Freedom and choice

How occupational pension schemes have implemented the pension flexibilities

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The Pensions Regulator

Contents

About this report

This report sets out how some occupational defined contribution (DC) pension schemes have approached the implementation of the new pension flexibilities. It is aimed at trustees, employers and the pensions industry in general, including financial advisers and scheme providers.

The report is based on a series of interviews we undertook with trustees and sponsoring employers during the second half of 2015. Our aim was to understand which flexibilities trustees and employers were offering, who made the decision to offer them and why, and whether there were any problems with the process.

Executive summary

Scheme demographics

Based on the evidence from our meetings, member-led demand for the new pension flexibilities in DC occupational pension schemes is currently low. One reason for this is that occupational DC schemes are relatively immature particularly if they have been established to meet automatic enrolment requirements. This means they may have fewer members over the age of 55, the age from which the flexibilities can be accessed. Another is that many 'DC schemes' are in fact sections of hybrid schemes. Members of these schemes are likely to have safeguarded benefits as well, which will influence their decisions about how to access their money. For example, such schemes often allow members to maximise their tax free cash sum from the DC (or additional voluntary contributions) pot before releasing their DB benefits.

Sponsoring employers

A decision to offer a new benefit structure in-scheme usually requires employer support under the scheme's trust deed and rules. Many employers retain a paternalistic attitude to the occupational scheme they support, and may subsidise it heavily for the benefit of their employees (for example, by meeting the administration costs). Many also view a pension as an integral element of their overall employee reward structure, and that its purpose is to provide an income in retirement. Employers told us that they wanted to retain their influence on benefit design and not be constrained by how the reward system was structured or delivered. They risk becoming disengaged if the scheme they established moves too far away from the purpose for which it was originally intended. Employer disengagement is likely to have a detrimental impact on occupational pension provision – in particular on automatic enrolment.

Employers wanted to retain their influence on benefit design.

Member engagement

Interviewees generally reported low levels of member engagement with pension saving. While lack of consumer engagement with pensions drove the default approach of automatic enrolment, the introduction of pension flexibilities heightens the risks to good outcomes. Such risks are likely to crystallise, for example, where the member does not express a clear intention in respect of when and how they choose to access their pension pot. In such circumstances a member may be defaulted into an investment strategy which might not be the best for them.

Trustees told us they were very concerned about risks to good member outcomes as a result of low member engagement at this critical point in their savings journey, and we hope that the recent changes to Pensions Wise allowing access from age 50 will partly mitigate these risks.

Members will now be able to access support from Pension Wise from age

Investing in systems and product capability

The pace of legislative reform has in some cases outstripped the capability and capacity of service providers in the occupational pension schemes market in a number of critical areas. These include member record-keeping systems, fund platform provision, investment products and the advice market. The trustees we spoke to recognised that pension flexibilities can be difficult to administer efficiently and effectively on existing systems. Administrative complexity combined with low demand – from both sponsoring employers and members – were frequently cited as reasons why trustees and sponsoring employers decided not to offer pension flexibilities at this time.

Service providers require both demand and a stable policy environment if they are to invest in the infrastructure required to implement and develop the pension flexibilities.

Regulatory risk to trustees and sponsoring employers

Trustees and sponsoring employers are concerned about the risks to which they may be exposed if they offer pension flexibilities. While most single employer occupational schemes do not currently propose to offer such benefits from within the scheme, they do want to help members access their savings flexibly, safely, and at a reasonable cost.

The market is still developing an approach to cater to such schemes and members. Trustees told us that they felt constrained by the regulatory environment if they wanted to direct members to a flexible solution provided by a third party. They were concerned that by signposting or guiding members in this way, they could be treated as having given members advice or as having acted as an introducer to a product provider. Trustees felt that the current regulations in this area were not working in members' overall best interests.

Master trusts will play a critical role for members who want to access pension flexibilities.

Trustees and sponsoring employers were also concerned about the changing nature of their responsibility to the member. Previously, their liability would end at retirement through the member's purchase of an annuity. There were concerns that the introduction of flexible options – and particularly flexi-access drawdown – could expose them to claims well beyond the point at which their duties would ordinarily end if it was shown with hindsight that a member made a bad decision. These are complex issues, and we understand that sponsoring employers and trustees will want to think carefully about their duties to employees and members in this evolving environment.

Innovation

A number of new models designed to facilitate access to pension flexibilities are starting to emerge from occupational pension schemes. These include informal arrangements between single employer schemes and master trusts which allow the member to transition their assets to the master trust. We believe that master trusts will play a critical role in the occupational pensions market for scheme members who want to access pension flexibilities. Some of these emerging models, however, may present new risks to members and we will work closely with government and the Financial Conduct Authority (FCA) to understand and, where necessary, address such risks.

