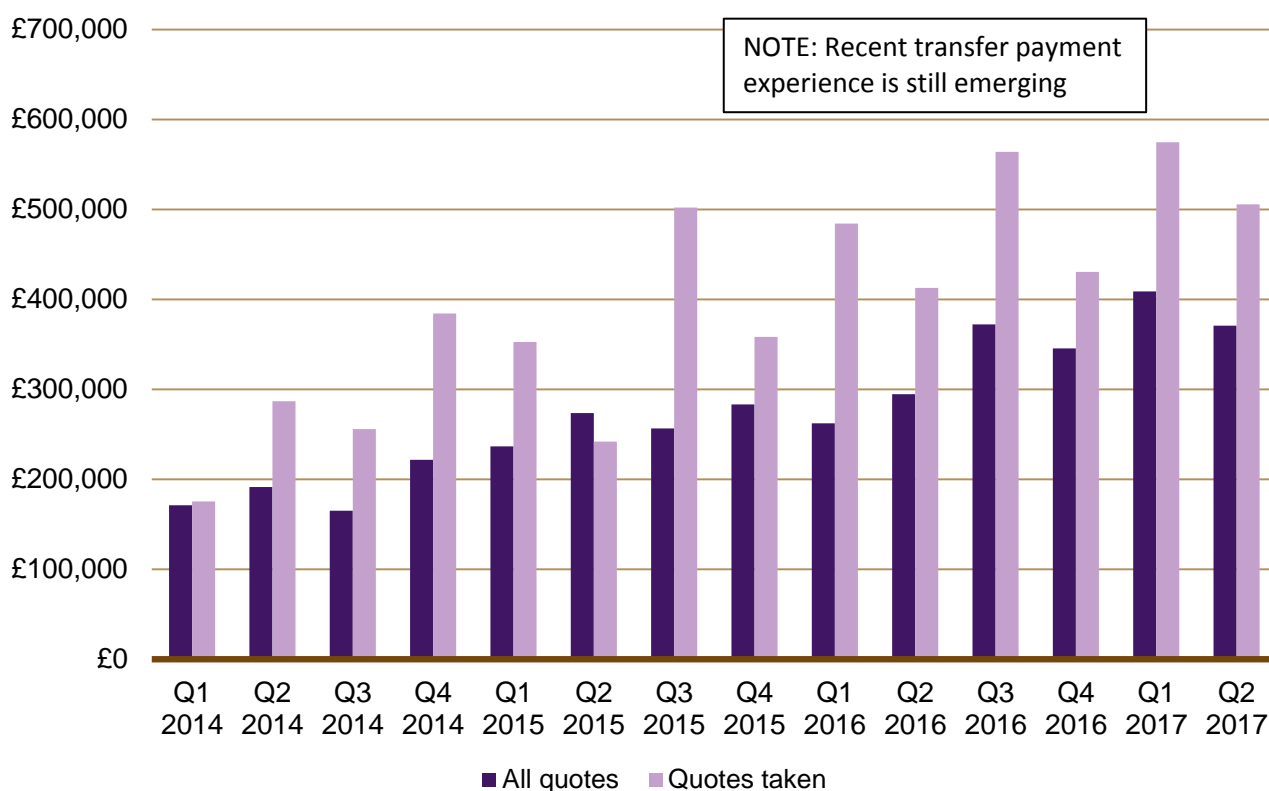
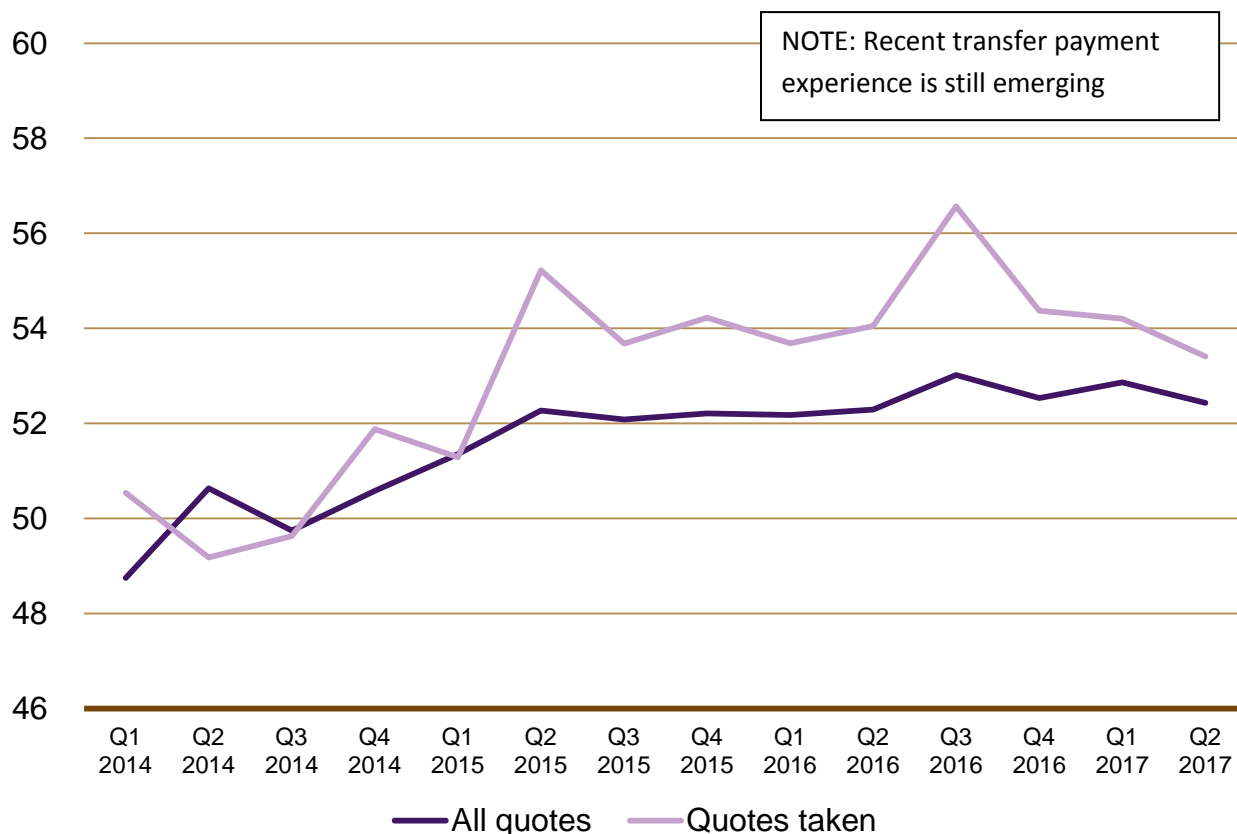


