

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 how partial transfers can bring members the best of both worlds – benefiting from defined benefit security and defined benefit contribution flexibility at the same time.



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

A man with a beard, wearing a blue button-down shirt, is seated in the driver's seat of a car. He is holding a smartphone in his right hand and has a laptop open on his lap. The car's interior, including the leather seats and dashboard, is visible. The background is slightly blurred, suggesting the car is parked or moving slowly. The overall lighting is somewhat dim, with a blue tint.

PARTIAL TRANSFERS

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CHAPTER

4 PARTIAL TRANSFERS

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Following the introduction of pensions freedoms, most schemes have experienced an increase in members transferring out to take advantage of pensions flexibilities. However, for members, the transfer decision leads to a 'binary' choice between long-term security from the regular income of a defined benefit pension, versus greater flexibility from transferring to the defined contribution world.

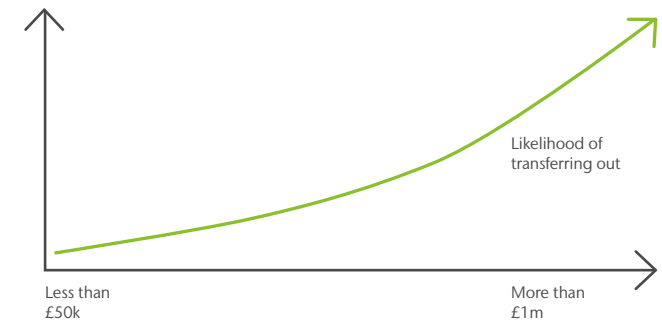
A partial transfer gives members the option of transferring just a proportion of their defined benefit pension and leaving the rest in the scheme. So, what is not to like about an option that provides members with both security and flexibility?



RICHARD COOK
SENIOR CONSULTANT

THE BEST OF BOTH WORLDS?

There are clear advantages for some members who could benefit from defined benefit security and defined contribution flexibility at the same time. Aon's analysis below shows that when only provided with the option of a full transfer, the members most likely to transfer are those with the largest pots.



Member decision by size of transfer

Offering partial transfers is seen as an extension to the full transfer process

Members with modest-sized pension pots may not be able to afford the risk of transferring all their defined benefit pension, but if a partial transfer was available, they may benefit from transferring a portion. Additionally, members who have multiple defined benefit pensions may be comfortable transferring one of their pots in its entirety and leaving the others unchanged. However, long-serving members do not have this flexibility unless they are provided a partial transfer option.

So, plenty of potential advantages for members – but what about trustees and sponsors?

A partial transfer may give some comfort to trustees and sponsors who are concerned that a binary option may not lead to best outcomes for members. Where there are concerns from trustees and sponsors regarding the risk of members/employees running out of funds in retirement, a partial transfer option can address those concerns. It also opens up opportunities for a much wider spectrum of members, leading to greater risk reduction overall.

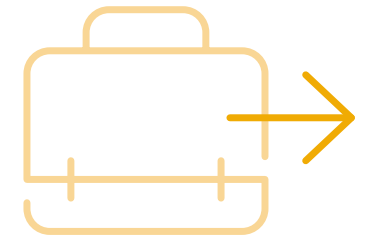
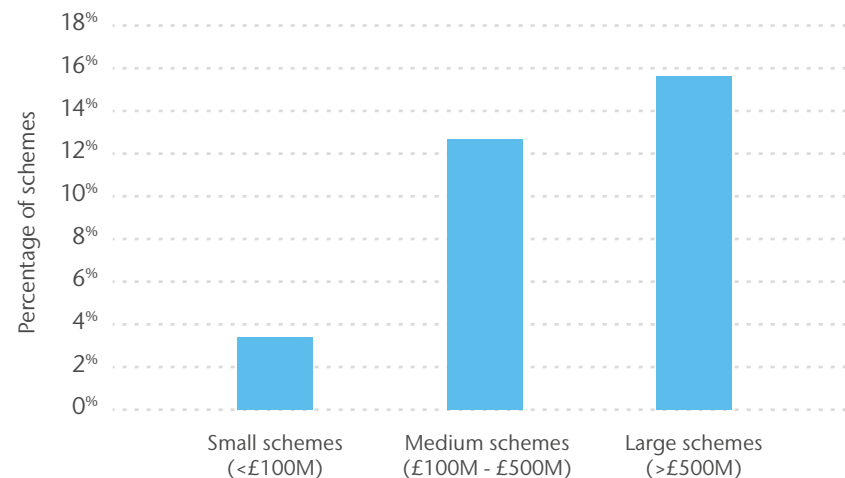
SO, HOW POPULAR IS THIS OPTION?

