PARTIAL TRANSFERS OF DB BENEFITS: THE BEST OF BOTH WORLDS?

A joint policy paper between LCP and Royal London
October 2019

EXECUTIVE SUMMARY

The number of people transferring pensions away from DB schemes remains very high, with likely more than 500,000 members having transferred out of schemes since April 2015. There are continuing concerns about the quality of financial advice being provided to members, and information provided by schemes is not always timely or complete. This is leaving many members of DB schemes at risk of making poor decisions.

Compared to an “all or nothing” approach, partial transfers of DB benefits - taking out some of the value of the pension as a transfer to a DC pot while leaving some DB rights behind – offer considerable flexibility to members, which can result in better pension outcomes for individuals and can also reduce risk for trustees, employers and financial advisers.

In this paper we present research undertaken by both Royal London and LCP in summer 2019 on partial transfers:

- Royal London’s research shows that financial advisers are strongly in favour of partial transfers and would like to see more schemes offer partial transfers;

- LCP’s research shows that a steadily growing number of schemes are offering partial transfers to members, but it is still only a little over 20% of schemes, so that nearly 80% of members currently do not have this option.

There are administrative and other practical matters to consider when offering partial transfers. We discuss these in detail, providing some practical solutions for schemes.

We provide two case studies of schemes that have introduced partial transfers, providing detail on the approach they have adopted, including the Ford UK Pension Scheme. We also provide an illustrative detailed “partial transfer policy” used by another scheme.

We call on all pension schemes to proactively consider whether they should introduce partial transfers as an option for members. We also call on government and regulators – particularly the Pensions Regulator and FCA – to encourage schemes to offer the option of a partial transfer, and we are pleased that the FCA is currently consulting on partial transfers as an approach to reduce risk for members.

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1. Introduction – the place of pension flexibilities

Every individual has their own unique pension history. An individual's accrued pension rights can come from a variety of state, occupational and private pensions and these in turn will reflect their employment history, their family history and their individual choices about savings and investments. Most individuals will also reach retirement as part of a couple and their choices will at the very least be made in the context of the pension assets of another household member.

Against this background of huge diversity in accrued pension rights, pension flexibilities and freedoms allow individuals to shape and re-shape their pensions to better fit their needs and aspirations in later life. For some, the ability to take a reduced pension before normal pension age may offer welcome flexibility around the timing of retirement. For others, the ability to convert some of their pension wealth into an accessible capital sum may help them manage debts or support the next generation. For still others, the ability to move pensions so that a greater amount can be passed on to heirs and successors will be a priority.

For all of these reasons, pension flexibility, supported by appropriate impartial financial advice and guidance, can help individuals and families make the best of their pension wealth.

One key pension flexibility which has come to the fore in recent years has been the ability for members who have not yet retired to turn their Defined Benefit ("DB") pension into a 'cash equivalent' which can be transferred into a Defined Contribution ("DC") pension arrangement. This freedom has been hugely popular with more than 390,000 people exercising this right to transfer a total of £60bn of funds in the last three financial years, based on information supplied by the Pensions Regulator. Given the lag in this data, we estimate that the total number of people who have transferred in this way could now be closer to half a million.

Based on previous survey data, it seems likely that the large majority of the transfers reported by the Regulator were cases where an individual transferred out their entire rights from a DB scheme. In some cases, this will have been one DB scheme from a number of schemes of which they were a member. But in others – particularly where individuals have lifetime service with a single employer or in a single industry – this will have involved converting their entire pension rights (other than state pension) from an environment where all of the risk of the pension arrangement fell on the sponsoring employer to one where the individual bears all the risk around personal longevity, inflation, investment returns and expense management.

Whilst a full transfer of pension rights might be the right answer for some, this is in many cases an 'all-or-nothing' decision, given that most DB schemes do not routinely offer members the opportunity to transfer part of their DB pension rights out of the scheme, and leave the rest in the scheme.

The purpose of this paper is to review the current state of the market for DB transfers and in particular to consider one area – the potential for **partial** DB transfers – where we believe there is scope to achieve both better outcomes for members and reduced risk for trustees and employers.

We start with a discussion of the current DB transfer market, commenting on the volumes of DB transfers and the advice being given to members around transfers. Given that members are required by law to take advice for any transfer of more than £30,000, the role of financial advice in this debate is crucial. We therefore report on concerns that have been expressed both by the FCA and by Parliamentarians about whether the current advice market is working. We also look at whether schemes are doing enough to support members in understanding their options within the scheme and in pointing members to high quality impartial advice when they are thinking of transferring out.

We move on to explain in more detail what a partial DB transfer might involve and why it could represent an optimal outcome for some members. We then report on the results of two surveys – one undertaken by Royal London into the views of financial advisers on partial transfers and one undertaken by LCP into how DB pension schemes are approaching the issue. We also discuss some of the technical and practical issues that need to be considered by schemes that are exploring partial transfers.

We then provide two case studies of schemes which have opted to offer partial transfers to members in different ways. The first is the Ford UK Pension Scheme who have kindly given us details of their partial transfer offer to members. The second is an anonymised case study provided by LCP which shows a different approach to delivering partial transfers.

We finish by offering some concluding thoughts on whether partial transfers should be promoted and what more can be done to support members to achieve good outcomes when considering a DB transfer.

2. The current market for DB transfers

a) The state of the market

There are two main sources of data on the scale of DB transfers. The first is the returns provided to the Pensions Regulator by occupational pension schemes. The second is the data supplied to the FCA by financial advice firms. Each data source has its limitations but taken together they give us a broad indication of what has happened to the transfer market since the introduction of pension freedoms.

i) Data from the Pensions Regulator

Returns provided to the Pensions Regulator by DB schemes are now required to report on the number and value of DB transfers. By its nature, this data is subject to a considerable time lag. For example, data for annual returns received in 2018/19 (which is the most recent data available) will include annual reports received in April 2018, which in turn will report on transfers which took place back in 2017. Specifically, the Pensions Regulator reports that for the 2018/19 information (which they have recently supplied in response to a Freedom of Information request by Royal London) the majority of scheme year end dates are either December 2017 or March 2018. The data also needs considerable 'cleaning' to deal with under-reporting and to strip out bulk transfers which are not relevant for these purposes, which creates some uncertainty around the results.

The following table shows the volume and value of DB transfers on this basis for each of the last three financial years:

Reporting year	Number of transfers	Value of transfers
2016/17	80,000	£12 bn (est)
2017/18	100,000	£14 bn
2018/19	210,000	£34 bn
Total	**390,000**	**£60 bn**

Sources: 2017/18 and 2018/19 figures confirmed in new FOI supplied to Royal London. 2016/17 volume figure from FOI on TPR website. Value figure for 2016/17 estimated on basis of average transfer value of approx. £150k across 2017/18 and 2018/19 data.