Chart 4 shows the average age of members requesting a transfer value quote, and also those actually taking a transfer value. These ages have been steadily increasing over time, with a typical age to actually take a transfer value now being around age 55.

Chart 4. Average age of members requesting a transfer value quote and taking a transfer



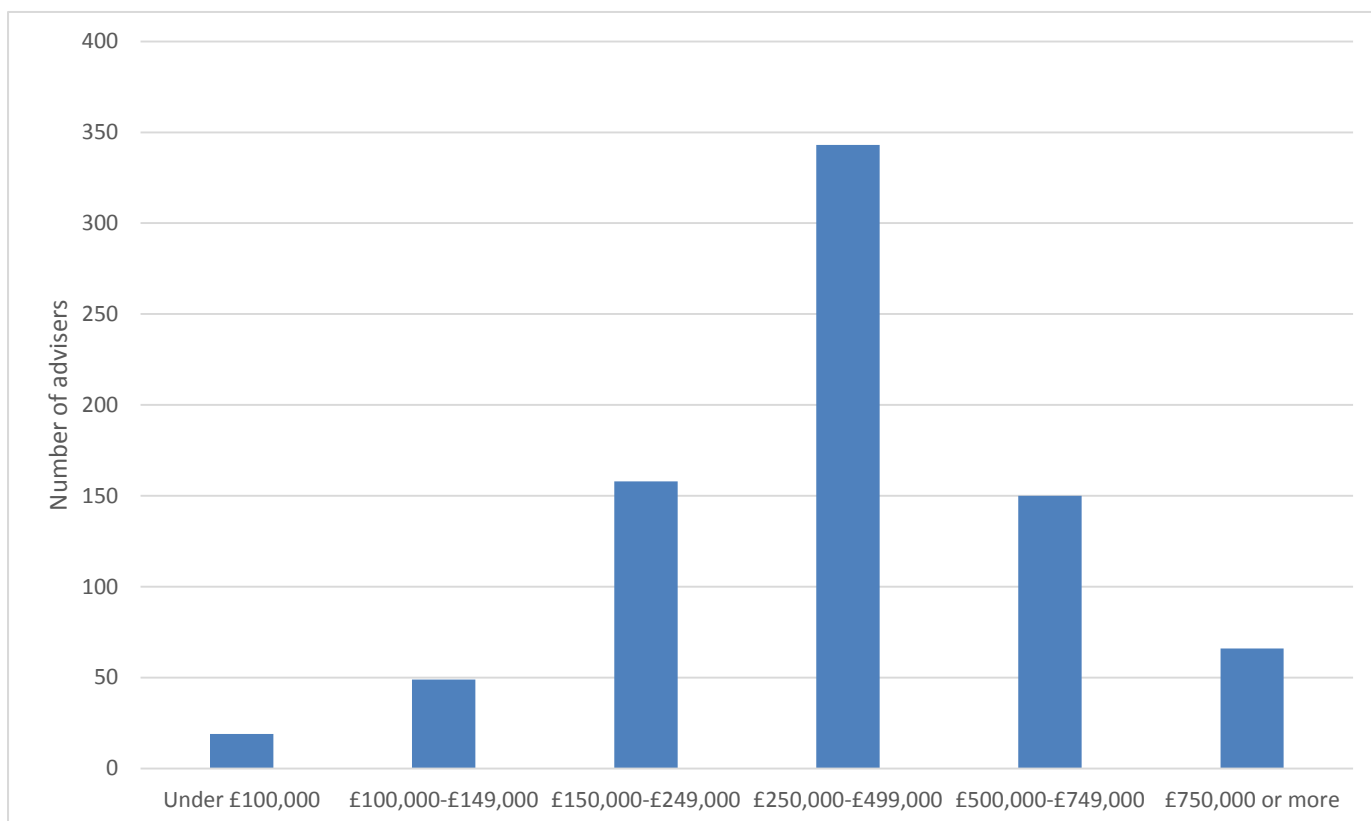
4. Royal London survey: Trends in the advice market around DB to DC transfers and views of advisers

Where individuals are considering transferring a DB pension right worth more than £30,000, they are required to take financial advice before acting. In this section, we report on a specially-commissioned survey of financial advisers undertaken by Royal London in May 2017. A total of 806 replies were received from a broad range of advisers. Headline findings about the current state of the market were:

- 94% of advisers said that they had seen a growth in the volume of requests for advice on DB to DC transfers compared with a year earlier;
- the median adviser estimated an increase of around 60% in inquiries, but more than a quarter said the increase was over 80%;
- around four fifths of advisers said that the volume of transfers going ahead was up on a year earlier, typically by around 50%;
- just under 80% of those being advised were in their 50s, whilst the majority of the rest were in their early 60s.

With regard to the characteristics of transfers, Chart 5 shows the distribution of transfer values on offer to those being advised.

