

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. This chapter looks at the trend for member option exercises to be run alongside the insurance broking process to make buyout more affordable. We include case studies on how this was achieved on fully funded buyouts for Rentokil and PA Consulting.



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



A NATURAL STEP AHEAD OF THE ENDGAME?

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2018 saw more full pension scheme buyouts over £500m than there had been in the previous three years combined, and a definite trend to move directly to full buyout rather than opting for a series of buy-ins first. For many schemes, the path to full buyout can seem a long way off. But what if there was a faster way to get there?

In recent years we have seen member options exercises being successfully carried out in advance of approaching the insurance market to bring down the cost of the buyout premium. What if we were able to integrate these exercises and carry them out at the same time, rather than treating them as separate projects?



IN 2018
OVER

£500M+

TRANSACTIONED IN FULL PENSION
SCHEME BUYOUTS



Tom Clarke
SENIOR CONSULTANT

CASE STUDIES

Schemes integrating member options with full buyout

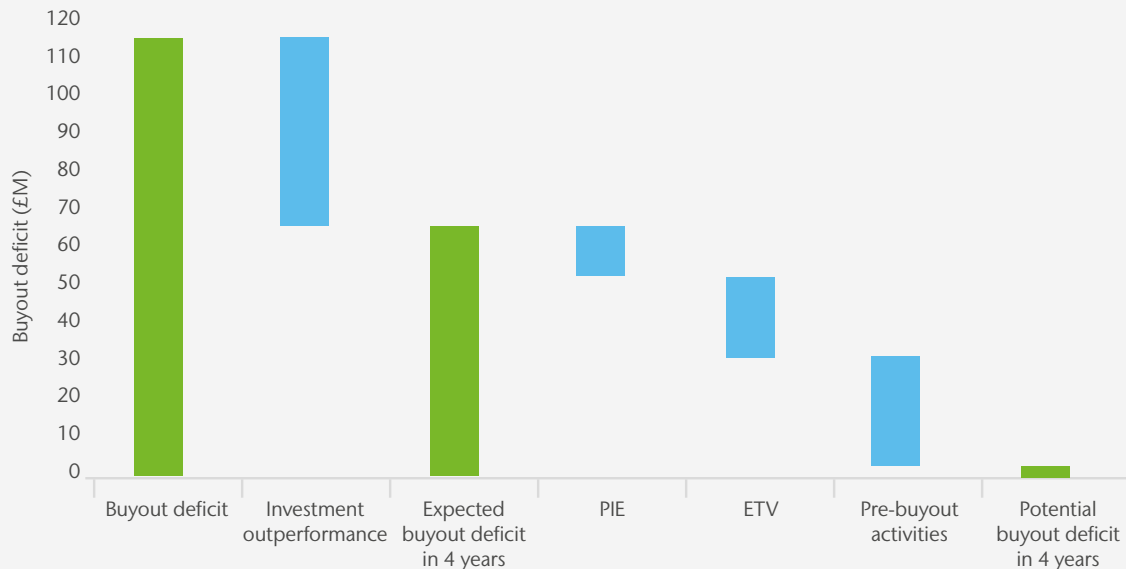


During 2018, Aon advised on fully-funded buyouts for Rentokil and PA Consulting, which were two of the largest exercises that we have ever seen. Both of these exercises integrated member options into the buyout process.

Although the parent companies of the two schemes were very different, a few years ago they both shared a common goal – to secure member benefits and free their businesses from their large pension scheme obligations. They were both keen on reducing risk, but their buyout targets were a long way off without a large cash injection.

When insurance pricing improved towards the end of 2016, a buyout started to look more affordable, so the schemes started to consider the possibility of carrying out member options exercises to help bridge the gap. At this point, neither scheme would have believed that what they went on to achieve with Aon in the next two years would have been possible.

Expected evolution of the buyout deficit at the start of the project.



RESULTS

Both schemes actually ended up with a surplus – a better outcome than envisaged at the start of the project. Members were given the option to reshape or transfer their benefits out of the schemes – and these exercises were carried out alongside the insurance broking process. Running the processes alongside each other in this way was a first in the market in 2018.

“This project has achieved the outcome we really wanted. By a collaborative approach from all parties, we have been able to secure a deal which no-one imagined possible at the outset.”

Kully Janjuah, PA Consulting



BUYOUT SPECIFIC CONSIDERATIONS

On the face of it, the structure of these exercises was similar to any other member options exercise; however, the key difference here is the proximity to buyout. If members took no action, they would end up with an insurance policy at the point of buyout. This means there are several special considerations for these projects compared to a regular member options exercise.

SCHEME TERMS V INSURER TERMS

After buyout, members will still be able to take a transfer value from the insurer, but this means that the transfer terms available in the scheme will need to be compared with the transfer terms that the insurers would offer members following the transaction.

The trustees in the two cases mentioned above were able to offer members terms that were more generous than the terms of the insurer, yet still provided savings on the buyout premium.

INSURER LIAISON

If the timing of the exercises means they can be concluded before the final round of insurer pricing, the impact can be captured in this pricing.

For one scheme, the buyout happened on accelerated timescales and, in this case, the insurer agreed to underwrite the risks associated with the transfer exercise as part of the final round of pricing. This was a first in the market and allowed the trustees and company to lock into the transaction more quickly than would otherwise have been the case.

COMMUNICATION WITH MEMBERS

Communication material will need to be carefully drafted to explain the offer being made, the potential buyout transaction and that the IFA advice is being provided to help members decide whether or not to transfer ahead of buyout. High quality advice is crucial in these circumstances, so it will also be necessary to fully brief the IFA so that they understand the process.

In one of our case studies, 85% of the members contacted the IFA for advice, which shows the importance of providing access to good quality advice in such projects.

IN THE FUTURE

As more schemes look to the insurance market as a way of reducing risk, we see it becoming increasingly common for member options exercises to be carried out alongside the insurance broking process. For those schemes that are moving towards full funding, there is now a lot of merit in giving serious consideration to whether that buyout target is closer than previously thought.

ALTERNATIVES TO BUYOUT

Throughout this article we have focused on buyout as the ultimate long-term destination, but it would be wrong not to comment on the alternatives to buyout at this stage.

Following the PLSA's document 'The case for consolidation' in 2017, 2018 saw the launch of two superfunds, 'The Pension SuperFund' and 'Clara'. Both have very different business models, and understanding the differences would be crucial for any scheme considering these as an option. What their propositions have in common is that they both involve taking on financial responsibility for the scheme, providing strong security for members and doing so at a cost that is expected to be cheaper than passing liabilities on to an insurer. The DWP has published a consultation document covering the consolidation of DB schemes and new regulation is expected in 2019. Although this will not be right for everyone, it could still be an exciting development for some. So watch this space!

READ PREVIOUS CHAPTERS

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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