In absolute terms, the figures in the above table are very striking for their scale, especially given that they do not capture the most recent transfers. It seems quite likely that approaching half a million members have by now transferred out of their DB pension scheme, with the total amount transferred now well in excess of £60 billion. This compares with total DB scheme membership of around 6 million non-retired members, and total scheme assets of around £1.5 trillion. These figures clearly demonstrate that a very significant number of people are transferring what will, in many cases, be very large amounts of money.

ii) Data from the FCA

The FCA recently provided its own update on the DB transfer market based on data supplied by over 3,000 financial advice firms which hold DB transfer permissions[1]. The period covered was April 2015 to September 2018.

[1] https://www.fca.org.uk/publications/multi-firm-reviews/defined-benefit-pension-transfers

The key findings were:

- Around 59,000 clients approached advisers for a conversation about a potential DB transfer, went through a generic 'triage' process to understand the general pros and cons of transferring and did not proceed to full advice;
- Around 235,000 clients received full financial advice about a potential DB transfer; of these, around 162,000 were recommended to transfer; of the 73,000 who were advised not to transfer, around 9,000 wished to proceed in any case and were processed as 'insistent' clients;
- Adding the 59,000 who dropped out at the triage stage to the 235,000 who received advice gives a population of interest of 294,000; adding the 162,000 recommended to transfer to the 9,000 'insistent' clients, gives 171,000 transfers; this would suggest that roughly 58% of those who approached an adviser about transferring ended up doing so;
- The average transfer value in this data was around £352,000, giving a total amount 'advised on' (over 235,000 cases) of around £83bn; but only just over half of these resulted in a transfer.

The FCA figures suggest a much lower volume of transfers but a much higher average value that than the TPR data. One reason for this is that the TPR data will include transfers under £30,000 where no financial advice is required. There are also timing differences between the two data sets.

The FCA data is likely to provide a better guide to the number of people undertaking transfers where financial advice was required. But the TPR data does give an idea of the trend in transfer volumes and suggests that at least until relatively recently more and more people were exercising their right to transfer.

iii) Recent market trends

A key issue in the DB transfer market is the supply of affordable, impartial financial advice. There is growing evidence of advice firms pulling out of the DB market, primarily because of the increasing regulatory and insurance cost associated with advising on DB transfers.

A major issue has been the rising cost of Professional Indemnity (PI) insurance. Advisers have reported soaring PI costs at renewal, with premiums and policy excesses far above previous levels.

One contributory factor has been the decision by the FCA to more than double the compensation limit for complaints to the Financial Ombudsman Scheme to £350,000 for advice given from April 2019 onwards. The FCA's own consultation acknowledges that this was likely to lead to upward pressure on PI premiums and could drive up to 1,000 advice firms out of the DB market in a 'worst case' scenario. The FCA's view is that those driven out will tend to be those who are the 'highest risk' advice firms who will not be able to obtain PI cover and that this is therefore not an unwelcome outcome. However, there is anecdotal evidence that at least some of the firms withdrawing from the market are those with high advice standards who have no record of upheld complaints with the FOS but who simply cannot obtain cover.

iv) The quality of advice

A key concern around DB transfers has been the quality of advice being given. The House of Commons Work and Pensions Committee has produced a number of reports on this issue with a particular focus on the advice given to the members of the British Steel Pension Scheme. The Committee has been highly critical of a number of aspects of this situation, including the role of unregulated 'introducers', the perceived slowness of regulators to respond to the emerging issues, and the potential conflict of interest of advisers charging on a 'contingent' basis. The Committee has repeatedly called for 'contingent charging' for DB transfer advice to be abolished.

In July 2019, the FCA published[2] proposals to ban contingent charging (with a few exceptions) and made further proposals to seek to improve outcomes for consumers.

As evidence to support the contingent charging ban, the FCA drew conclusions from the survey data reported on in (ii) above, which do make for worrying reading. In particular, looking just at clients who proceeded to full advice, the FCA found that 69% were recommended to transfer. Looking more broadly so as to include those who were put off at the 'triage' stage, the FCA still found that around 55% of clients were being advised to transfer. It is hard to reconcile these results with the regulatory presumption that in most cases a transfer is not in the member's interests. The FCA also found considerable variation between firms in the rates of recommendation to transfer and noted that more than half of the firms that they surveyed were recommending more than 75% of their clients to transfer.

It could, of course, be argued that people who approach advisers to consider a transfer are, by definition, self-selecting and potentially those for whom a transfer is more likely to be suitable. The large majority of DB scheme members never get as far as consulting an adviser about a potential transfer. But it is a concern that some advisers seem to have been 'nodding through' transfers, and previous FCA analysis of individual case files at advisers of concern, showed worryingly high levels of unsuitable advice.

The FCA's consultation closes in October 2019, and, with few dissenting voices so far, we anticipate a contingent charging ban will be promptly implemented. This can be expected to have a significant impact on the availability of advice, and also the demand for advice. In particular:

- Financial advisers who have operated contingent charging models may choose to exit the market

- Members may be less inclined to seek advice as, if they are advised not to transfer, they may perceive the advice to be expensive, potentially paying £1,000s to be advised to "do nothing"

One welcome recent initiative to drive up standards in this area is the new DB transfer advice 'Gold Standard' set out by the Personal Finance Society. This aims to describe an advice process which goes beyond the 'minimally compliant' and growing numbers of firms are now signing up to this standard.

[2] https://www.fca.org.uk/publications/consultation-papers/cp19-25-pension-transfer-advice

In their consultation paper, the FCA have made a number of other proposals to improve member outcomes, and also sought views on some areas that are outside of their remit. The two that are most relevant to this paper are that the FCA is seeking views on:

- Whether a requirement on schemes to offer partial transfers might lead to more suitable transfers

- Whether pension scheme trustees (or another body, for example the Money and Pensions Service) should be required to provide guidance to members considering a DB transfer option

b) The Role of Pension Schemes

Pension schemes clearly have a crucial role to play in shaping the transfer market and influencing whether members get good outcomes.

In 2017 we reported[3] that too many pension schemes were not providing sufficient information to members about their pension flexibility options within the DB scheme, nor providing sufficient support to members considering transferring out. Anecdotally there are a number of schemes that have made improvements to member options and communications in the last two years, however there are still many improvements that can be made.

