

Flexible Retirement

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Final salary schemes provide members with a pension that increases at a specific rate together with specific benefits on death. Whilst this may suit the needs of many members, others may require more flexibility to reflect their lifestyle and/or other pension arrangements. Currently the only flexibility most schemes offer is the ability to take benefits early from age 55 and exchange some pension for a tax free lump sum.

Many members do not appreciate that they can take their benefits before normal retirement age. It may be in the interests of some members who are aged over 55 to access their pension now and Trustees/sponsors could consider running an exercise to make members aware of their options.

As part of such an exercise members can be given options on the flexibility that would be available to them, details of which are shown below.

Scheme Early Retirement Pension

Most schemes currently have procedures in place where members can commence their pension from age 55 on a reduced basis (to reflect early payment). This would include an option to exchange some of the pension for a tax free lump sum. The pension would increase, and provide death benefits, in accordance with the scheme rules.

In a recent exercise, a retail client sent each member over age 55 an early retirement quotation. Of the 400 issued, 133 (33%) members elected to take their benefits early; £1m was paid out in tax free cash and the deficit fell by £800,000.

Pension Increase Exchange (PIE)

If the scheme provides pension increases in excess of those required by Regulation it would be possible to offer members the option of exchanging non statutory increases for a higher pension and/or a higher tax free lump sum. This additional flexibility may make early retirement a more attractive option for a member due to the higher tax free amount or the ability to receive a higher pension now (before State Benefits commence).

In a recent exercise, a charity client offered a PIE option as part of an early retirement exercise and 83% of members electing to take their benefits early took the option of a higher pension/lump sum and lower pension increases. The additional cost of including the PIE option in the early retirement quote was minimal and the deficit reduced by £100,000.

Immediate Vesting Personal Pension option (IVPP)

Even with a PIE option schemes still provide specific pension increases and dependents benefits. An IVPP option provides members with an indication of the pension they could receive now from an insurance company in exchange for taking a transfer value (potentially enhanced) from the scheme. The member would be able to select the level of increases they want and also the level of dependents benefits. They may also benefit from enhanced annuity terms dependent on their health and lifestyle. The IVPP option allows the member to compare the pension he could get from an insurer with what the scheme is offering on a basis that suits his requirements and there may be more tax free cash available. This provides the member with full flexibility and provides access to drawdown which may be appropriate for some members.

Pensions Reshaping

For some members there is the option of reshaping their pension so that they effectively receive a higher pension from the scheme but this higher pension it is only payable until State Pension Age (SPA). The advantage of this for a member is that they get access to a higher pension now and because the scheme pension payable from SPA is lower, entitlement to any means tested State Benefits may be higher.

Trivial commutation

Members who have a pension with a value of less than £18,000 have the option to commute their pension for a lump sum at the point of retirement. This can be attractive to members and avoids future (relatively excessive) administration costs for the scheme in managing a small pension.

What are the benefits for a scheme?

The overall benefit for a scheme is a reduction in long term risk/volatility and potentially a reduction in deficit. Trustees are meeting their duties to members by keeping them informed of their options. Specific benefits are :

- Members are made aware of what benefits they can take from the scheme now and given information to help them assess the full flexibility on how they take these benefits
- Members typically take the lump sum option which reduces the quantum of liability left with the trustees (lower risk going forward) and can also reduce the deficit.
- Members who take the IVPP or Trivial Commutation option are taking their benefits away from the scheme and leaving no liability with the Trustees
- The IVPP and PIE options are generally on a basis that is favourable to the scheme (in the same way the cash commutation option usually is) thus reducing the deficit.
- The above options can have a significant reduction in the cost of buying out these liabilities

Are these options and benefits available to all schemes?

Generally yes although specific consideration would need to be given to the Scheme Rules. The extent to which such an exercise would be financially viable will depend on the specific membership profile. The first step in considering these additional options for members would be a feasibility study. PCS have developed a modeller that can review the membership records of all deferred members over age 55 and identify which of the above options were feasible. This study would also identify the costs associated with offering the options together with an indication of the reduction in liability/deficit of running an exercise for these members.

For further information please contact your JLT consultant or alternatively call Rob Dales on 0113 203 5883 or rob_dales@jltpcs.com