Background to the flexibilities and our engagement

Changes in the law which took effect from 6 April 2015 gave many members of occupational pension schemes increased flexibility over how to take their DC benefits[1]. These new flexibilities represented a significant change to the pensions market, changes to which members, schemes and sponsoring employers are still acclimatising. While these changes introduced choice for members at or after age 55, they also introduced new risks for members who decide to access them and for the schemes that decide to offer them.

Our regulatory response to these changes has included guidance tailored to the duties and legal circumstances of pension scheme trustees. It explains the requirements to make members aware of Pension Wise and, where relevant, requires them to seek advice from an FCA-regulated financial adviser. We also recommend the use of generic risk warnings for members to consider before choosing one of the options for accessing their pension pot. The Department for Work and Pensions (DWP) has since confirmed the introduction of a new legislative requirement for trustees to provide members with information on the risks associated with the decumulation options offered by a scheme.

The government has also consulted on pension transfers and early exit charges, having become aware of potential barriers faced by people seeking to access their pension savings. Alongside the FCA we published survey findings on the extent of the problem to inform the government consultation[2]. Our new code of practice and associated guidance will support trustees to ensure transfers out are processed promptly and accurately. We are also considering how a new regulatory requirement to report transfer performance will be introduced. In addition, a new cap on early exit charges will be implemented across all pension schemes. We are currently working with the DWP and FCA to achieve this.

1
The research did not directly address the effect of the flexibilities on schemes and members with non-DC benefits. However, this document references such schemes and members where relevant.

2
www.tpr.gov.uk/access-2015

We also decided to undertake a programme of engagement with senior representatives of occupational DC schemes. We wanted to understand their approach to the flexibilities in the following areas:

- Which flexibilities are or may occupational schemes be offering?
- What was the basis for that decision and who took the decision?
- What risks and issues had schemes and/or sponsoring employers identified and what mitigations had they put in place?

We considered the risks to fall into two main categories. The first was risks to members as a consequence of the decisions they make, the information on which they base those decisions (eg important and relevant information about longevity, investment, inflation and tax), and the presence in the market of poor value products. The second was risks to schemes as a consequence of communication that informs member decisions, the administration of these decisions, and governance in respect of the schemes' approach to the pension flexibilities.

Our approach

We identified 32 single employer and master trust occupational schemes as potentially appropriate for interview. The basis for scheme selection was the number of members and scheme type, ie single employer, master trust, DC only, or those providing both DC and non-DC benefits. The larger the scheme, the more likely we were to want to engage with it, because evidence suggests that larger schemes are more likely to offer pension flexibilities or were further advanced in their evaluation of whether or not to offer them. We also wanted to engage with a range of scheme types (eg single employer, master trust etc).

Based on replies to our initial approach, we selected 17 schemes to interview. These schemes were also asked to complete and return a pre-populated form which asked which pension flexibilities they currently offer to members (either in-scheme or via a third party) or which the scheme plans to offer in the next 12 months.

Schemes selected for interview represented 68%[3] of all occupational DC members. The interviews took place between May and November 2015. Interviewees were either employees of the sponsoring employer, typically acting as the pension manager, trustee or chair of trustees of the relevant board, or secretary to the trustees.

Interviewees were taken through a series of identical questions covering risks associated with administration, communications, investment and governance in the context of the flexibilities. All interviews were conducted on a confidential basis and this report does not name schemes or attribute comments to specific interviewees.

The sections that follow summarise what schemes told us about their approach to the flexibilities. Quotations have been used throughout to illustrate the issue under discussion.

The schemes we interviewed represented **68%** of all occupational DC members.

3 The Pensions Register as at 1 October 2015.

Scheme implementation of pension flexibilities

What pension flexibilities are occupational schemes offering?

Before the introduction of pension flexibilities, DC members would typically purchase an annuity from an insurance company with their accumulated pot. Legislation now gives members with DC benefits the right to access their benefits flexibly from age 55, but does not oblige occupational schemes to offer them. Therefore, if an occupational scheme does not offer pension flexibilities, the member may transfer their pot to a scheme or retail product that does.

The options now available to the member are displayed in the left-hand column of Table 1 (see over). Some of these benefits may be provided in-scheme and some via a third party. Because the legislation allowing for pension flexibilities remains relatively new and schemes continue to consider their position, we also asked whether they planned to offer a particular flexibility in the next 12 months. Their responses to these questions were self reported, and a summary of these responses are in Tables 1 to 3. Table 1 details the responses for all schemes we interviewed, Table 2 for master trusts only, and Table 3 for single employer occupational schemes only.