Chart 5. Size of transfer value

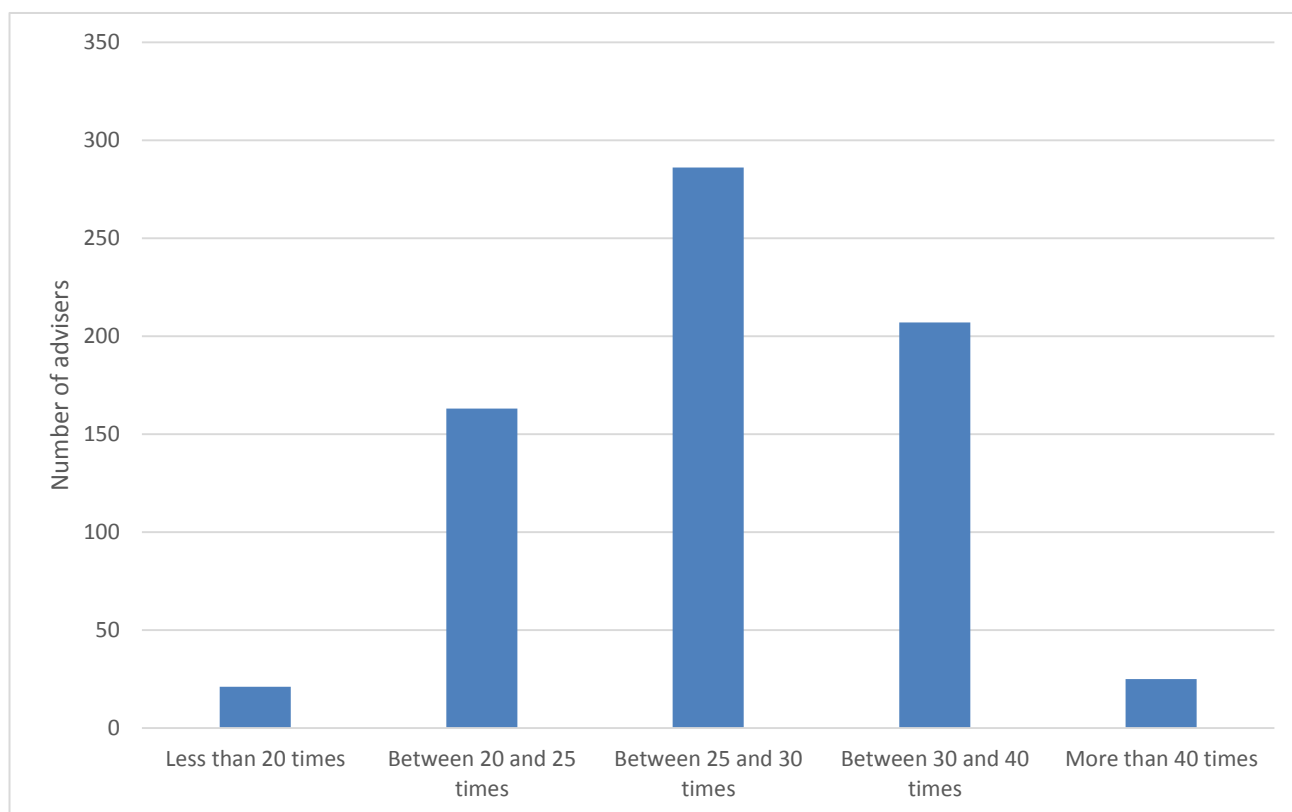


The most common transfer value on which advice is being offered clearly lies in the range £250,000-£499,000, though around a quarter of advisers said they were typically dealing with transfers worth in excess of half a million pounds. These figures concur with the results of LCP's survey and demonstrate the amounts involved for many individuals are extraordinarily large and similar, or even higher, than the value of any home that they may own.

An alternative way of looking at transfer values is to express the lump sum on offer as a multiple of the annual pension which the member would have received at retirement. In part, a large multiple may simply reflect a more valuable pension (eg payable at an earlier age, with more generous indexation, with better survivor's benefits etc) but it may also in part reflect the scheme's investment strategy and/or whether the scheme is looking to encourage or discourage transfers out.

Chart 6 shows the distribution of lump sums on offer expressed as a multiple of the annual pension:

Chart 6. Typical conversion factor from annual pension to lump sum transfer value offered

