All change for DB transfers

LCP's quarterly review of the transfer experience of the schemes we administer

Issue 26, March 2022

Transfer quotations reach new highest average size

- Following the lowest quotation rate in five years in Q3 2021, transfer activity returned to a more normal level in Q4 2021. LCP's administration teams issued 131 quotations for every 10,000 deferred members, 22% higher than the Q3 figure and similar to the rates seen earlier in 2021.
- The average transfer value quoted in Q4 2021 was £413,000. Against a backdrop of rising inflation, this was the highest figure since we started our analysis in 2014.
- As a result, £153m of transfer quotations were issued in Q4 2021, the highest total since Q2 2019.
- The take-up rate (proportion of quotations ultimately paid out) rose significantly, from 17% of Q1 2021 quotations to 21% of Q2 2021 quotations.
- Take-up however continues to be low for small and mid-range transfers, continuing a trend that began when the FCA contingent charging ban came into effect in October 2020.

New transfer scams legislation take effect

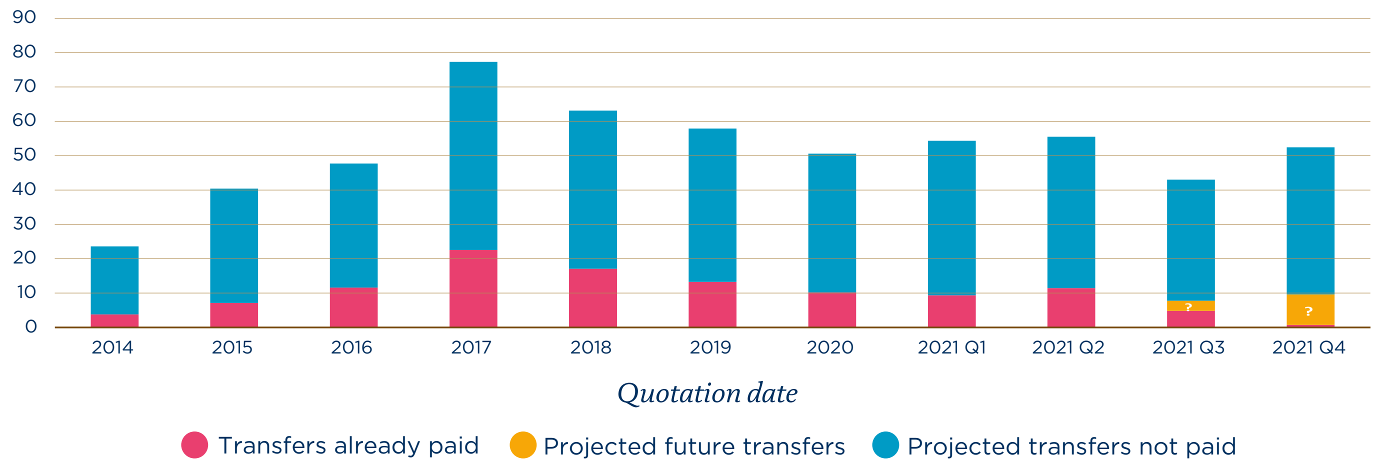
New legislation came into effect on 30 November 2021, requiring trustees to carry out due diligence on transfer requests received with the aim of protecting members from pension transfer scams. The Pensions Regulator (tPR) issued new guidance to trustees and scheme managers alongside the legislation. Under the new legislation, if a transfer request raises an "amber flag", the member will need to attend a guidance session with the Money and Pensions Service (MaPS) before the transfer can proceed. If a "red flag" is raised, the trustees will be required to block the member's statutory right to transfer. There are seven possible amber flags and six possible red flags, as set out in tPR's guidance. Any impact on quotation or take-up rates will not become apparent until next quarter's analysis.

One of the amber flags is "a sharp, unusual rise in transfers involving the same scheme or adviser". Alongside our main quarterly analysis, we are continuing to centrally monitor individual schemes' transfer request activity to help LCP administration teams spot any concerning rises in requests. This involves comparing each scheme's request activity in a given month against the average for other LCP clients in that month and against that scheme's recent historic activity. If activity is flagged as being higher than expected, we notify the client team so that they can check for a concentration of requests involving the same adviser or members looking to transfer into the same receiving arrangement.