The least available pension flexibility was partial drawdown.

All schemes offered small pot lump sum withdrawal and the option for an annuity purchase via a third party. Most schemes offered withdrawal of the 25% tax free lump sum (WTFLS) from within the scheme, and a full uncrystallised funds pension lump sum (UFPLS). Approaches to pension flexibilities were more varied in respect of a partial UFPLS, and full and partial drawdown (DD). The least available flexibility in occupational schemes was partial drawdown, although some schemes already offer, or plan to offer, this benefit to their members in the next 12 months.

We also asked interviewees whether or not they would accept transfers into the scheme for the purpose of accessing pension flexibilities where an individual was not already a member of that scheme. No single employer occupational scheme permitted this. A minority of master trusts indicated that they might or would accept individuals to membership of their occupational scheme for the purposes of accessing pension flexibilities.

Table 1: Decumulation breakdown – pension flexibilities offered to members (all schemes)

Decumulation option	Provided by scheme currently		Will be provided by scheme in next 12 months		Provided by third party currently		Will be provided by third party in next 12 months		Not provided	
	No.	%	No.	%	No.	%	No.	%	No.	%
Small PLS	17	100	0	0	0	0	0	0	0	0
WTFLS	14	82	0	0	0	0	0	0	3	18
Full UFPLS	16	94	1	6	0	0	0	0	0	0
Partial UFPLS	9	53	2	12	1	6	1	6	4	24
Full DD	2	12	1	6	3	18	7	41	4	24
Partial DD	2	12	1	6	3	18	7	41	4	24
Annuity	0	0	0	0	17	100	0	0	0	0

Small pots lump sum (Small PLS)
Defined contribution pots not exceeding £10,000 may be taken in full as cash from age 55 or over. 25% will be tax free and the remaining fund is taxed at the members' marginal rate.

Withdrawal of tax free lump sum (WTFLS)
The withdrawal of 25% of the member's defined contribution pot tax free, paid from the scheme before transferring to a third party decumulation product.

Full uncrystallised fund pension lump sum (UFPLS)
The facility to take the full fund as an authorised lump sum paid from uncrystallised funds under a DC arrangement to individuals aged 55 or over, without the requirement to buy a decumulation product.

Partial uncrystallised fund pension lump sum (UFPLS)
Facility which will allow members to take an income from a portion of their pension fund, while the remaining fund continues to be invested.

Full drawdown (DD)
Facility which will allow members to take an income from their full pension fund, while the remaining fund continues to be invested.

Partial drawdown (DD)
Facility which will allow members to take an income from a portion of their pension fund, while the remaining fund continues to be invested.

Annuity
A product that allows a consumer or member to convert their pension savings into a regular guaranteed income that will last for the rest of their life.

Table 2: Decumulation breakdown – pension flexibilities offered by master trusts only

Decumulation option	Provided by scheme currently		Will be provided by scheme in next 12 months		Provided by third party currently		Will be provided by third party in next 12 months		Not provided	
	No.	%	No.	%	No.	%	No.	%	No.	%
Small PLS	5	100	0	0	0	0	0	0	0	0
WTFLS	5	100	0	0	0	0	0	0	0	0
Full UFPLS	5	100	0	0	0	0	0	0	0	0
Partial UFPLS	4	80	0	0	0	0	0	0	1	20
Full DD	2	40	1	20	1	20	0	0	1	20
Partial DD	2	40	1	20	1	20	0	0	1	20
Annuity	0	0	0	0	5	100	0	0	0	0

Table 3: Decumulation breakdown – pension flexibilities offered by single employer occupational schemes only

Decumulation option	Provided by scheme currently		Will be provided by scheme in next 12 months		Provided by third party currently		Will be provided by third party in next 12 months		Not provided	
	No.	%	No.	%	No.	%	No.	%	No.	%
Small PLS	12	100	0	0	0	0	0	0	0	0
WTFLS	9	75	0	0	0	0	0	0	3	25
Full UFPLS	11	92	1	8	0	0	0	0	0	0
Partial UFPLS	5	42	2	17	1	8	1	8	3	25
Full DD	0	0	0	0	2	17	7	58	3	25
Partial DD	0	0	0	0	2	17	7	58	3	25
Annuity	0	0	0	0	12	100	0	0	0	0

Who makes the decision about what pension flexibilities to offer and on what basis?