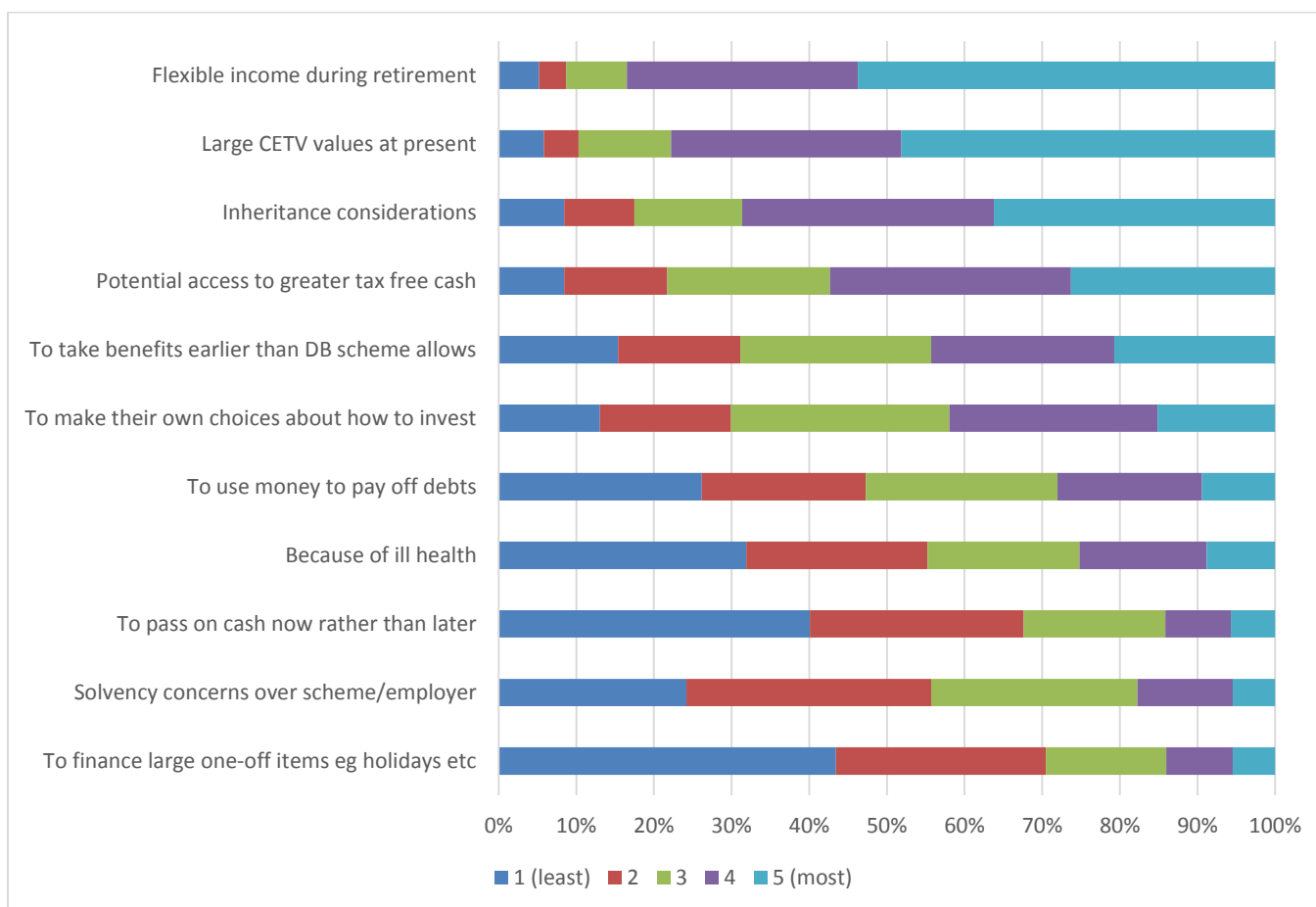


Given typical retirement lengths, it is perhaps not surprising that individuals are being offered a lump sum equivalent to 25 to 30 times their annual pension. However, nearly one third of advisers who replied to the survey indicated that they regularly saw members being offered multiples in excess of 30 times annual pension. Even a relatively modest annual DB pension will convert to a substantial lump sum when multiplied by thirty or more. However, it is important

that scheme members understand that these large cash lump sums will potentially have to support them through a retirement running into several decades. Being well advised both about whether or not to transfer and about managing the lump sum after the transfer is of crucial importance to the well-being of scheme members in retirement.

Of particular relevance to our analysis are the reasons why individuals are (and are not) choosing to transfer. Advisers in our survey were given 11 different reasons why clients may wish to go ahead with a transfer and asked how often each was cited as a major factor in the decision to transfer. A score of 5 meant this was a common motivation whilst a score of 1 meant that it was rarely the reason for a transfer. The results are shown in Chart 7.

Chart 7. Main reasons people give for wanting to transfer, having received advice



By far the biggest reason for wanting to transfer DB rights into a DC arrangement is the desire to have greater flexibility. Whilst DB pensions have great advantages in terms of certainty – providing a guaranteed payment as long as you live, not affected by the ups and downs of the stock market and generally with a measure of protection against inflation – they are also seen by those transferring out as unnecessarily rigid. In particular, individuals who might want to change the profile of their income in retirement, perhaps ‘front-loading’ their income and spending to a time in their life when they are most able to enjoy it, have much greater freedom in a DC environment.

The chart also shows that very large headline transfer values, partly driven by low interest rates, are proving a strong motivator to transfer, as is the potential for heirs to inherit a lump sum from a DC arrangement rather than – at best – a survivor’s pension from a DB scheme⁴.

At the other end of the scale, Chart 7 shows that transfers are rarely undertaken simply to finance a one-off purchase (eg holiday or home improvement) and are also rarely motivated by a fear that the DB pension scheme or its sponsoring employer will go bankrupt.

We also asked advisers what reasons they gave to clients when they advised them **not** to transfer. By far the biggest reason given was because of the certainty and security provided by remaining in a DB arrangement. Advisers also often felt that their clients would not be happy with the level of risk involved in transferring out or simply felt that the transfer value on offer did not represent ‘value for money’. They were also less likely to recommend a transfer when the DB pension at stake was the client’s only source of regular, reliable income in retirement beyond their state pension. These are clearly important reasons why it remains in a majority of members’ best interests to remain in a scheme. But even in these cases, it is important that members receive information and help in deciding which scheme options are best for them.

⁴ Note that advisers were also allowed to write in their own ‘other’ reasons for transferring and the phrase ‘death benefits’ was repeatedly cited spontaneously as an important factor.

5. Potential reforms

A DB pension can often be the most valuable financial asset that an individual holds. Indeed, our survey of transfer values suggests that for those who approach advisers about a DB to DC transfer, the typical transfer value is greater than the average house prices in the UK.

However, our research suggests that many members may be currently in the dark about their DB pension options. They are not always told about their options in good time, and their options are not always quantified for them.

In addition to a full DB to DC transfer, there are other options that many schemes do offer or could offer that would be more beneficial to some members and to the scheme and the employers – from partial transfers to levelling pensions. But members may not even know about these options because the disclosure requirements are out of date and do not reflect the range of options members now have. Furthermore, where individuals would benefit from taking independent financial advice about their choices, schemes rarely help members to identify a suitably qualified adviser.