In our view, schemes should:

- Ensure that member options are appropriate; in particular, and the main focus of this report, in our view they should actively consider whether members should be offered the option of a partial DB transfer;

- Ensure that communications are timely and balanced and provide all the information required; in our view too many schemes still only communicate in line with statutory requirements, whilst a range of industry voices including the Incentive Exercises Code of Good Practice[4], an independent report on British Steel welcomed by the Pensions Regulator[5] and PASA[6] have all recognised this is not good enough for members in the new world – in our view "good practice" includes balanced reminders being sent to members, with quantification of options from age 55 and, if a member over the scheme's minimum retirement age asks for a transfer quote, an early/immediate retirement quote should also be provided alongside;

- Actively consider providing members with access to good quality advice, and pay for some or all of the advice if felt appropriate.

This report considers progress made over the last two years by schemes and concentrates on partial transfers which we think are a good option which should be offered by more schemes.

[3] https://www.royallondon.com/siteassets/site-docs/media-centre/policy-papers/helping-db-members-make-better-retirement-choices.pdf
[4] http://incentiveexercises.org.uk/the-code-of-practice
[5] https://www.thepensionsregulator.gov.uk/en/media-hub/press-releases/regulatory-and-consumer-bodies-welcome-review-of-pension-scheme-communications-provided
[6] http://www.pasa-uk.com/content/db-transfers-guidance

3. Why partial transfers?

The FCA states that financial advisers should start from the assumption that a member with DB pension rights would be best served by retaining those rights rather than transferring them out.

The Pensions Regulator[7] is of the view that it is likely to be in the best financial interests of the majority of members to remain in their DB scheme; however, accessing their pension flexibly may be better suited to the financial interests of certain members in their particular circumstances. We agree. As noted earlier, every individual is unique and there may be individual circumstances where the potential advantages of re-shaping pension benefits via a DB transfer may produce better outcomes for the individual member.

The box below summarises the pros and cons of transfers in general.

The pros and cons of DB transfers

A Royal London document that is widely used by financial advisers to assist with (pre advice) triage of clients interested in a DB transfer summarises the pros and cons of transfers as follows:

Pros

- Flexibility – DB pensions can sometimes be quite rigid in terms of when and how benefits are taken, whereas a DC pot gives more options; indeed, the FCA's latest proposals recognise that a transfer may be more appropriate for those with urgent financial needs;

- Tax-free cash – members of DB pensions can generally take a quarter of their pension rights in the form of a tax-free lump sum; but the terms on which scheme benefits are converted into a lump sum may be relatively ungenerous; someone who takes a cash transfer value out may find that a quarter of the transferred sum generates more tax-free cash;

- Inheritance – when a DB scheme member dies, a pension may be paid to a surviving spouse or partner, but when a single or divorced member dies, no pension may be payable; by contrast, any unspent balance in a DC pension fund can be passed on to heirs and successors;

- Health – whilst one of the great advantages of a DB pension is that the 'risk' of needing to fund a long retirement is borne by the scheme, the flip side of this is that those with shorter life expectancies will get less out of the scheme; if a transfer value is based (broadly) around average life expectancies then those who transfer out and have lower life expectancy will tend to get more by leaving the scheme than by remaining in it; the FCA's latest draft rules suggest that those with a life expectancy under 75 should be exempted from the ban on contingent charging, in order to help ensure they continue to have access to affordable advice about a potential transfer;

[7] https://www.thepensionsregulator.gov.uk/en/document-library/regulatory-guidance/db-to-dc-transfers-and-conversions

- Sponsoring employer concerns – DB pensions are safe as long as the sponsoring employer continues to operate and contribute; but if the employer goes bust at a time when there is a shortfall in the scheme, the scheme may end up in the 'lifeboat' Pension Protection Fund ("PPF"); although this is a welcome level of security for members, PPF benefits will generally fall short of full scheme benefits in a number of respects; members who transfer out of a scheme which subsequently ends up in the PPF may end up in a better position overall.

Cons

- Certainty, especially around longevity – a DB pension will pay out for the length of the member's life, no matter how long or short; by contrast, those who move into a DC pot have to consider how to manage the wide variation in how long they may live; they face the twin risks of running down their money too quickly and running out, or being unnecessarily cautious and facing a reduced standard of living in retirement;

- Inflation risk – most DB pensions provide a measure of protection against rising prices, a factor that is of considerable importance when retirements can last thirty years or more; by contrast, a DC pot is eroded each year by rising prices and it can be expensive to replace the inflation protection provided by a DB scheme;

- Investment risk – with a DB scheme, the ups and downs of the stock market and other investments are borne by the scheme and the sponsoring employer; with a DC pot, the investment risk transfers wholly to the individual; although there are ways in which that investment risk can be managed, those who are uneasy with investment uncertainty would be well advised not to transfer out of a DB scheme;

- Survivors – most DB pensions have built in provision for a surviving spouse / partner or other dependants; whilst any unspent element of a DC pot can be passed on, there is no regular guaranteed income for a surviving spouse in a DC world; where DC pots are used to buy annuities, most people buy only a single-life policy which means that when the policy holder dies, so does the stream of income;

- Taxation – where a transferred DB pot is moved into a DC environment and then accessed, the tax consequences can be significant; whereas a regular DB income is taxed as income steadily over the course of a retirement, a lump sum DC withdrawal can take a saver into higher rates of tax or can generate higher tax bills overall.

Source: https://www.royallondon.com/media/good-with-your-money-guides/five-good-reasons-to-transfer-out-of-your-company-pension-and-five-good-reasons-not-to/

Even before the introduction of pension flexibilities and freedoms in 2015 and the recent surge of DB transfers, scheme members had some flexibilities around DB rights. Most schemes offer, as standard, the option of taking a quarter of the value of the pension in the form of a lump sum rather than a regular income, and many allow people to take a pension earlier than the 'normal' pension age at a reduced rate. Some schemes have also offered members the opportunity to reshape their pension benefits by, for example, sacrificing certain non-statutory benefits such as annual pension increases in return for a higher starting pension. Each of these options may be suitable for some but not for others.

We believe that pensions flexibility is, in principle, a good thing, and we recognise that given the complexities surrounding pensions it would generally be helpful for members to be supported by impartial and high quality financial advice and guidance when making decisions around their options.

However, the option to transfer out of a DB pension scheme can all too often be an 'all or nothing' option. A 2017 survey by LCP found that only around 15% of schemes had the option of a 'partial' transfer in their rules (taking out some of the value of the pension as a transfer to a DC pot while leaving some DB rights behind), and in many of these cases members were not made aware of the option and/or the trustees did not have a formal policy for calculating and communicating partial transfer values.

For members who do not currently have access to a partial transfer option, this can increase the risk of the transfer process, especially where the member has long service in a single scheme and is transferring out all of their non-state pension rights into a DC arrangement.