A decision to change the benefits structure of an occupational pension scheme will typically be a decision for the employer, or the employer in conjunction with the trustee. In some circumstances the decision may rest with the trustee alone, although this is rare. Most single employer occupational schemes we interviewed said that a decision to offer pension flexibilities would be a joint decision for the trustee and employer. A trustee decision to offer pension flexibilities in the absence of employer support was considered improbable. All interviewees of single employer occupational schemes were aware of the need for employers and trustees to work very closely together when deciding whether or not to offer pension flexibilities.

Master trusts were different in that the decision to make pension flexibilities available sits with the trustee, and may be influenced by the sponsoring commercial entity. A range of factors was likely to influence a decision in respect of master trusts, including commercial viability and administrative capability.

The basis on which single employer occupational schemes will form a decision whether to offer pension flexibilities, and which pension flexibilities to offer, was based on a range of factors. These included member demand, administrative capability, employer and member cost in respect of administration and advice, risk and attitude to benefit design.

> For example, a number of schemes noted that only a handful of members had so far requested a UFPLS. Another scheme that provided DC and non-DC benefits noted: "We were expecting a lot of people to be interested in cashing in their pension. However, we have received only one request so far. Most of the older staff are in the DB scheme and have already retired, and the younger staff in the DC scheme have not yet reached the minimum retirement age."
>
> Another scheme, a master trust, noted: "We are not expecting high levels (of demand) at the moment, so have only manual processes in place. However, there is scope for thousands in the future, so we will prepare for that."
>
> continued...

> Another scheme cited membership demographics and administrative limitations as a factor: "Due to the age of the systems, this (the provision of pension flexibilities) has not been seen as a priority, and due to scheme demographics there has been limited demand."

The absence of current member demand for pension flexibilities, although surprising to many schemes, was not viewed as necessarily negative. This is because it provided schemes with some time to consider their approach.

A further factor in schemes' decision making process was cost: "The scheme did not want the cost burden of flexible access drawdown (FAD), and at this stage there is no intention of offering FAD."

Trustees and employers of single employer occupational schemes were particularly conscious of the risks to which either might be exposed should they take a decision to offer pension flexibilities, particularly in-scheme FAD. These risk factors played a significant role in respect of whether or not to offer some of the pension flexibilities. One scheme's employer representative noted that, while they were generally supportive of the flexibilities, FAD represented a long-term fiduciary risk for the employer and the trustee.

Absence of member demand for pension flexibilities was not viewed as necessarily negative.

Trustees were typically concerned about extending their fiduciary responsibilities in respect of DC members into the decumulation phase. One scheme informed us that their plans to offer in-scheme FAD had been interrupted by concerns expressed by their parent company for this very reason. Employers shared similar views to trustees, and were also concerned that should such risks crystallize, the member might seek financial redress from their employer. Employer concerns such as this were cited as reasons for not offering some in-scheme pension flexibilities.

Risks to members and schemes

The flexibilities have the potential to introduce new risks to members who decide to access them and to schemes that decide to offer them. Risks to members include the decisions they make and the basis on which these decisions are made. Risks to schemes may include the way in which they implement or administer pension flexibilities, how they communicate with their members in respect of those benefits, and the governance and regulatory risks to which trustees and employers may be exposed as a consequence of the reforms.

We wanted to understand the specific risks trustees and pension scheme representatives had identified in the four areas of administration, communications, investment, and governance. We also wanted to understand what mitigations they had put in place in respect of these risks.

Administration risks

The administration of pension flexibilities requires occupational schemes to directly pay members the benefit they want. Some benefits are more difficult for DC occupational schemes to administer than others, with flexi-access drawdown considered the most complex. DC occupational schemes are not typically established or equipped to provide regular or occasional payments to members. Instead, their administrative systems are primarily designed to service members' needs during the accumulation phase of their membership: "To offer multiple (payment) opportunities is complex from an administration perspective."

Because the 2015 reforms enabled the provision of pension flexibilities which require payment to the member, we wanted to understand how schemes that decided to offer these benefits would administer them. All but one scheme we interviewed said that any pension flexibilities which the scheme might decide to offer would be administered by their existing third party administrator. The only exception to this was one scheme that already had an established payroll function and undertook all its administration in-house: "All our admin is done in-house. It has not been difficult. The trust runs three of its own payrolls, which has made the transition easy."

We also identified a relationship between scheme type and scheme capability to offer pension flexibilities. Schemes that offered DC and non-DC benefits acknowledged that they could administer pension flexibilities because of their existing payroll functionality, but this capability did not generally correlate with a decision to offer pension flexibilities: "There is the potential for creating payroll for flexi-access drawdown, but due to demographic, members may not like it because the average pot size was £3k in 2014."

We also asked schemes what due diligence they had undertaken in assessing their own capability and that of potential third parties in respect of administering pension flexibilities.