In our view, the objective of the regulatory system should be:

- to ensure members are well equipped to make well informed decisions that are best for them, and to reduce the risk that members make poor decisions;
- to help schemes and employers manage costs and risks appropriately, but not at the cost of poor decisions from members.

We do not think these objectives are being met well at the moment, and to help ensure they are met we are calling for the following:

a) Improve information provided by schemes to members

It has now been two years since the very significant “freedom and choice” reforms were introduced in April 2015. Whilst some DB pension schemes have responded by changing the nature of the communications they provide to members, many have not yet made changes, and yet it is clear that there is steadily increasing demand from members to make use of some of the new flexibilities.

Before April 2015, it could be said with some confidence that the vast majority of DB pension scheme members should not transfer out of a pension scheme, and “good practice” was to simply inform members of their expected normal retirement pension as they approach normal retirement age and encourage them to look for their own financial adviser if they wanted to explore things further. This approach increasingly carries more risk, as market practice develops.

In our view, now would be a good time for trustees and employers to review the options offered by their scheme and their communications to ensure they remain fit for purpose:

- should members be offered new options, including levelling pensions, partial transfers and pension increase exchanges, that will better suit the needs of members and their families?
- are all scheme options communicated and quantified appropriately and in good time – for example should transfer values be regularly quoted to members, and should retirement communications start from age 55?
- is the information provided to members adequate enough for a financial adviser to advise the member on the best option for them?

To assist this, we think it would be helpful for the government to undertake a review of the disclosure requirements, to ensure they remain fit for purpose in the modern world. For example, it would seem to us to be appropriate for deferred members to be provided with:

- **A benefit statement including a transfer value every year (providing more regular information is in line with the direction of travel of European pension law requirements that may shortly become UK law in any event)**
- **A warm up communication at age 55, setting out the member's options as they approach retirement**

Improvements in scheme communications along these lines would also be in keeping with the requirements for DC schemes and the requirements for consumer communications within the insurance and banking sectors, which require regular, timely and balanced communications to be provided to enable consumers to make good decisions.

There is of course a balance to be struck over providing too much information that can overwhelm members. If all options are quantified every year for every member from age 55, it will be a significant administrative burden and cost, and members are unlikely to thank the trustees! However, a number of schemes are developing more nuanced approaches, including sending warm up letters from age 55, including quantifying an early retirement pension and a transfer value at that point, then sending an annual reminder communication thereafter, with the opportunity to request more information and quotes when the member wants them. Others are making increased use of technology, making information available via websites. We suspect this will be the way of the future.

In addition, we would encourage trustees and employers to work together to identify impartial financial advisers who are experienced experts in this field and to provide their contact details to members.

In most cases, the trustees' and employers' advisers should be able to help identify financial advisers for members who have expertise in occupational pension schemes. In some cases, schemes or employers may also want to contribute towards the cost of the advice to encourage

members to seek advice, but even the provision of contact details goes a considerable way to reduce the risk that members make ill informed decisions or do not seek appropriate advice. There is also a considerable efficiency advantage in using a financial advisor who can become familiar with the benefits and processes of the scheme.

Whilst all of these developments will involve additional cost for trustees and schemes, many employers are likely to be supportive of the additional costs once they appreciate the benefits. Providing better information to members, to enable them to make better decisions, reduces everyone's risks. Better options for members, better communicated, around early retirement and levelling pensions, can mean more members feel able to leave service earlier, which can be attractive for an employer managing a work force (equally, in some cases, it may not be attractive, if an employer needs to retain older experienced talent). Either way, it is worth also noting that an attraction for the employer is that the taking up of options (both within the scheme and transfers) will typically reduce the funding and accounting liabilities and risks in the pension scheme. This can also be an attraction for trustees, as it can strengthen the financial position of the scheme and shorten the time to de-risking and ultimately securing benefits with an insurer.