When considering whether to advise a client to make a DB transfer, one thing which advisers will look at is the base level of guaranteed income to which the client would have access. This could include state pensions, other DB rights, annuity income etc. For someone with only a state pension and a single large DB pension, a full DB transfer will reduce their secure income to a very low level. This might mean that the adviser recommends against a transfer.

But if a partial transfer was on offer, the member might be able to secure a guaranteed acceptable income via a combination of state pension and (partial) DB scheme benefits, with the balance transferred to a DC arrangement for added flexibility. This could significantly de-risk the whole process from the point of view of the member, the scheme and the adviser:

- For the member, even if the transferred DC investments perform badly, the member will still be secure in the knowledge that they have a regular income from a DB scheme which will continue for their lifetime. The member also gets the upside of a flexible income and assets from the DC transfer, including the possibility of funding an income gap during early retirement (eg until their state pension commences), and much more flexible provision for dependants.

- For the adviser, the fact that the client will always have a secure DB pension income is likely to reduce the number of dissatisfied clients and almost certainly the number of complaints against advisers. The adviser also gets the upside of being able to more efficiently help the member to a suitable outcome, balancing risk and flexibility, without needing to consider the purchase of expensive annuities.

- For the scheme, partial transfers will reduce overall liabilities but do so in a way which minimises any risk of challenge from (ex) members who might otherwise blame the scheme if things worked out badly post-transfer.

- For the employer, current and former employees are likely to welcome the new flexibility without them being exposed to the risks associated with a full transfer; PPF levy bills and the cost of de-risking are also likely to be reduced as the scale of scheme liabilities falls as a result of partial transfers.

We discuss in a later section how a partial transfer might work in more detail and in particular how the different 'tranches' which make up DB pension rights might be handled. But the basic concept is a simple one: schemes would offer members the option of transferring out some of the value of their DB pension into a DC arrangement whilst retaining some rights in the DB scheme. This has the potential to give the member access to all of the flexibilities and advantages of a DC pot, as noted above, whilst retaining the security of regular income from a DB scheme.

As we show in a later section, large and small pension schemes have introduced partial transfer options for their members and we encourage all trustees to think about whether their members would benefit from such an option.

In the next two sections we report the results of two new surveys on partial transfers, one from the perspective of those who advise on pension transfers and the other from the perspective of pension schemes.

4. The role of financial advisers – new survey data from Royal London

A DB pension scheme member with a transfer value of £30,000 or more is required by law to seek financial advice before transferring. Financial advisers therefore have a crucial role to play in the transfer market and its evolution.

In order to understand the views of advisers on the potential for more use of partial DB transfers, Royal London undertook a survey in June/July 2019 to which nearly 350 advisers responded. The survey was completed before the FCA published their proposals to ban contingent charging.

All those who took part in the survey have advised on DB transfers at some point, and roughly four fifths had done so in the last year. Key features of the sample were:

- Around half had advised on between 1 and 10 transfers in the last year, while just under 10% had advised on more than 20 transfers;
- Around 1 in 5 of the sample had at some point advised a client to take a partial DB transfer.

We first asked advisers if they would like to see more schemes provide the option of a partial transfer, and there was strong support for this proposition, with five out of six wanting to see this:

Would you like to see more DB schemes offer the option of a partial transfer?	Response Percent	Response Total
Yes	86.49%	301
No	6.32%	22
Don't know	7.18%	25

When asked why they would like to see more schemes making this offer, more than two in five of those who supported the proposition said this was because of the greater flexibility which partial transfers could offer. Several pointed out that a partial transfer, leaving behind a guaranteed level of DB income could allow clients to get a combination of a secure baseline income and greater flexibility over use of the balance of their pension wealth. As discussed below, many advisers thought that this would enable them to recommend a transfer in situations where they would otherwise recommend against an 'all-or-nothing' transfer. The phrase 'best of both worlds' was used spontaneously by a number of survey respondents.

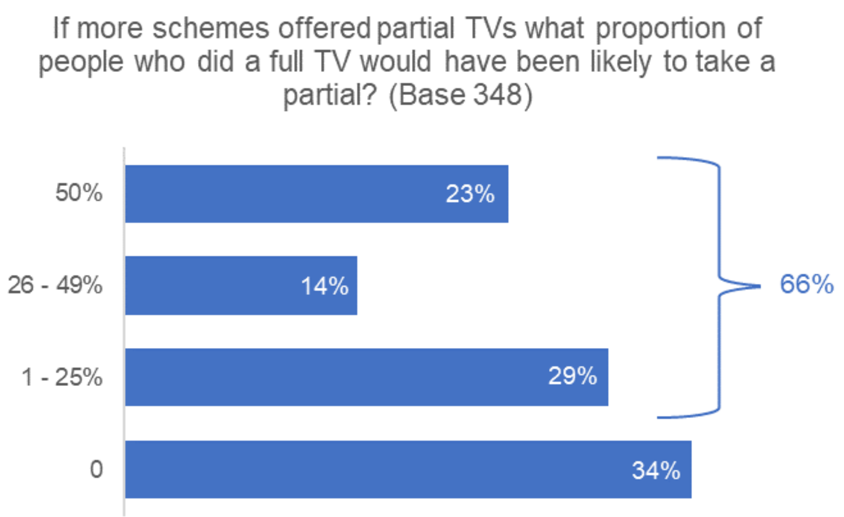
We then asked advisers if they supported the idea of members having a legal right to have a partial transfer and this was the response:

Do you think DB scheme members should have a legal right to take a partial transfer?	**Response Percent**	**Response Total**
Yes	67.72%	235
No	17.87%	62
Don't know	14.41%	50

There was strong support for partial transfers being a legal right, with two thirds of advisers backing such a change. But one third of advisers had reservations about whether this would be a good idea, with a number of advisers raising concerns about the potential complexity and implications for schemes and members.

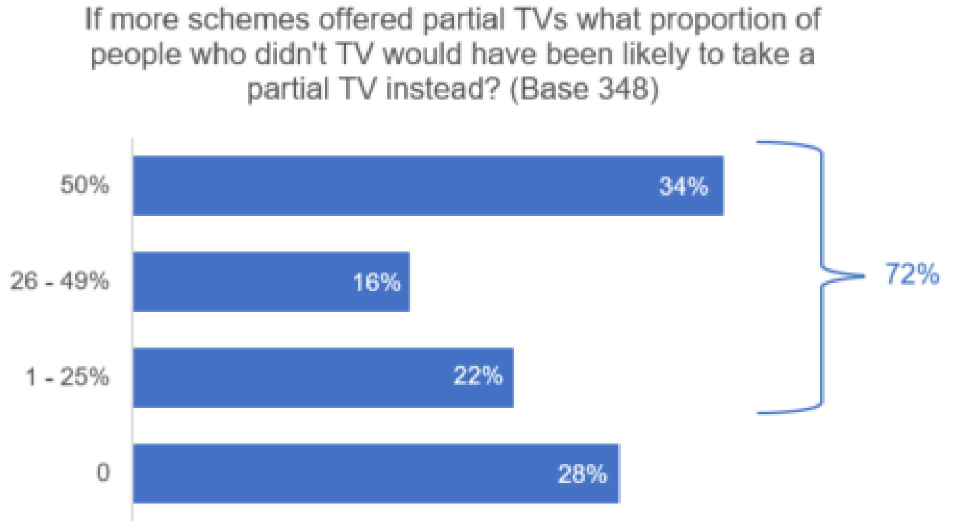
We then asked three questions about the potential impact of more schemes offering partial transfers on the pattern of transfer activity, the frequency of discussions over pension transfers and the net impact on flows out of DB schemes.