Schemes typically reported that due diligence in respect of administration was an ongoing process. Interviewees described meetings, assessments and reviews taking place as a matter of course, and not as a consequence of the introduction of the pension freedoms. One interviewee did, however, note that the introduction of the charge restrictions in April 2015 had been the specific catalyst for a wholesale review of their third party administration contract.

Schemes typically reported that due diligence in respect of administration was an ongoing process.

Some schemes noted that they planned to formally review their administration arrangements over the coming months. Some also noted that they would do this when it was clearer to them what was required from their relationship with their administrator in respect of the flexibilities because they had not yet decided what pension flexibilities, if any, to offer to their members.

Key criteria that schemes referenced in respect of their administrator were standards and performance, that the administrator remained in a market-leading position and would continue to be able to offer members good quality solutions: "It was important to understanding how much flexibility was in the system and the long term sustainability of the provider. We were also concerned about the member journey – the benefits available to them were an important consideration."

Where the scheme was not currently offering pension flexibilities but was considering doing so, schemes referenced the capability and experience of the administrator, and the existence of a proven platform on which the administrator was already offering pension flexibilities to other clients: "We were keen to link our third party administrator more closely to the investment platform and the annuity bureau so as to provide the member with a more seamless service."

We also wanted to know what changes, if any, schemes had made or proposed to make to their service level agreements so that pension flexibilities would be administered efficiently and effectively. Most schemes reported that no changes were currently required to their service level agreements because they had not yet decided whether or not to offer all pension flexibilities. Some schemes also noted that the generation of benefit statements was already addressed in their service level agreement, although they were now experiencing greater demand from members for such benefits statements. However, there was no evidence that costs associated with the administration of pension flexibilities had so far been fully incorporated into formal service level agreements.

DC schemes are not typically equipped to administer payments to members, so we wanted to understand what specific risks schemes had identified in respect of administering the pension flexibilities, and what mitigations had been put in place in respect of those risks where schemes offered them.

The overwhelming majority of schemes recognised that there were risks with administering pension flexibilities, and only one scheme said that no risks had been identified. Those that had identified risks reported a broad range, and it was not always possible to separate an administration risk from other risks.

The most frequently cited administration risk or concern which schemes reported was the increased activity which the freedom and choice reforms had brought about, specifically transfer quotations, benefit quotations and general requests for information from members in respect of their benefits. This is despite the fact that these requests did not typically result in a request to access a pension flexibility or transfer the members' pot to another scheme or arrangement which did offer pension flexibilities. A number of schemes reported that media attention in respect of pension flexibilities had led members to request information about their benefits.

The majority of schemes recognised there were risks with administering pension flexibilities.

Additional risks associated with the administration of pension flexibilities included increased concerns about pension scams, money laundering where schemes accept transfers in to access pension flexibilities, risks associated with holding cash to pay pension flexibilities, and the interaction between the administration of pension flexibilities and taxation.

Because most schemes we met were not wholly decided in terms of their approach to pension flexibilities, many of the administration risks identified were considered as a part of the decision-making process and not as immediate risks in need of mitigation.

Communication risks

The majority of schemes reported that effective communication with members was a critical element for successful and safe implementation of the pension flexibilities. In this context, we wanted to know what changes to their communications schemes had introduced, when they did it, and any challenges they had experienced in doing so.

All schemes reported that they had complied on time with the new disclosure requirements placed on trustees of occupational schemes. Most schemes also reported that they had undertaken a comprehensive review of all their member communications in advance of April 2015. This was to ensure that their communications not only met the legal requirements, but also provided their members with the information they believed was relevant to their specific membership. Schemes reported that it was important for them to be not merely compliant, but also helpful to their members: "Improving member engagement through communications is one of three confirmed strategic priorities for the trustee for the next 18 months."

A minority of interviewees said they had not undertaken such a wholesale review because they expected further changes to legislation and were reluctant to complete a review until the legislative background was more stable: "The scheme has done a good job, and spent a lot of money, with the possibility that they are going to have to spend more."

Schemes consistently reported that the process of reviewing and updating their communications was lengthy and intensive. One scheme noted that they had over 300 communications to review, while another said that it had taken them six to eight months to prepare a spreadsheet detailing the number of communications to be reviewed. A small number of interviewees had set up communications sub-committees of the trustee board to undertake this task – although this was considered an unusual step.

Cost and the expenditure of employer time and resource were frequently cited as a concern, particularly where the employer bore the cost of communications. This is particularly common in single employer occupational schemes: "There was a significant external communications cost, approximately £100,000, but the real cost was time and resource which constituted multiples of this."