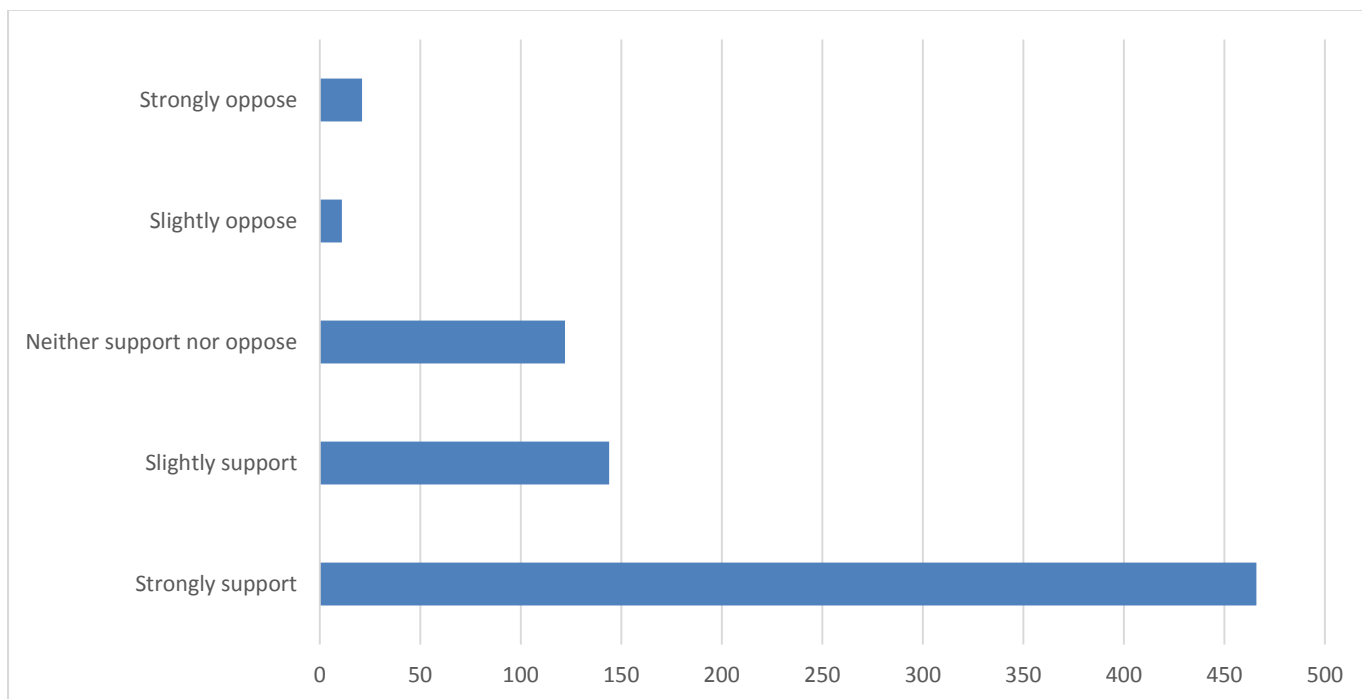
b) A right to a partial DB transfer

Where an individual has accrued DB pension rights in a number of different schemes they have the option to retain some DB rights and to convert others into a DC arrangement. This can mean that they can secure a regular guaranteed income but also have more flexibility about how to use the rest of their pension rights. But where an individual has long-service in a single scheme, this option may not be open to them. As shown in our survey of schemes, most occupational schemes do not offer the right to transfer part of your pension rights and leave the balance in the DB scheme. Transfers out are often on an all-or-nothing, 'take-it-or-leave-it' basis. Whilst an intermediate option of a partial DB transfer may in many cases be the best option for the member and may also provide a lower risk option for an adviser (in terms of future regulatory challenge), members may not have this option.

We therefore propose that the government should legislate to give scheme members a limited legal right to partially transfer their DB pension rights.

The right to a partial transfer was strongly supported by the advisers who replied to our survey as shown in Chart 8.

Chart 8. Would you support or oppose a right for people to transfer only part of their DB pension rights, as an additional option?



There would clearly be practical issues which would need to be addressed. These include:

- How to treat different elements of the accrued pension? For example, where part of the pension is a 'guaranteed minimum pension' (GMP) what would be the effect of a partial transfer on the GMP obligations of the scheme?
- How to treat small pensions, where the cost of implementing a partial transfer is significant relative to the size of the pension?
- How frequently individuals could undertake a partial transfer? Clearly there will be a cost to the scheme of providing transfer quotes for partial transfers, and it would be inappropriate for DB schemes to be treated like 'cash machines' by members.

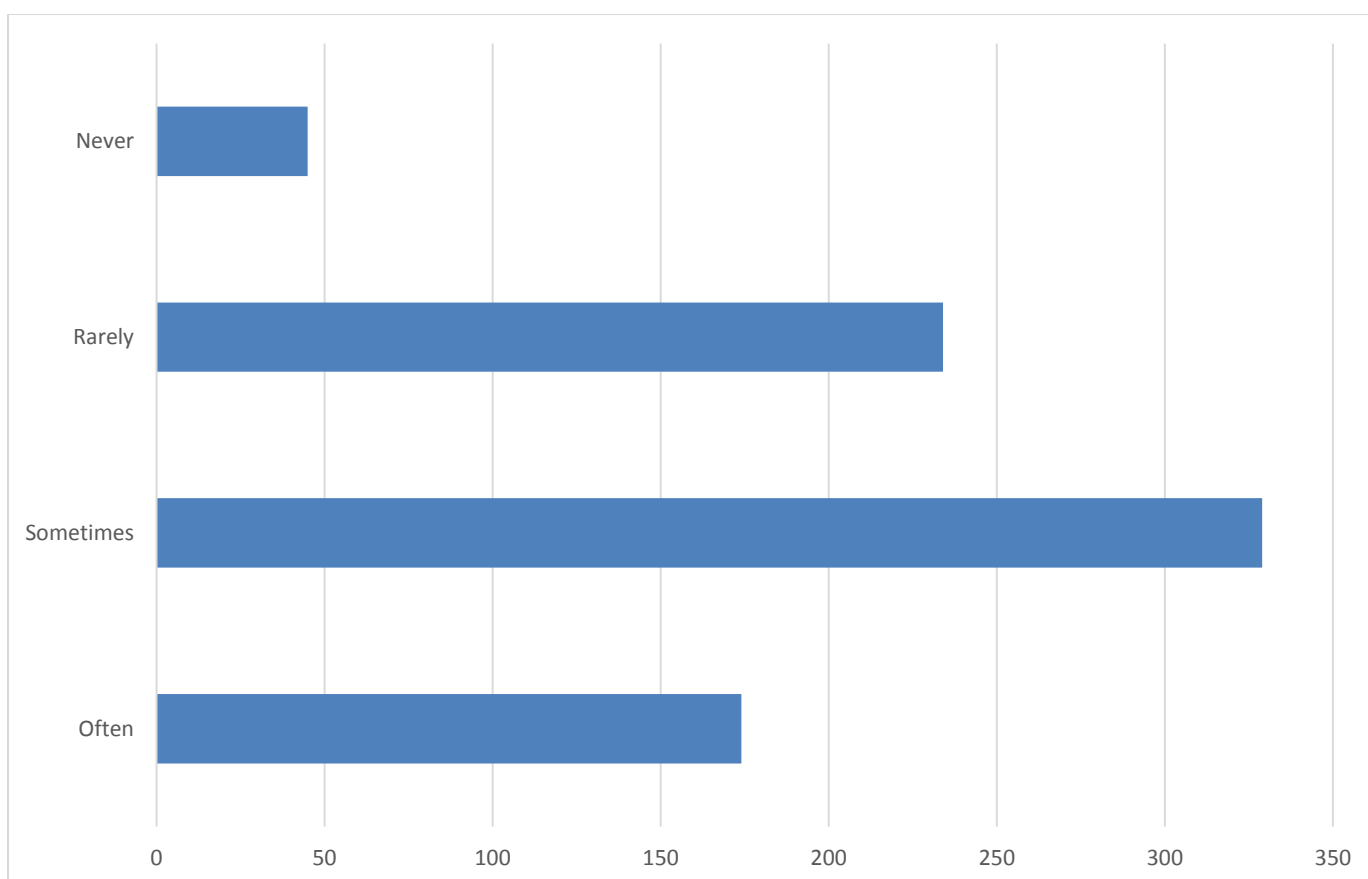
Whilst these practical issues create some challenges, good practice is emerging from a number of schemes who have developed ways of implementing partial transfers in a cost-effective way.