First, we asked about clients who had completed full transfers but who might have done a partial transfer if one had been on offer.



66% of advisers thought that some of their clients who took full DB transfers would be likely to take a partial transfer instead if one had been on offer.

Second, we asked about clients who had not transferred:



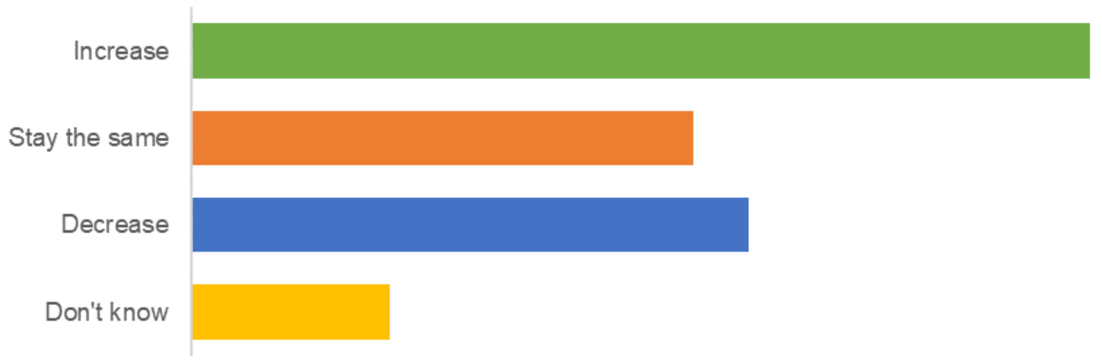
72% of advisers thought that some of their clients who didn't take a DB transfer would have been likely to take a partial transfer – with around a third thinking that 50% or more of clients who chose not to take a full transfer would have been potentially likely to take a partial transfer (instead of not transferring) if the option had been available.

Third, we asked about the potential impact of a partial transfer option on the volume of discussions around transfers, and the results are summarised below:

Would you have more conversations about pension transfers with clients if partial DB transfers were more widely available?	**Response Percent**	**Response Total**
Yes - a lot more	17.24%	60
Yes - a few more	40.52%	141
No - it wouldn't change	36.49%	127
Don't know	5.75%	20

As the table shows, a majority of advisers thought that the availability of partial transfers would lead to more discussions overall about DB transfers, and around one in six thought it could generate a lot more conversations.

Taking account of people who might have gone for a partial transfer instead of a full transfer, and those who might have gone for a partial transfer instead of not transferring at all, we then asked advisers what they thought the net impact of more partial transfers being on offer would be on overall asset flows out of DB schemes. Their replies are summarised below:



If partial transfers from DB schemes were more widely available and considering the impact of the scenarios in the previous questions, on balance do you think the total amount of money transferring out of DB schemes would:	Response Percent	Response Total
Increase	41.67%	145
Stay the same	23.28%	81
Decrease	25.86%	90
Don't know	9.20%	32

On balance, advisers were more likely to think that greater availability of partial transfers would lead to increased asset flows out of DB schemes, though opinions were somewhat divided on this issue.

We then moved on to the crucial question of the pros and cons of partial transfers for individual clients and the types of clients for which advisers thought a partial transfer might be suitable.

By far the biggest theme of the replies was that greater availability of partial transfers would give clients more options. It would also give them access to some of the other advantages of pension transfers such as potentially enhanced death benefits and improved access to tax free cash. Sample comments by advisers included:

- *Greater flexibility whilst maintaining an element of secured benefits*

- *Allowing for a fixed level of 'guaranteed' increasing income to cover essentials and being able to draw on remaining funds flexibly - the best of both worlds - meaning FCA requirements and client's objectives could both be met*

- *Leaving a level of benefits in the scheme that covers core retirement needs while offering the ability to move surplus benefits to a DC environment this is far better than an all or nothing situation*

- *May allow access to some capital and income flexibility while keeping some benefits on a guaranteed income basis, usually this benefits those looking to retire early*

- *It derisks the decision most importantly for the client but also for advisers as well. Advice costs could reduce as a result. It means the client can enjoy the benefits of both main pension arrangements*

Groups mentioned by advisers as potentially finding a partial transfer of particular interest included:

- Those who need a proportion of their DB benefits to secure a guaranteed minimum income level;
- People with long service / large transfer values;
- Those who need to access a lump sum for a particular purpose;
- Those wishing to retire earlier than normal pension age (or state pension age);
- Those with health issues;
- Single people.

The final four points mirror the general points in favour of any DB transfer, but the first two points are particularly applicable to the option of taking a partial transfer.

However, not all advisers were enthusiastic about the partial transfer option and finally we therefore asked about the main drawbacks of partial transfers. The main reservations were around the complexity of a partial transfer, including administrative complexity (for pension schemes), the possible regulatory issues around advising on partial transfers, and the concern about poor customer outcomes where the best outcome would in fact be not transferring at all. The following responses give a flavour of adviser concerns:

- *How scheme administrators will cope with providing us with the relevant information. They're already a nightmare to deal with!*
- *More complicated advice scenarios with clients making poor decisions.*
- *People taking transfers out who shouldn't from an advice point of view.*
- *I think it tends to smack of hedging your bets. Anyone who transfers should have a clear view of their decision and it might be a soft option for poorer advice processes.*
- *Risks to the main scheme - same administration burden, but more members with smaller benefits.*

Adviser views - summary

Advisers are generally very supportive of more schemes offering partial DB transfers and indeed most would support making this a legal right. Advisers recognise that some people who have in the past chosen a full transfer might have preferred a partial transfer if one had been on offer, whilst others who never sought transfer advice might have considered it if a partial transfer had been on offer.

Advisers believe that there is a range of people for whom a partial transfer might be particularly attractive, including those who need to use part of their DB pot to secure a decent base income and those who could use partial access to facilitate early retirement and provide much more flexible provision for dependants, including after death. Many regard the combination of a secure level of DB and state pension income and a flexible DC pot as representing ‘the best of both worlds’. However, some are also sceptical of the additional complexity that partial transfers would entail and are concerned that they might lure in some scheme members for whom any transfer out would be inappropriate.

