BARNETT WADDINGHAM
beyond the expected

FTSE350 pensions

DB transfers and the endgame

The ‘Freedom and Choice’ reforms were a major event in the pensions industry. The secondary impact on defined benefit (DB) pension schemes, as members were provided with a new option to access the cash value of their DB pension, rapidly established a new market for DB pension transfers. Six years on, and the industry appears to be finally settling on the best approach for supporting members with this complex issue.

From a DB funding perspective, the market for DB pension transfers provided a unique opportunity for companies to settle liabilities at a lower cost than had previously been the case. In addition to this, there was a growing recognition that a DB pension was not the optimal form of retirement income for all members. As a result, putting in place a framework to support members to make an informed decision in relation to their retirement benefits has become the gold standard for DB schemes — and a crucial component of DB endgame planning.

INTRO VIDEO -
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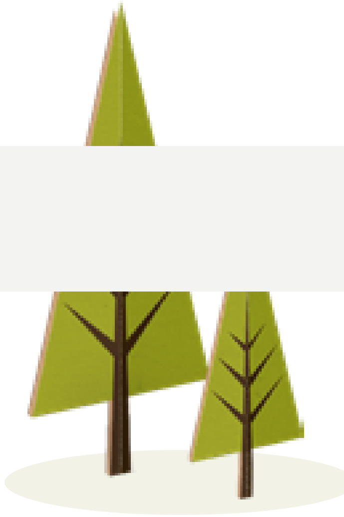
In this analysis of the DB schemes of the FTSE350 companies, we look at the transfer value experience of the FTSE350 DB schemes since ‘Freedom and Choice’ and how transfer values will influence the time to the DB endgame.

Has the transfer value market peaked?

The chart opposite shows the benefits paid from the FTSE350 DB schemes since 2012, divided between the amounts expected prior to the 'Freedom and Choice' reforms and the estimated amounts arising after the introduction of the 'Freedom and Choice' reforms.

Overall, our analysis suggests that an estimated £45bn of additional benefit payments have been paid out of the FTSE350 DB schemes over the last six years due to the 'Freedom and Choice' reforms. The UK's four largest banks have seen an especially high outflow of transfer payments, with the £4.2bn paid out by Barclays in 2017 leading the way.

However, since the initial spike in transfer payments, the market appears to have slowed down over the last couple of years. This is consistent with our experience of the transfer value market, based on the data collected from our clients, and we have set out below the various reasons for this slowdown in activity.



Reasons for the slowdown in DB pension transfer activity +

As noted, Covid-19 resulted in a clear reduction in the number of transfer value exercises being carried out, as well as an overall decline in transfer requests from individuals. This has resulted in schemes retaining more liability than they otherwise would have done - and a significant backlog of demand from those individuals that would ordinarily have considered transferring their benefits. There is also an expectation that transfer requests will increase as the government's Covid-related support measures unwind and individuals reassess their financial options.

We are now seeing these factors come into play, as our data shows transfer activity returning to pre-pandemic levels. It is therefore an ideal time for companies and trustees to revisit their strategy for approaching this issue.