c) Standardised / ‘template’ information provided alongside transfer quotations

In order to provide advice to clients considering a DB to DC transfer (or indeed any other retirement option), advisers need to fully understand the nature of the benefits being given up. Whilst a transfer value figure is part of the story, the adviser also needs to understand things like the current (ie revalued) value of the DB pension, the future revaluation and indexation of that DB pension, the value of survivor benefits under the DB pension scheme and so forth. Where this information is not forthcoming, advisers have to seek further information from the scheme and this can sometimes result in a transfer quote lapsing (after a period of three months has elapsed). This in turn means that a new quote has to be obtained - sometimes at a cost to the member – and the whole process can become very protracted and inefficient for all parties.

Chart 9 shows how often advisers encounter delays of this sort leading to a new transfer quote being required:

Chart 9. How often do you need to get a new CETV calculated because of processing delays?

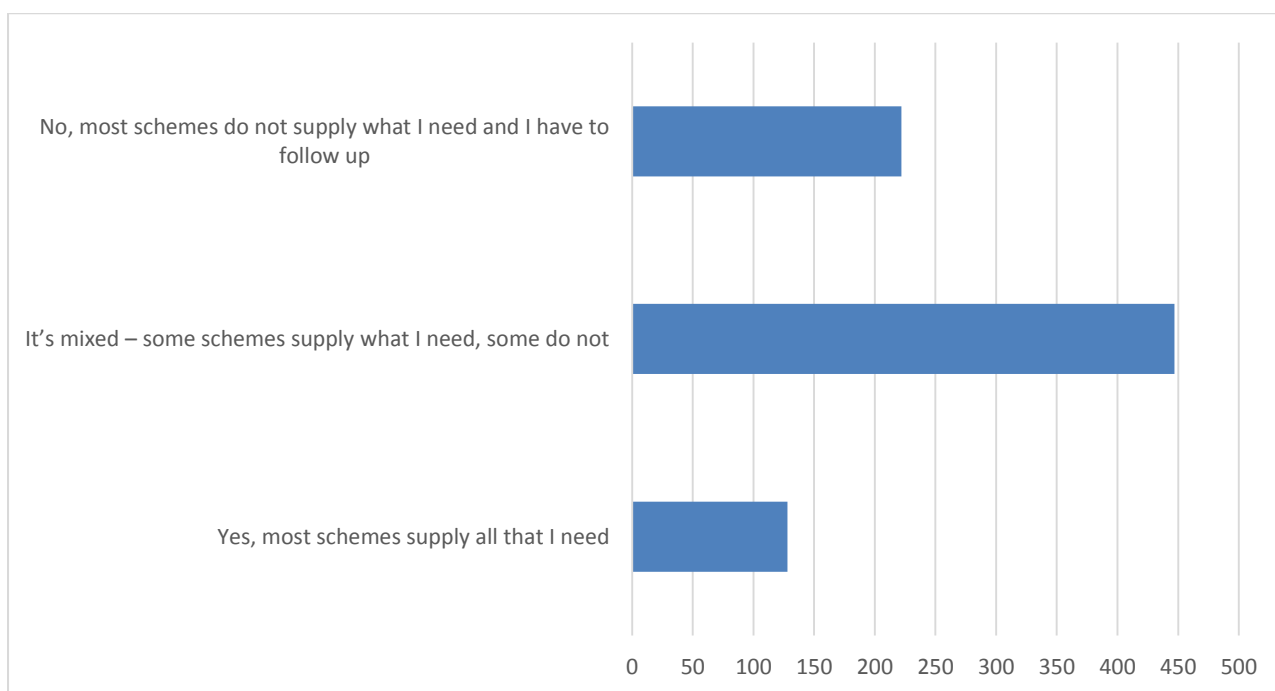


Most advisers have clearly had experience of new transfer quotations having to be obtained, which implies that the advice could not be provided and acted upon within three months of the date of

the transfer quote being issued, whilst nearly one quarter said that this was ‘often’ happening to them and to their clients.

In terms of the reason for these delays, lack of detail from schemes was clearly a big factor as shown in Chart 10:

Chart 10. Do you find you generally have a ready access to the information you need to assess the merits of a transfer value?



We therefore propose that DB schemes should be required to provide standardised information alongside transfer quotes, sufficient to allow an adviser to make a proper assessment of the relative attraction of remaining in the DB scheme or transferring out. If the potential for legislative change is limited, this could be implemented by changes to Pensions Regulator guidance or an industry Code of Good Practice in the first instance.