5. The role of pension schemes – new survey data from LCP

In July 2019, LCP undertook a survey of more than 100 pension schemes with a wide range of scheme sizes from less than £50m to more than £10bn, and across a wide range of industries.

From LCP's similar survey in 2017, we reported that 15% of schemes at that time had a partial transfer option in their rules, although only some of those schemes had adopted a formal Partial Transfer Policy.

In 2019, this has increased to 22% of schemes, with 80% of those schemes having agreed a formal policy and communicating the option to members. This steady increase in schemes offering partial transfers is supported by anecdotal evidence from around the industry and occasional announcements of further schemes introducing the option, for example the Ford UK Pension Scheme earlier in 2019. And it is not just very large schemes who have introduced partial transfer options. In LCP's survey there were a wide range of different sizes of pension schemes (and sectors of sponsoring employers) who have made this option available to members, with two-thirds of such schemes having less than £500m of assets including a number of schemes with assets of less than £50m.

Anecdotally, LCP also report a steady increase in the number of members and financial advisers making enquiries about partial transfers to trustees and pension administrators.

Take-up of partial transfers is nevertheless currently very low. In a number of cases this is because formal policies have only recently been agreed and communicated and it appears to take time for momentum to build. For example, for one scheme in the telecoms sector where a partial transfer policy was introduced in 2017, after an initial slow start there were 7 partial transfers out of a total of 38 transfers in 2018.

The approach taken to communicating partial transfers can be expected to have a significant impact on take-up. LCP's view is that to maximise the benefits from partial transfer values, including reducing the risk that members inappropriately take full transfers, and increasing the chance that members who would benefit from a partial transfer do take one, a communication package including elements of the following would be helpful:

- A communication to members at age 55 and regularly thereafter to remind them of all their options in a balanced way, not favouring one option above others;

- When providing any benefit quote for members after age 55, also provide quotes for all their other options – eg if a transfer quote is requested, also provide a partial transfer quote and an early retirement quote, and if an early retirement quote is requested, also provide a full and partial transfer quote;

- Provide a full range of quotes automatically as members approach normal retirement age;

- Provide access to financial advice, from a non-conflicted adviser appointed by the employer or trustees to support members, and ensure the adviser is fully educated on the partial transfer option;

- Probably only realistic for larger schemes: provide on-line modelling tools for members, to allow members to get real time quotes on all their options, including the partial transfer option.

6. Considerations for designing and implementing partial transfers

There are 5,500 pension schemes in the UK with around 6 million "not-yet-retired" members. There is no statutory right to a partial transfer of DB benefits, although members do have a right to transfer any DC entitlements separately (for example, Additional Voluntary Contributions). Many pension scheme rules do not currently allow for partial transfers.

If more members are to be offered a partial transfer option, more trustee boards, supported by their advisers, will need to make changes to their rules, administration procedures and communications to enable this. This section discusses the typical process trustees go through to implement partial transfers, the technical and practical issues that need to be considered, and the typical content of a partial transfer policy. We then provide two case studies, the first being from Ford and the second being a smaller pension scheme.

i) Process

In LCP's experience, when considering implementing partial transfers, trustees usually go through the following process:

- Consider whether partial transfers are a good idea in practice for the scheme bearing in mind: the level of current transfer activity; whether the scheme membership may particularly benefit from partial transfers (eg long servers, large transfer values); the potential costs;
- Seek legal advice and amend the rules to allow partial transfers in a flexible way, usually setting a legal framework that requires trustee and employer agreement on the approach for partial transfers from time-to-time;
- Design a "Partial Transfer Policy" for use by administrators to address the technicalities of the calculation and administrative practicalities (eg minimum/maximum partial transfer amounts, number of times a member can take a partial transfer);
- Produce a summary of the policy in the form that can be shared with members and their financial advisers;
- Rework retirement and transfer communications to present the partial transfer option in a fair and balanced way;
- Consider how the partial transfer option fits into the scheme's wider communication policy, including whether access to a financial adviser should also be offered to members.

ii) Technical considerations

Given the complex history of many DB schemes, including being contracted-out of the state pension scheme and special rights attached to Guaranteed Minimum Pensions ("GMPs"), there are typically a number of technical matters to consider when designing a Partial Transfer Policy. These include the following:

- Obtain legal advice on what the Scheme Rules allow, and the nature of any required amendment – usually this requires a short and simple addition to the Rules;

- Obtain legal advice to ensure an appropriate legal discharge is obtained through the Rules of the Scheme, supported by wording in the proposed member communications and forms, as no *statutory* discharge is available for partial transfers (this is in line with a number of other transfers, for example transfers within one year of normal pension age);

- Obtain legal advice on the splitting of contracted-out rights. LCP's experience is that in many cases it is confirmed that GMPs cannot be split by a partial transfer, but post-1997 COSR rights can be split by a partial transfer[8] – this means that many Partial Transfer Policies require GMPs to be transferred out of the scheme "first";

- Obtain advice on the implications for spouses and dependants and whether there are any resultant special considerations for the trustees;

- Consider GMP rectification and equalisation matters, which are similar to those that apply on normal transfers; generally GMPs continue to normally be transferred out "first", but partial transfers do open up the possibility of retaining GMPs in the scheme to be equalised at a later date;

- Consider the approach to Additional Voluntary Contributions ("AVCs") (eg decide that these should be required to be transferred out before (and in addition to) any DB partial transfer);

- Consider the approach to any special benefits such as benefits previously transferred-in from another pension scheme (eg decide that these should be required to be transferred out as the first tranche of a DB partial transfer);

- Consider how to deal with multiple tranches of member benefit; there are typically three different ways of doing this:

  - Agree a policy on the order in which tranches are transferred out

    Eg, AVCs, then GMPs, then any transfers-in, and then the oldest tranches of pension could be transferred, in age order, until the required partial transfer value is achieved

  - Agree that each non-GMP tranche is split in the fixed proportion required to achieve the overall required outcome

    Eg, GMPs and AVCs and then eg 60% of each of the other tranches could be transferred, to achieve the required partial transfer

[8] LCP are not lawyers, and they cannot provide legal advice. There are many legal constraints around the treatment of contracted-out rights by pension schemes. In practice, in LCP's experience this generally means that both pre-1988 Guaranteed Minimum Pension and post-1988 Guaranteed Minimum Pension (together) must be either retained in the scheme, or transferred out in their entirety, for any given member. However, a member's post-1997 contracted out rights in a salary related scheme ("post-1997 COSR rights") can generally be split in any way – some (or all or none) being retained in the scheme and some (or all or none) being transferred out.