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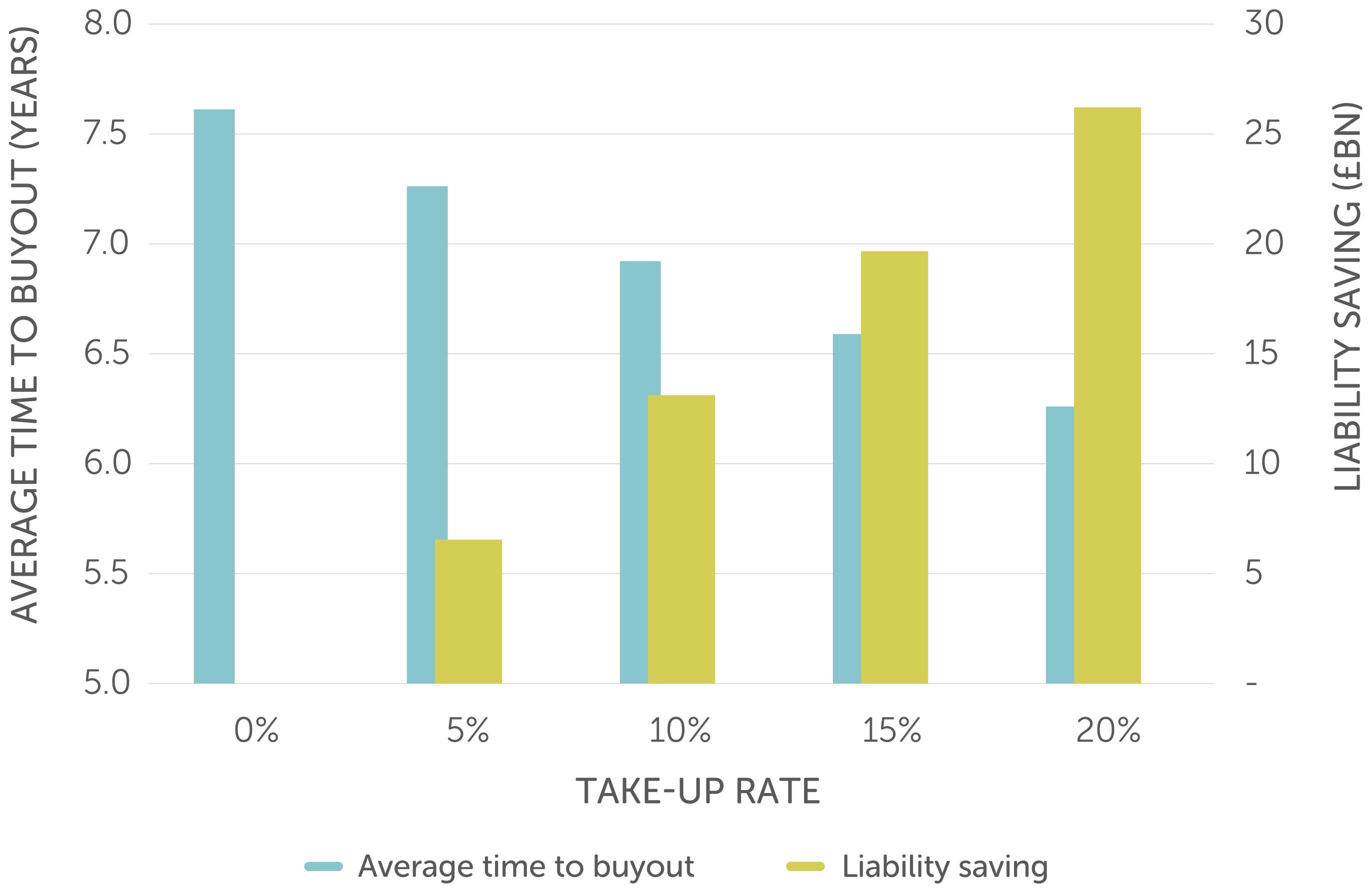
Recovery of DB transfer activity

While we do not expect the transfer market to return to the heights experienced in 2017 and 2018, we believe that there remains an underlying level of demand that means transfers will continue to form an important component of DB scheme funding strategies over the coming years.

Accelerating the DB endgame

One of the key considerations for companies undertaking transfer value exercises, alongside achieving better member outcomes, is the impact that the exercise will have on the DB endgame journey. Because transfer values are typically paid out at a cost that is lower than the liability reserve required to achieve the scheme's long-term objective, a well-run transfer value exercise can have a significant impact on the overall cost and timescales to reach that objective.

The chart opposite shows the average time to buyout[1] for the FTSE350 companies as at 31 May 2021, and how this changes depending on the proportion of deferred members that choose to transfer their benefits. It also shows the overall liability savings anticipated relative to the cost of securing annuities for these members.



The chart shows the average time to buyout reducing as the proportion of members transferring increases. As an example, if 15% of deferred members choose to transfer their benefits, the average time to buyout for the FTSE350 companies will reduce by around one year. The liability saving resulting from a 15% take up of the transfer option would be around £20bn relative to amount required to secure annuities for these members – funds that could be used to bridge the gap to buyout for the remaining members.

1. The average time to buyout calculation excludes schemes where time to buyout exceeds 30 years

Support framework and risk management

Agreeing a strategy for supporting members in relation to DB transfers can be a tricky undertaking. However, a clearer idea of industry best practice has emerged over recent years as the market has evolved. With transfer requests returning to pre-pandemic levels, and individuals potentially facing difficult financial decisions, this is an issue that should be high on company and trustee agendas – either to put in place a support framework if this is not already in place, or to review any existing support strategies.

Given the difficulties members now face accessing suitable transfer advice, it is becoming more and more difficult for those managing DB schemes to justify taking no action in this area. Putting in place a robust support framework, built on solid due diligence and technology, will ensure that members make the decision that is right for them, leading to better member outcomes.

For companies and trustees, the risk management benefits of a DB transfer support framework should also be considered. If a long-term funding strategy has been agreed, it is straightforward to assess the value of supporting members in relation to DB transfers. More often than not, the cost of putting in place a support framework will be easily recovered by liabilities being settled at a lower cost and a related decrease in the time to achieve the long-term funding objective.

Companies and trustees should also consider the wider array of options that could be offered to members; for example, pension increase exchange and a bridging pension option. The risk-reducing benefits of each option will vary depending on each scheme's individual circumstances — but the potential benefits should be assessed as part the wider journey plan.

DB Navigator®

Mapping the course of your DB pension scheme

DB Navigator® is our clear and simple decision-making framework that gives you the knowledge, structure and tools to optimise your strategy for tackling the journey towards your DB pension endgame.

It's packed with case studies to help you navigate each confluence, takeaways to steer you on the right course and videos to guide your DB pension scheme strategically through the choppy waters of endgame planning.

DB NAV VIDEO -
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Please contact your Barnett Waddingham consultant if you would like to discuss any of the above topics in more detail. Alternatively get in touch via the following:

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