In a further survey question, more than 700 of the 806 advisers who responded to our survey said that they would find this ‘very useful’, though just under 100 thought that although this would be helpful they would probably still need to make further inquiries.

d) Update to FCA rules on advising on DB to DC transfers

The current rules around advising on DB to DC transfers were written before ‘pensions freedoms’ were implemented in April 2015. This raises serious questions about their fitness for purpose for those advising around transfers today. We therefore welcome the recently published consultation by the FCA (covered in Section 2 above) which proposes an updated regime.

Under the present system, advisers are expected to start from the assumption that a transfer is not in a client’s interests. They are then expected to undertake a comparison between the DB pension foregone and the income that could be secured if the transfer value was invested up to retirement and used to buy an annuity. If the yield on the investment needed to provide an annuity better than the DB pension foregone (the so-called ‘critical yield’) is relatively high, then the adviser will generally feel under pressure to recommend against the transfer⁵.

Whilst the FCA would be at pains to stress that this is not a mechanistic process, and that the adviser is free to recommend a transfer even with a relatively high ‘critical yield’, many advisers are nervous that if things do not turn out well for their client they will be open to subsequent challenge for recommending a transfer. There is also evidence that providers of Professional Indemnity Insurance take a dim view of advisers who recommend transfers where critical yields are relatively high and this in turn can manifest itself in increased premiums to the advisory firm.

Given that many of those choosing to exercise their pension freedoms do so precisely because they want an alternative to a regular, guaranteed income for life, it seems odd to continue to regard the purchase of an annuity as the central benchmark when advising on transfers.

This was a strong theme of the responses to our adviser survey. Verbatim comments when asked how the current regulations around transfers should be changed included:

“do away with comparing the purchase of an annuity against DB scheme, because the client wouldn't purchase an annuity from the transfer proceeds!!!!!!!!!!!!”

“removal of TVAs comparison against irrelevant annuity”

“get rid of the reliance of the TVAs! - it should be used but not relied upon”

“alter the assumption basis for comparison. If someone needs a secure income then a transfer of any kind is unlikely to meet their needs. Why do we compare annuity-based comparison when that is almost never what a client wants?”

The proposed new FCA regime⁶ does not do away with the concept of benchmarking against an annuity but seeks to communicate the information in a different way. Rather than calculate a ‘critical yield’ advisers will have to present a lump sum figure for the amount of cash which would

⁵ Under FCA requirements, this analysis is undertaken using a prescribed ‘Transfer Value Analysis’ approach and the results are referred to as a ‘TVAS’.

⁶ Source: FCA CP17/16 – Advising on pension transfers, June 2017

be required today to generate a regular income at retirement equivalent to the DB pension given up. This will then be compared with the actual size of the transfer value. It is argued that this will be easier for clients to understand.

In addition, advisers will be expected to consider:

- the client's outgoings and therefore potential income needs throughout retirement;
- the role of the ceding and receiving scheme in meeting those income needs, in addition to any other means available to the client – effectively obtaining an understanding of the client's potential cashflows;
- the role of death benefits on a fair basis, for example where the death benefit in the receiving scheme will take the form of a lump sum, then the death benefits in the ceding scheme should also be assessed on a capitalised basis, and both should take account of expected differences over time.

Based on our adviser survey, we would expect these changes to be welcomed by advisers. Some of their suggestions for changes to the regulatory regime included:

“we should be looking at longevity of income stream and the ability to draw higher income in early years then reducing as the ability to enjoy diminishes”

“I think the use of cashflow modelling should be an absolute requirement in transacting such business”

“include compulsory cashflow modelling assuming 2/3/4% growth”

“not so much emphasis on critical yield as opposed to client circumstances and their objectives”

In addition, the proposed new regulatory regime refines the requirement on advisers to start from the presumption that a transfer will not be in the individual client's interests. The Consultation Paper notes that the advent of 'pensions freedoms' has tipped the balance for some individuals so that transfers which might previously not have been in their interests could now be suitable. As a result, whilst the FCA continues to believe that transfers will, in general, not be in a client's interests, advisers will now be expected to start from a 'neutral' position in respect of the particular client who they are advising.

We welcome the efforts by the FCA to update their advice framework to reflect the impact of pensions freedoms and other policy changes. We believe that advisers should look at the 'holistic' position of clients rather than give undue weight to crude measures of 'critical yield'.

e) Advice and support post-retirement

Whilst advice is mandatory for those wishing to transfer pension rights worth £30,000 or more, there is no requirement to receive ongoing advice or guidance once the transfer has taken place. Given that typical transfers are greater than the average house price in the UK, making good choices about the ongoing investment of the transferred sum will be of central importance to the long-term financial well-being of the individual. Yet there is little clear evidence as to how many individuals who have made large transfers are then seeking to manage their wealth on a 'DIY' basis, nor as to whether such individuals are achieving good outcomes.

We believe that both the Financial Advice Market Review and the FCA's most recent consultation on DB to DC transfer advice should consider whether more can be done to support individuals not just at the point of making a transfer but also through retirement to ensure that their transferred pension wealth is well managed. The same support should of course also be provided to those retiring with DC pots, as highlighted by the FCA's 2017 Retirement Outcomes Review.

6. Conclusions

Vast amounts of pension wealth lie in the nation's DB pension schemes, and individuals have more choices about how to access that wealth than ever before. But many individuals with DB pension wealth appear to have little or no information about the choices available to them, nor the support they need to make the best choices.

We believe that schemes, advisers, regulators and government all have a part to play in improving the situation. In many cases there is a 'win-win', with schemes able to reduce their liabilities whilst supporting scheme members to make the choices that best fit their individual circumstances. Legislative and regulatory changes such as improved information from pension schemes, an updated regime for advising on DB to DC transfers and new legal rights to partial transfers could all help to deliver better outcomes for savers.

This is a special policy paper, jointly produced by LCP and Royal London. Royal London have produced a number of previous policy papers.

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