- Obtain the member's consent as part of the process to "tidy-up" their benefits and to convert (on actuarially cost neutral terms) the pension remaining in the scheme to a standard benefit structure – perhaps including standard pension increases and spouse's provision

Note that this level of detail is required to be considered given the subsequent impact on member pension increases, the different approaches the actuary will take to valuing each tranche, and the impact on PPF levy and protection calculations.

iii) Practical considerations

Concurrently with the technical considerations, the trustees and their advisers will need to consider a number of practical matters, often including the following:

- *The view of the administrator and any preferences they have for the way in which partial transfers are to operate*: many schemes mitigate the administrative complexities by careful design, including providing members just one opportunity to partially transfer, around the time of retirement, with a limited range of partial transfer options;

- *Interaction with the terms for commuting pension for cash*: some schemes have commutation terms that are worse value-for-money than transfer value terms; offering a partial transfer value can highlight this and in some cases it may even be better for members to partially transfer than to commute for cash – this will need to be considered by the trustees and employer as it may result in perverse outcomes;

- *The range of members entitled to a partial transfer once the policy has been settled upon:* it is often helpful to "slice and dice" the members and look at the number and type of members who will have access to a partial transfer, and at what quantum of transfer value, under different partial transfer policies; this will help to ensure that there is an easy way for the administrator to identify who is, and who is not, entitled to a partial transfer; for example, if there are big GMPs in the scheme, few members may be entitled to a partial transfer of a large proportion of their benefit – this may call into question whether it is worthwhile introducing certain policies;

- *The proposed method of communication and provision of advice:* a complex policy will be complex to communicate and may result in few partial transfers. A simple policy, supported by access to financial advice, and regularly and effectively communicated from eg age 55, is likely to result in better engagement and thereby lower risks for all parties.

iv) Elements of a typical Partial Transfer Policy

Having considered the above, a typical Partial Transfer Policy will have the following key elements:

- Constraints on the number of times a member can take a partial transfer (commonly, just once);

- Constraints on when a member can take a partial transfer (for example, after age 55 and sometimes only just before they draw their DB pension, when in any event full retirement pension calculations will be undertaken by the administrator and the member will be considering their retirement options);

- Any constraints on a minimum amount that must be transferred (commonly AVCs and GMPs are included in this, and there may also be a minimum amount of transfer value required in order to make the process worthwhile, eg £30,000);

- Any constraints on whether a minimum level of pension (or transfer amount) must be retained in the scheme, as it doesn't make sense to administer small pensions (for example, this could be a pension of £3,000 per annum);

- The range of partial transfers permitted (this could be any partial transfer within the range of the maximum and minimum set above, or it may be a single figure – eg Ford only permit a partial transfer of half of the member's whole transfer value);

- The agreement of a limited amount of administrator discretion to offer a partial transfer (or not) in borderline cases (eg where a partial transfer was available previously but it no longer available because market conditions have changed the relative size of the GMP value).

The Appendix sets out an example Partial Transfer Policy. Section 7 provides the detail of the Ford UK Pension Scheme's approach and policy. Section 8 is a case study for a small pension scheme.

7. Guest case study – the Ford UK Pension Scheme

With many thanks to Oliver Payne, European Pensions Manager and Actuary, Ford Motor Company Ltd have kindly allowed us to include details of their partial transfer policy as a case study in this paper.

> *"Following the introduction of Pensions Freedom and Choice we have worked closely with our Union and Trustee colleagues to design a package of changes to help ensure our employees have suitable options, good information and are well equipped to made good retirement decisions when faced with the increased complexity of freedom and choice. We're of the view that this should result in better outcomes for employees and a lower risk of inappropriate decision making. We're also delighted that in our case we were able to develop a simple approach to partial transfers - thanks to the support of our advisers."*
>
> Oliver Payne, European Pensions Manager and Actuary – Ford Motor Company Ltd

Background:

The Ford UK Pension Scheme has a long history in the UK, and currently has around 8,000 active members and 11,000 deferred members. It is common for active members to have worked for Ford for decades, with many workers spending the bulk of their career with Ford and as a member of the pension scheme.

Following the introduction of pension flexibilities and freedoms in 2015 all parties involved in the pension scheme, including unions, were involved in discussing various possible ways to mitigate the associated risks for members and for Ford (including reputation risk). Various changes were made as a result of that, including improved member communications, and it was also agreed to implement a partial transfer option for active members, which was launched in 2019.

The partial transfer option has only recently been launched for active members and so take-up experience is not yet available, but employee feedback has been positive.

Partial Transfer Policy:

Ford's objective was to keep the partial transfer option as simple as possible for all parties. The headline message therefore is simply that a member has one partial transfer option at the point of retiring directly from active service, and that the option is to retain half of their pension, and take half of their transfer value. The option is not available to deferred members, which is in contrast to many schemes that offer partial transfers. Part of the thinking behind this is that deferred members are more likely to have other pension savings and therefore may have other ways to create the income and asset flexibility they are looking for.

Under the bonnet, the way in which this simplicity is achieved is as follows:

- GMPs are transferred out first, and as the option is only available to active members, GMP values are always less than half of the value of the member's entire pension – therefore GMPs do not constrain the option;

- Most pension tranches have similar inflation linked pension increases, so that the value of £1 in one tranche is similar to the value of £1 in another tranche;

- If the member has no GMP, the administrator halves all tranches of member pension and pays out half the whole transfer value;

- If the member has GMP, the administrator deducts a fixed percentage to apply to all non-GMP tranches so as to end up with a pension that is exactly half the original pension (eg if the GMP is 20% of the pension, a fixed percentage of 62.5% is applied to all other tranches), and pays out half the whole transfer value;

- Whilst it is recognised that the technical actuarial value of the benefits transferred-out may not be exactly equal to half the whole transfer value (as the partial transfer has 100% of the GMP), Ford and the Trustees agreed this was acceptable because the amount by which the partial transfer is under/over half the transfer value should be offset by the value of the pension retained in the scheme.

8. LCP case study – partial transfers for a smaller scheme

Background:

The employer operates in the media sector and supports a pension scheme with assets of around £100m that currently has around 500 deferred members.

The trustees originally considered their response to pension flexibilities and freedoms in 2015 and shortly thereafter introduced a simple pension scheme rule that allowed the possibility of partial transfers. However, it wasn't until a member inquired about partial transfers in 2018 that the trustees responded by developing a formal policy and stepped up the communication to all members about the option. LCP advised the trustees on how the policy could be structured in terms of what benefits are taken and any restrictions that might apply.