It is early days, but Aon's 2019 Member Options Survey showed that, where a scheme provides members with the transfer option at retirement, slightly more than one in ten schemes offer a partial transfer option – with the flexibility more likely to be found in larger schemes.

Given the advantages, why are more schemes not doing this?

The most likely reason is that schemes have only recently started considering the support they provide around full transfers – such as communications, online tools and IFA support. Offering partial transfers is seen as an extension to the full transfer process and this is only just starting to make it onto the agenda for most schemes.

Schemes offering a partial transfer option alongside a transfer value at retirement



1 in 10

Currently around 1 in 10 schemes offer a partial transfer option alongside full transfer values – it's likely more schemes will be considering this option going forwards

IT SOUNDS LIKE A WIN-WIN, SO ARE THERE ANY PITFALLS?

We have talked about the potential advantages of offering members a partial transfer option, but there are some potential pitfalls to consider when setting up such an option.

COMPLEXITY

First off, although it may be a valuable option for a wide range of members, it has the danger of leading to member disengagement if not communicated properly. Clear and engaging communications that do not overwhelm members are therefore vital to realise the benefits.

ADMINISTRATION

Secondly, there will be administration considerations when the option is first set up to ensure the administrators can calculate the correct portion of benefits to transfer and the correct portion to put into payment at retirement. Administrative challenges can be reduced if the option is well designed – administrators are used to processing a cash lump sum option on behalf of most members at retirement; a partial transfer option would work in a similar way. Options to reduce the administration burden include limiting the availability

of the option to ‘at retirement’ only and to limit the offer to fixed proportions, such as 25%, 50% or 75% of pension.

In addition to administration and communication, there are a range of structural considerations, including:

- Which tranches of pension should be transferred first – eg, will the ‘more expensive’ or complicated slices of pension be transferred first (maximising any funding savings and risk reduction)?
- How do schemes deal with smaller benefits? Does the scheme impose a minimum size of partial transfer or residual benefit left in the scheme?
- Will the option be included as part of any bulk exercise, or just as a ‘business as usual’ option?
- Will the option be available at any point before retirement, only at retirement as a one-off or unlimited?

Partial transfers will not be right for all schemes and they need to be carefully structured to reduce complexity. Given the benefits, we think more schemes will be considering this option going forwards.

CASE STUDY

COMPANY EXTENDING OPTIONS FOR ITS EMPLOYEES

TASK

Ford Motor Company Limited recently put in place a standard partial transfer option for its 8,000 active employees to consider at the point of retirement.

The Company, Trustees and Union were concerned that only offering the option of a full transfer was too much of a binary choice for members between an income from the Ford Pension Funds or transferring all their benefits to an alternative arrangement. The view was this could lead to significant risks for some employees and so they worked closely via a joint working group to address these concerns.

SOLUTION

A partial transfer was one of the solutions decided upon, along with increased communications and an online and paper-based service to help educate employees. Members are offered the option to transfer 50% of their pension at retirement and retain the rest in the fund, with those deciding to take up the option benefiting from defined benefit pension, defined contribution flexibility and retaining an ongoing link with the group.

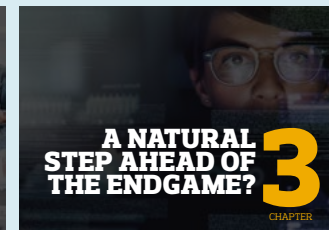
The option was made simpler to administer and for employees to understand by providing one partial transfer option of 50% at retirement, along with the full transfer option. The more complicated GMP slice of pension is transferred out first, leaving the scheme with a simpler set of benefits in respect of partially transferring members.



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