

GUIDE TO

MEMBER OPTIONS

2019



HELLO

Following the introduction of 'Freedom and Choice' for defined contribution (DC) pensions in April 2015, we have seen increasing numbers of members transfer out of defined benefit (DB) schemes to access these new freedoms.

While these options could be attractive for some members, they represent important considerations for both trustees and companies alike:

- For trustees, considerations include how to support members to fully understand the options available, whether to increase the range of options available in the DB scheme itself and implications for a scheme's investment strategy; and
- For corporate sponsors, a consideration may be using the new flexibilities as a way to manage risks in a scheme, reduce costs and bridge the gap to a possible future buyout.

Whether you are a trustee or a corporate sponsor, there is a range of issues to consider in relation to the new pensions freedoms.

In our 2019 review, we take a look at:

- How trustees are supporting members in their decision making at retirement
- The latest on bulk member options exercises and the IFA market
- Examples of schemes which have used member options exercises to bridge the gap to buyout
- Trends in relation to partial transfer options
- Investment considerations of carrying out member options exercises

Our insights are underpinned by the results of Aon's 2019 Member Options Survey covering 320 defined benefit schemes, as well as our experience advising on more member options exercises than any other consultancy in recent years. In this chapter we address bulk exercises, focusing on IFA support and implications of GMP Equalisation.



BEN ROE
SENIOR PARTNER AND
HEAD OF AON'S MEMBER
OPTIONS TEAM

A man and a woman are standing in a workshop or office, looking at documents. The man is holding a spiral notebook, and the woman is holding a sheet of paper. They are both wearing denim jackets. In the background, there is a whiteboard with sticky notes and a wooden shelf with a small house model and a potted plant.

AN UPDATE ON BULK EXERCISES

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2 AN UPDATE ON BULK EXERCISES

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During 2018, Aon advised on a new bulk transfer value exercise or Pension Increase Exchange (PIE) exercise roughly every other week, covering a wide range of schemes from £100m to over £7bn in size. We continue to see extensive activity in the markets this year. So, what kinds of offerings are we seeing?



Jamil Merali
PRINCIPAL CONSULTANT



Offer terms, the IFA market and GMP equalisation should be considered when running a bulk exercise



TYPICAL OFFER TERMS

Based on recent experience, most bulk transfer exercises offered an enhancement to the scheme's standard transfer value – on average around 20% and we see a correlation between the size of the enhancement and the level of take up of the transfer value option.

PIE exercises also remained very popular in 2018. Typical offer terms provided members with 70-80% of the value of their pension increases, with the remaining 20-30% improving the funding position of the scheme. However, unlike transfer value exercises, take up of the PIE offer is not generally correlated to the terms on offer. This is because in our experience, members already have a view on how much they value inflation protection, which is independent of the terms of the offer.

IFA MARKET

The IFA market remains busy. However, this has not been a limiting factor so far for schemes wishing to conduct member options exercises – provided they are planned in advance with some flexibility on precise timing, to accommodate individual firms' availability.

In addition, 2018 saw a number of new firms enter the market, further increasing capacity for schemes looking to run member options exercises. What is the appetite within the IFA market for this type of work?