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The cost of time and resource was cited as a major concern, especially when the cost of communications was also borne by the employer.

A further challenge which schemes consistently reported was the limited amount of time which they had available to make the changes to their communications.

Some master trusts had adopted the FCA's risk warnings for occupational and personal schemes.

The majority of interviewees had focused their attention on updating online information (website or intranet) and letters and guides. Some also communicated with members via other channels, including company TV and DVD, pension roadshows, and face-to-face sessions.

While some had created entirely new warm up packs or member guides that explained the freedoms available, most had concentrated on updating and revising existing materials. These updates included signposting members to Pension Wise and providing them with Money Advice Service guides to the new freedoms, and restructuring their member 'retirement pack' so that information on pension flexibilities appeared at the front. Schemes also reported that they had given added prominence to the 'Scorpion' pension scams campaign in their member communications.

A number of schemes commented on the increasingly prescriptive nature of the disclosure requirements they were required or advised by their advisors to adopt, specifically the 'risk warnings'. Some schemes also noted the different disclosure requirements for warnings that applied to occupational schemes and work-based personal pensions. Some insurer-sponsored master trusts reported that they had adopted the FCA's 'tailored risk warning' requirements for both their occupational and personal schemes as doing so was considered more efficient than having two sets of communications materials for the two types of pension scheme.

In respect of the disclosure requirements, a number of single employer schemes remarked that trustees' ability to tailor their communications to their members' needs was becoming increasingly compromised, and that single employer occupational schemes were not providing regulated products in the way that FCA-regulated entities were. They noted that this justified the different requirements that were placed on occupational schemes and work-based personal pensions.

Interviewees of single employer occupational schemes who raised these concerns expressed a desire for caution in respect of additional and mandatory disclosure requirements, and of regulation in general. They were concerned that the positive elements of occupational pension schemes and their distinctive governance arrangements would become diluted over time if further changes were made.

We also wanted to know who was responsible for reviewing and approving communications, and what specific governance arrangements schemes had put in place to ensure that members received the right information at the right time.

All schemes reported that it was the trustee board who had ultimate responsibility for reviewing and approving member communications, but that trustees did not act in isolation. Input was sought from a variety of other sources including financial and legal advisers, scheme actuaries, third party administrators, and the employer and their representatives.

As a result of the complex decisions facing members in deciding to access pension flexibilities, some schemes reported that they were tailoring the information they sent out. For example, one scheme reported that they were planning to develop individual packs to help members engage with the decision-making process. A small number of schemes also said they were making use of interactive modelling software to ensure that members received individual messages at the appropriate time.

However, trustees in particular were conscious of rules regarding the provision of regulated financial advice (not guidance). They reported that they took a cautious approach to individual interaction with members so that their communications could not be construed as regulated financial advice: "It was difficult to help members without tripping over the FCA regulations. The hurdle of what is 'advice' is not clear."

Some schemes said that they were intentionally forcing members to take a more considered approach to their decision making. One had implemented a 'pause and reflect' mechanism where members are required to fill in a form if they are interested in receiving further information about their pot. If so, they also have to fill in a 'risk warning' form. Another had decided that members would only be sent a benefits quote after the second approach from the member. However, schemes recognised that steps designed to protect members can sometime be frustrating for them: "It can sometimes be frustrating for the consumer... customers were complaining that the process (of accessing pension flexibilities) is too lengthy."

Lack of engagement was an issue – in one case only **13%** of a scheme's members responded to its communications.

Overall, schemes recognised the potential for significant member-level risk in terms of their communications with them. Only two schemes said that no significant communication risks to members had been identified at the time of interview.

A number of commonly identified risk themes emerged. These included being subject to fraud or pension scams, a lack of understanding of tax implications, and generally making poor decisions about their pension assets: "Due to newspaper and media coverage members perceived that the lump sum would be tax free and not the fact that only the first 25% is tax free."

Schemes reported that these risks were exacerbated by a general lack of engagement amongst members. One scheme had written to all members aged over 55, giving them the opportunity to select a different lifestyle option depending on whether they were planning to purchase an annuity or take cash with their pension pot. In this case, only 13% had responded.

All schemes were reviewing their investment strategies.

One interviewee had taken a decision to limit the amount of information sent to members to avoid overloading them with material which might potentially cause confusion or a bad decision: "We do not want to unwittingly lead people down the wrong path just by giving them all the information."

Some interviewees said they had asked members to confirm that they had visited the Pension Wise website or spoken to Pension Wise, although they conceded that it was not possible to know whether the member had actually done so.