The option is referred to in transfer value quotations and standard retirement illustrations. Members are then able to request further details from the scheme if they want to know more about the option.

Partial Transfer Policy:

The policy proposed by LCP was designed to be simple and cost effective for the scheme. The option is available to all members at any time before retirement and members may take up to a maximum of three partial transfers during their period before retirement. Key features are:

- If a member also has a defined contribution fund, from additional voluntary contributions, they must transfer the full amount of this fund;

- Few deferred members have GMPs and pre-1997 accrual, but where they do, the member would be required to transfer out (as part of their first partial transfer) the entire pre-1997 benefit as a minimum;

- Any further partial transfer amount is used to reduce all post-1997 benefit tranches in equal proportion;

- To avoid disproportionate administrative costs:

  - the size of each partial transfer must be both at least £30,000 and at least 25% of the transfer value of the full original benefit (for the first partial transfer, the pre-1997 benefits must also be covered);

  - the remaining benefit after the partial transfer must also have a value that is both at least £30,000 and at least 25% of the transfer value of the full original benefit; and

  - within these bounds, the member may choose any partial transfer size

- Members are required to pay for the administration costs of providing anything more than three partial transfer quotations over the member's lifetime.

9. Conclusions and recommendations

The risks associated with DB transfers remain high. Evidence suggests that some pension scheme members are making poor decisions that leave them out of pocket, and in some cases may result in severe financial hardship later in retirement.

In our view, an option of a partial transfer has many attractions for all parties involved in the provision of the member's benefits. For the member and their family, a partial transfer can truly offer the best of both worlds – a secure income in a DB scheme and a flexible retirement income on top, along with an asset that continues to have value following their death. Offering members better options, and not just "all or nothing" options, reduces risk for schemes, sponsoring employers and financial advisers.

Financial advisers are very supportive of partial transfers. However, only a little over 20% of schemes offer partial transfers, leaving nearly 80% of the UK's DB pension scheme members without the option.

Whilst there are a number of administrative complexities associated with partial transfers, none are insurmountable hurdles and we have provided a number of different solutions in this paper.

We call on all pension schemes to proactively consider whether they should introduce partial transfers as an option for members. We also call on government and regulators – particularly the Pensions Regulator and FCA – to encourage schemes to offer the option of a partial transfer, and we are pleased that the FCA is currently consulting on partial transfers as an approach to reduce risk for members.

Appendix - Illustrative Partial Transfer Policy

This policy is taken from the real case of a £1 billion pension scheme of a large UK employer, with some details changed simply to ensure confidentiality.

Under Rule X of the Scheme's rules, a member may in writing request the Trustee to make a transfer representing part of his or her accrued benefits in the Scheme. Such transfers may proceed with the agreement of both the Trustee and the Principal Employer, and shall be calculated on a basis decided by the Trustee with Principal Employer consent.

The Trustee and the Principal Employer recognise that the administration process for partial transfer values could be complex if there are no constraints on the timing of requests, the number of times a member can elect to take a partial transfer, or the size of partial transfer. The possibility that these additional options and flexibilities may concern or confuse members also needs to be considered.

This policy does not override the rules of the Scheme. In the event of any conflict between this policy and the rules of the Scheme the rules shall prevail.

Agreement of the Trustee and Principal Employer to partial transfers

Subject to their powers under the Scheme's rules, the Trustee and the Principal Employer give their agreement to partial transfers of members' defined benefits being made under Rule X for the time being, subject to the conditions set out in this policy document.

The parties shall review the terms of this policy at annual intervals and may at any time agree in writing to alter any of its terms subject to any member communication requirements. Either party may terminate this policy at any time by written notice to the other party subject to any member communication requirements.

The parties note that if a member has accrued rights to a category of benefits as a result of paying AVCs, he has a statutory right to transfer all of that category of benefits out of the Scheme at any time before any of the rights to that category of benefits are crystallised.

Constraints

- Members will only be permitted to take one partial transfer during the period of their membership, and the timing of the transfer will be at the time (in practice, just prior to the time) they start to receive their pension (ie usually between ages 55 and 65).

- Members will be given only three partial transfer options:

    1. Maximum amount that can be partially transferred out of the Scheme: A partial transfer value of defined benefits covering all GMP and leaving only £3,000 pa non-GMP defined benefit pension in the Scheme;

    2. Minimum amount that can be partially transferred out of the Scheme: Partial transfer value of defined benefits covering all GMP subject to a minimum transfer value of £30,000; and

3. Half-way: An option half way (in terms of size of transfer value, not pension) between the maximum and minimum options.

- The Pensions Administration Team will have discretion to round figures, or exclude or include options where a member's benefits are close to the boundaries mentioned in the previous paragraph, or where market conditions change to mean that a previously available option is no longer available. At each quarterly trustee meeting the Pensions Administration Team shall present a report summarising any cases involving the exercise of discretion on their part in connection with this partial transfer policy.

- No partial transfer shall proceed unless the Trustee has (where required by section 48 of the Pension Schemes Act 2015) been able to confirm that the member has received appropriate independent advice within the meaning of that section.

- No partial transfer shall proceed unless the Trustee has received an (in its opinion) appropriate discharge form signed by the member.

- The offer of a partial transfer will be included within the information pack provided to members either when they request a retirement illustration or as part of the standard administration process for members approaching their normal retirement age or earlier (eg from age 55) as agreed between the Trustee and Principal Employer from time-to-time.

- The retirement information pack will only include details of the partial transfer options for members who are eligible for the partial transfer option. Members who are not eligible will not receive information about partial transfers.

- Partial transfer values will be determined using the same basis as for statutory cash equivalent transfer values from the Scheme. Formal requests for quotations will be guaranteed for three months, as for statutory transfer value quotations.

- No partial transfer shall proceed unless the member agrees to transfer out of the Scheme at the same time the entirety of any rights that he has accrued through the payment of AVCs. For the avoidance of doubt, any such rights that a member has accrued under the Scheme are not defined benefits and accordingly they will be ignored for the purposes of determining the three partial transfer options (maximum, minimum and 'half way between') referred to above.

Order in which pension is to be partially transferred

The elements of which a member's benefit entitlement under the Scheme may be comprised are to be transferred out of the Scheme in the following order of priority, and any partial transfer value shall be calculated accordingly:

- First, pre and post 1988 Guaranteed Minimum Pension ("GMP");

- Transferred-in pension (where it can be separately valued and transferred in its entirety);

- Historic special element, in its entirety;

- Post 2012 pension;
- 2002 to 2012 pension;
- 1997 to 2002 pension; then finally
- Pre 1997 pension in excess of GMP.

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We would welcome feedback on the contents of this report which can be sent to Jonathan Camfield, Partner, LCP at jonathan.camfield@lcp.uk.com

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