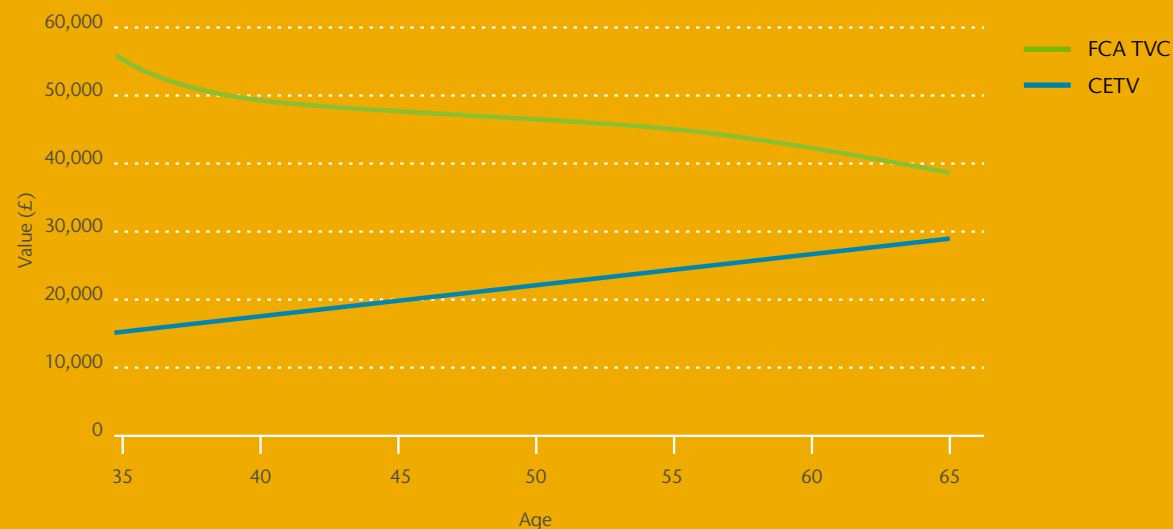
Case	Coverage in the IFA market
PIE	Most of the IFAs that Aon works with will offer advice to current pensioners and some IFAs specialise in PIE advice.
IFA support 'at retirement'	In our experience, almost all IFAs are willing to advise on standard transfer cases.
Bulk exercises – Over 55s	Most IFAs will offer advice to members over 55.
Bulk exercises – Under 55s	Far fewer IFAs are prepared to offer advice here. This may be driven in part by the new TVC regulations introduced on 1 October 2018.

NEW RULES

New rules for IFAs came into force on 1 October 2018. They now need to provide members with a value of how much the benefits in their defined benefit scheme would cost today in the open market, known as the Transfer Value Comparator (TVC). The TVC shows both the transfer that has been offered by

the scheme, and the estimated 'risk free' cost of replacing the member's DB income through an insured annuity. This is illustrated below for a typical scheme. The new advice regime focuses on members having a clear retirement plan; and taking a transfer is deemed to be a suitable way to meet that need. Therefore,

this is unlikely to have an impact on older members who typically do have a retirement plan. However, an IFA may now be less likely to advise a younger member to take a transfer value, particularly where they do not have a clear retirement plan.

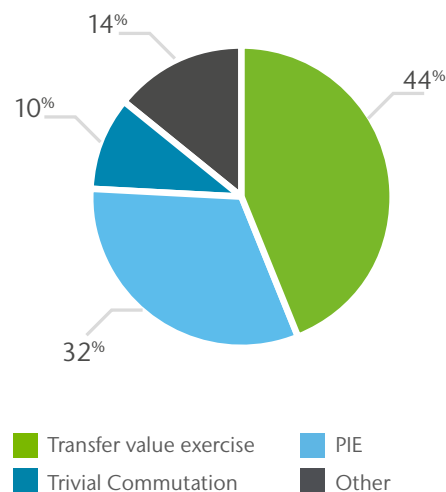


GMP EQUALISATION: A POTENTIAL BANANA SKIN?

On 26 October 2018, the High Court published its judgment on Lloyds Banking Group Pension Trustees Limited vs Lloyds Bank plc (and others). The pensions industry finally had some guidance on this long-standing issue. Many had expected that the requirement to equalise GMPs between the sexes would throw a spanner into the works of bulk member options exercises.