The potential for members to make rash decisions was also considered a key risk by schemes and something that should be addressed in communications. One scheme had also advised members that they might wish to consider postponing a transfer request in order to access pension flexibilities, because an in-scheme drawdown option could become available in the future.

Investment risks

The introduction of pension flexibilities has significant implications for scheme trustees and their members in respect of their investment strategies, particularly in the lead up to the date at which a member may access their benefits. Before pension flexibilities were introduced, a scheme's default arrangement would typically de-risk members' pots in the run up to decumulation and re-allocate the assets to match their objective.

This would tend to involve an allocation of 25% cash and 75% in assets that gave some protection from fluctuations in annuity rates. Trustees therefore had a degree of certainty in respect of when the member was likely to decumulate – the scheme's normal retirement age or the member's nominated age – and what their objective would be (cash plus an annuity). In the absence of an express wish by the member to take an alternative approach, this would generally constitute the scheme's 'default' option.

As members are now less likely to buy an annuity, we asked schemes if they had reviewed their investment strategies and whether they proposed to make, or had already made, any changes as a result.

All interviewees said that they had reviewed, or were in the process of reviewing, their investment strategies. However, these reviews were not always prompted by the introduction of pension flexibilities, because schemes reported that they regularly undertook such reviews: "The investment strategy was due a review, and the changes probably brought forward this review a little."

All schemes shared a common understanding of why an investment strategy review was required, and recognised that a default glide path of, for example, 25% cash and 75% annuity matching or correlated assets, might no longer be appropriate for their members. However, not all reviews undertaken in light of the flexibilities resulted in a change to investment strategy: "The targeting of the annuity default might change once there was enough data available (both fund-specific and market) on member choices in practice to form a considered view."

Interviewees cited a range of factors to take into account when reviewing their investment strategies and glide paths. The most frequently cited factor was the projected pot size of the member. This is because schemes believed that members with moderate projected pot sizes (those small enough not to have significant tax implications) were considered likely to want to take their entire pot as cash. However, some schemes reported that they were not comfortable defaulting members into a glide path based on the size of their pot with the scheme. This is because this pot size was likely to provide only a partial account of a member's total pension assets: "We now have lifestyle options for those who want to annuitise and those who want cash but do not have a lifestyle option for those who want to go into drawdown. We may have to choose the least detrimental route and consider pot sizes when choosing defaults."

Schemes also reported that actual member behaviour was not yet clear, making it difficult for them to make firm decisions at this stage: "We worry about spending further funds on changes to investment options until we see what members want. We are not currently seeing a great deal of desire for change from the members."

In cases where glide paths had already been amended, there were variations in respect of what the new one would seek to achieve. Some schemes targeted the member's entire pot toward cash at the scheme's standard retirement date or member's nominated date, others 50% to cash and 50% to risk-bearing assets which hedged inflation risk. Some had introduced a number of glide paths which their members were asked to choose between based on what they planned to do with their pot. Others had decided to retain their existing glide path because the decisions which their members might make were not yet clear. One scheme noted that the trustees believed that their management of investment volatility was within such a narrow band that de-risking in the run-up to age 55 was, on balance, not the best course of action.

A number of schemes planned to engage more closely with members as their decumulation date approached.

Three broad themes were typically reported:

- A revised glide path should provide greater flexibility for members in light of the number and range of new potential retirement outcomes.
- For members with small or moderate pot sizes, an increased proportion of assets in cash is likely to be appropriate.
- Member pot sizes and intentions should be monitored more closely as decumulation approaches, with a view to defaulting members into an appropriate glide path based on the size of the pot. It was felt that this approach might be necessary in the absence of the member expressing an instruction in respect of their intentions.

A number of schemes reported that they planned to engage more closely with members as their decumulation date approached, or at pre-determined trigger points. At these points, schemes would explain the options to members and ask them to select the most appropriate glide path.

However, a number of interviewees reported that members were not engaged enough for this approach. They said that the introduction of pension flexibilities, coupled with low levels of member engagement, presented significant challenges for trustees in determining an appropriate glide path for their members: "It is difficult for trustees to make decisions regarding defaults at or approaching retirement if their membership is not engaged."

Schemes were therefore aware that an inappropriate glide path constituted a risk to good member outcomes. The three broad themes referenced above can therefore be considered mitigations in respect of these risks.

We also asked schemes whether or not they had made changes to their contractual relationships with their platform providers or investment managers as a direct result of the flexibilities.

Most schemes reported that they had made changes to existing relationships, but these changes were generally restricted to the glide path and asset allocation alterations noted above. Schemes did not report, for example, that they were re-tendering their investment mandates in a direct response to the flexibilities. Some schemes did, however, tell us that they were examining the capability of their existing platform provider to administer member-initiated investment decisions as a result of the flexibilities.

