New retirement options

For many schemes, introducing new retirement options could be a win-win for the company and scheme members. In an environment where companies and trustees are working extremely hard to manage their pension commitments, the advantage of reviewing retirement options is that new options can be implemented relatively quickly and cheaply.

**Partial or full transfers**

The new flexibility created by the minimum income requirement means that, for individuals whose overall pension benefits are above £20,000, it can be an attractive option to transfer out part or all of their scheme benefit at the point of retirement (in the new arrangement, they will have the freedom to take some or all of their transfer value as cash). For others, the rationale may be to re-shape their pension, e.g. no spouse's benefit for those who are single. Members have no statutory right to take a transfer value at retirement, if they are within a year of normal retirement age, but most scheme rules give the trustees discretion to allow such transfers (if not, a rule change should be straightforward).

In most schemes the assumptions used for transfer values and technical provisions are similar for a member at retirement age, so it is unlikely that this option will result in a saving on a technical provisions basis (a financial strain is actually more likely on an accounting basis). However, this option does result in liability being discharged at the point of a member's retirement, on a basis considerably weaker than self-sufficiency or buyout.

As an incentive, the company could consider offering an enhancement to the transfer value, but this would obviously increase the cost to the company.

**Why is the introduction of new retirement options attractive?**

The relatively new focus on retirement options has evolved from companies getting to grips with the principles of enhanced transfer value (ETV) and PIE bulk exercises. Some companies have completed ETV and PIE offers for their deferred and current pensioners respectively and are now exploring whether there is anything further they can do. In contrast, there are other companies that have ruled out doing these bulk exercises for philosophical or reputational reasons, but are still keen to do something to help manage down their pension liabilities.

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Re-vamping a scheme’s retirement options can be attractive for the following reasons:

**Possible reduction in past service liabilities**

In exactly the same way that a member exercising their right to commute pension for cash will often lead to a saving on a technical provisions or accounting basis, the PIE at retirement option can achieve the same effect. For this to happen the company needs to hold back some of the value of the increases being exchanged, e.g. only offer members 80% of the value when calculating the level of uplift.

Many schemes now have an explicit assumption in their liability calculations for the proportion of members that will exercise their cash commutation option. This principle can be extended to any retirement option and, for a PIE option, is likely to result in an immediate reduction in the scheme’s liabilities. Of course, the trustees and their scheme actuary will need to accept this assumption, if it is to count on the technical provisions basis.

**No cash injections**

The retirement options discussed in this Briefing do not usually require any form of enhancement from the company. Even if there is some form of enhancement, this only applies at the point of a member’s retirement, so any cash injections are on a drip-feed basis over a number of years.

**No bulk exercise**

As we are talking about member options at the point of retirement, there is no mass communication exercise and companies do not need to invest time or money managing a large scale exercise, which may only produce a low take-up rate.

**Code of practice does not apply**

The new code of good practice for incentive exercises is explicit that it does not cover the design and communication of retirement options, as long as these are available to all members at retirement. Whilst this should not be taken as an excuse for a lack of communication, guidance or advice to members, it does mean the company has much greater freedom to decide how it wants to apply best practice principles to the retirement option process for its scheme members.

**Practical issues to consider**

The introduction of these options may well require rule amendments, which in turn will need trustee agreement. However, new retirement options are often much more palatable to trustees than bulk exercises. They do not need to be concerned about a mass member offer, with all of the ensuing technical and practical issues, nor worry about compliance with the code of practice. Even if trustee agreement is not required, the company will want the trustees to be comfortable and supportive of the new options.

Typically, trustees will have questions in three main areas:

- how have the terms of the option been set, in particular when considering a PIE option, what proportion of the value of the increases being exchanged has been used to provide the uplift?
- how is the option going to be communicated to members?
- will members have access to independent financial advice?

The trustees’ perspective may be that these new options should be treated in a similar fashion to an ETV or PIE bulk exercise, with their implementation having close regard to the code of practice.

The company may well seek to argue that these new options are akin to cash commutation. Commutation terms are typically not cost neutral on a technical provisions basis. The communication to members is usually very light touch and almost always members make their decision without the company facilitating access to an IFA.

In terms of designing retirement options, a design created to generate a significant saving on a technical provisions or accounting basis may face greater challenge from the trustees and result in lower member take-up rates. So, from a company perspective, a balance needs to be struck between managing long term risks (by achieving high take-up rates) and achieving a reduction in liabilities.

As retirement options do not fall under the code of practice, the company and trustees have considerable scope to agree a communication and advice framework that works for their specific circumstances. Whilst there are no restrictions for a PIE offer, it should be remembered that members will be required to take financial advice before being able to transfer benefits out of the scheme. However, there is no legal requirement for the company to facilitate or fund that advice.

As a general point, it is worth noting that, as retirement options become more sophisticated, the need for more comprehensive communication is essential. To protect the member, the company and the trustees, providing access to independent advice may be a sensible step. This will also help alleviate a number of potential trustee concerns. For more information on how BAC can support you cost-effectively in this area, please look at our website or contact one of our team.