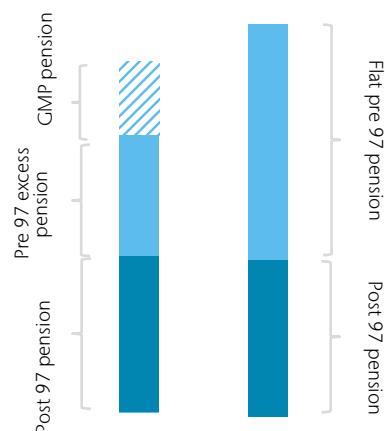
While GMP equalisation brings its own challenges, evidence to date suggests the impact on transfer value and PIE exercises has been more limited in practice. Since the judgment date, we are only aware of one scheme that has placed a bulk exercise on hold due to the legal complexities. Furthermore, based on the results of Aon's 2019 Member Options Survey, 41% of schemes are still planning to run a bulk exercise in the next couple of years.

What bulk exercises are schemes planning?



GMP CONVERSION: A POTENTIAL WAY FORWARD?

In light of the GMP equalisation judgment, we are starting to see a greater focus on GMP conversion as a possible solution. This has the potential to make a PIE exercise more attractive, as the converted GMP pension could be included in the PIE offer.



PRIOR TO CONVERSION AND PIE:

Scheme pension is a rainbow of multiple tranches of benefit. Only non-GMP pre 97 tranches are eligible for PIE.

POST GMP CONVERSION AND PIE:

GMP can be converted into a regular scheme pension which is then in scope for PIE. A range of different increases can be exchanged for a higher flat pre 97 pension.

Bringing the GMP part of the pension into scope for a PIE exercise typically increases potential savings by around 20%, but this is very scheme-specific.

WHAT IS GMP CONVERSION?

One of the administrative challenges of dealing with GMP is that it usually increases in a different way to other scheme benefits, both in deferment and payment.

GMP conversion permits schemes to transform an existing GMP benefit into a different form of pension with the same actuarial value. In doing so, a potentially complex series of pension tranches can be exchanged for a single benefit. Not only is this significantly easier to administer, it should be easier and cheaper to secure with an insurer when the time comes to buyout.

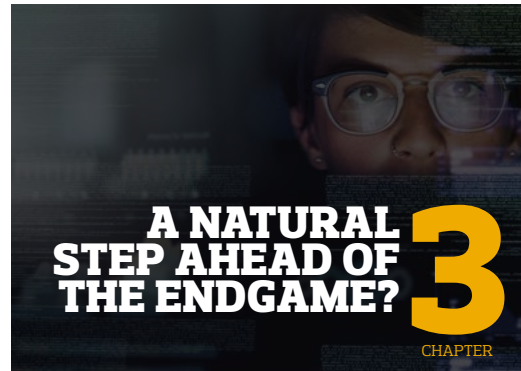
In summary, these type of exercises continue to feature prominently on corporate and trustee agendas, with a significant number of exercises either being planned or already underway in 2019. IFAs in this space continue to be busy but there is capacity in the market, supported by new entrants and increased capacity in existing firms. While most schemes have yet to address the issue of GMP equalisation, we do not expect this to be a significant barrier in the near term. In any case, we expect 2019 to be another busy year for scheme sponsors and trustees.

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OUR PEOPLE

Ben Roe
SENIOR PARTNER AND
HEAD OF MEMBER
OPTIONS



David Bunkle
PARTNER



Jamil Merali
PRINCIPAL CONSULTANT



Lauren Ramsey
SENIOR CONSULTANT



Louise Tucker
CONSULTANT



Kelly Hurren
PRINCIPAL CONSULTANT



Andrew Gaskell
SENIOR CONSULTANT



Tom Clarke
SENIOR CONSULTANT



Thomas Williams
SENIOR CONSULTANT



Oliver Cowan
SENIOR CONSULTANT



Andrew Fryer
PRINCIPAL CONSULTANT



Paul Estruch
SENIOR CONSULTANT



Gemma Cowan
PRINCIPAL CONSULTANT



Richard Cook
SENIOR CONSULTANT



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Satnam Rai
PRINCIPAL CONSULTANT