Schemes also reported a further set of risks to which members, schemes, trustees and employers were potentially exposed in the investment space. These risks included accessing their benefits in such a way that their pot was exhausted, or that exposed the member to tax liabilities that could have been otherwise avoided. We consider what schemes told us about these risks in the next section.

Governance and regulatory risks

Interviewees considered effective scheme governance to be central to the efficient and safe implementation of the pension flexibilities. 'Governance' in this sense meant the policies and procedures that support trustees' effective discharge of their legal responsibilities, their overall fiduciary duties to act in members' best interests, and the legal and regulatory environment in which these duties are to be met.

One risk that was consistently raised by trustees was the difficulty many faced in deciding which approach to take where members wanted to access pension flexibilities but the scheme had decided not to offer them. On the one hand, trustees wanted to help the members find a solution that met their needs, but they were also cautious of assisting members in such a way that it might place them within the perimeter of FCA-regulated financial advice: "The trustee has adopted a position that we will avoid any communications which could be perceived to be 'advice', which will constrain our ability to communicate creatively using behavioural insight. We are very keen for the regulatory framework to be anchored and consistent."

Trustees were also conscious of risks associated with signposting a member to an FCA-regulated product or provider, or an occupational master trust, to access pension flexibilities, because this could mean that they were at risk of providing regulated financial advice.

A related risk raised by trustees and pension scheme managers representing their employer interests was the potential vulnerability of the trustee and the employer to requests for financial redress from a member at some point in the future. For example, where the member felt that they had not received enough information, or the right information, or where they had made a decision to access pension flexibilities that they might subsequently regret: "The employer and the trustee were concerned that an employee may come back to either if they had transferred and regretted it."

Trustees and employers typically reported a low appetite for risk in this area, which they frequently recognised as potentially leaving members vulnerable to poor decision making: "There is a fear of things going wrong and claims being made against the ceding scheme, which puts the risk back on the members."

The overriding concern was that the introduction of pension flexibilities created or extended trustee and employer liability into the decumulation phase. However, this was coupled with a general desire to act in members' best interests over the lifetime of their pension saving. Single employer occupational schemes were particularly sensitive to this risk.

The overriding concern was that pension flexibilities extended trustee and employer liability.

Glossary

Accumulation	The phase during which a consumer or member saves into a pension during their working life to build up a pension pot for their retirement.
Decumulation	The phase during which a consumer or member converts their pension savings into a retirement income, or makes a withdrawal from their pension pot.
Defined benefit (DB) pension	A scheme that offers a pension based on how much a member earns and how long they are an employed member of the pension scheme.
Defined contribution (DC) pension	A scheme that offers a pension based on value of the fund that has accrued as a result of contributions that have been, made together with the investment returns.
De-risking	The process of changing an accumulation investment approach to one that takes account of an expected decumulation objective, with the overall aim of minimising the risk of financial loss. See also glide path.
Glide path	An investment strategy that defines the asset mix of a fund or funds at a particular point in time. This takes into account the member's decumulation date and their objective.
Hybrid scheme	A scheme that offers a combination of both DC and non-DC benefits.
Income drawdown products	Products that allow consumers or members to take an income from their pension fund, while the remaining fund continues to be invested. Retirement income can increase or decrease according to the volatility of funds. Types of income drawdown products include flexi-access drawdown (FAD), partial designation drawdown and phased drawdown.
Master trust	An occupational trust-based pension scheme which provides benefits to members who are staff of unconnected employers and where each employer group is not included in a separate section with its own trustees. For this purpose, employers are connected if they are part of the same group of companies (including partially owned subsidiaries and joint ventures).

Self-invested personal pension (SIPP)	A pension 'wrapper' that holds investments until an individual retires and draws a retirement income. It allows individuals to make their own investment decisions from a range of investments approved by HM Revenue and Customs (HMRC).
Uncrystallised fund pension lump sum (UFPLS)	An authorised lump sum which can be paid from uncrystallised funds under a DC arrangement to individuals aged 55 or over, without the requirement to buy a decumulation product.
Warm up pack	A communication package provided to members at least four months before their chosen retirement date with information on the actions they need to take. Typically this includes the value of the pension and the retirement options available from the scheme, and highlights the importance of shopping around. Also known as a wake up pack.

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www.trusteetoolkit.com
Free online learning for trustees

www.pensionseducationportal.com
Free online learning for those running public service schemes

Freedom and choice How occupational pension schemes have implemented the pension flexibilities

The Pensions Regulator