Rebound in transfer quotation volumes

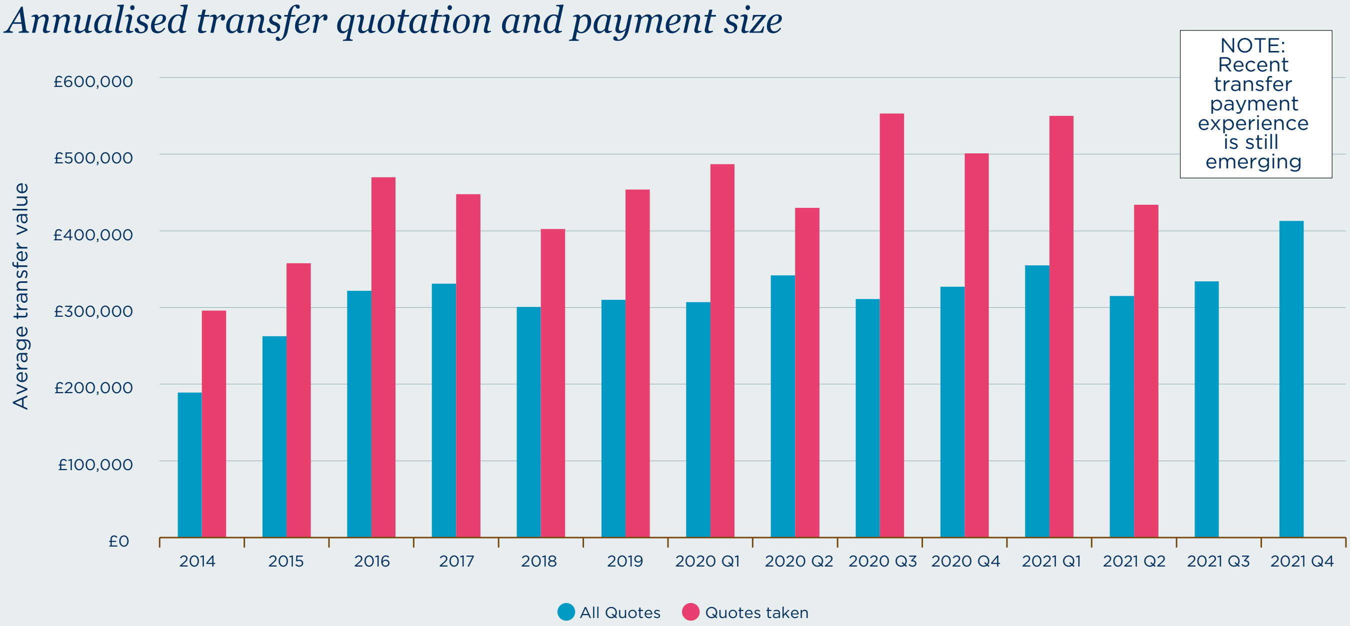
The annualised number of transfer quotations issued per 1,000 deferred members rose from 43 in Q3 2021 to 52 in Q4 2021.

Annualised quotation and payment rate per 1000 deferred members



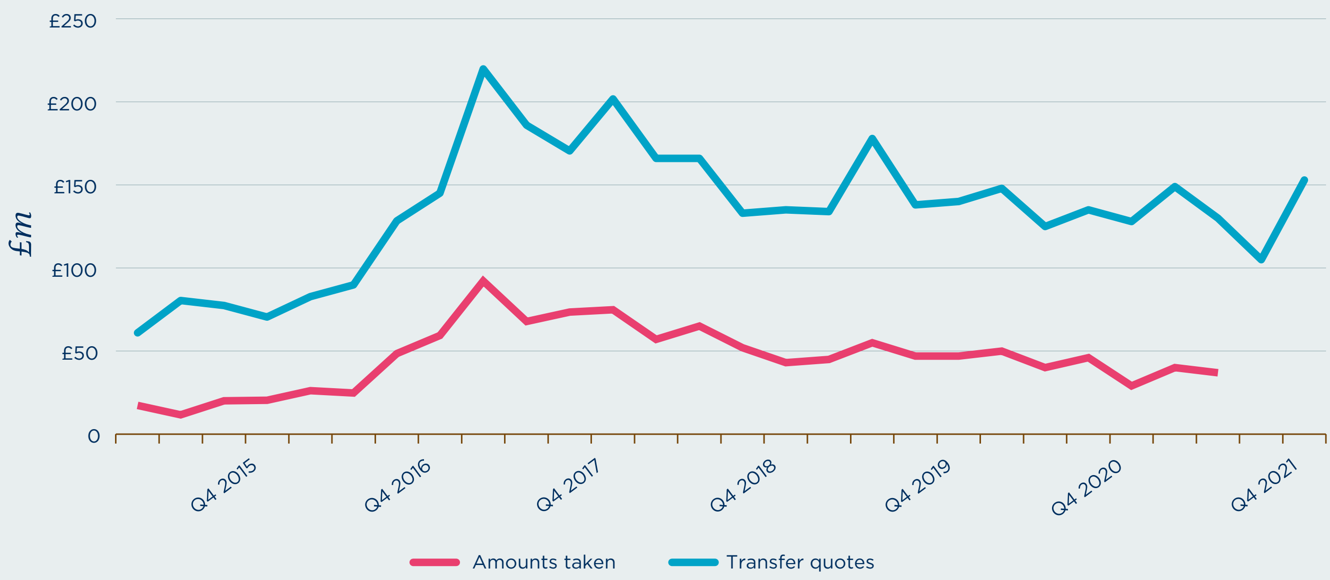
After remaining stable for a long time, the average quotation size jumped to £413,000 in the latest quarter. This is the highest figure since we began monitoring transfer activity in 2014, and only the second quarter where this figure has been above £400,000 – the other being Q1 2017.

Annualised transfer quotation and payment size



With the number of quotations also returning to the levels seen in the first six months of 2021, following a substantial dip in Q3, the total transfer value quoted rose by 46% from £105m in Q3 2021 to £153m in Q4 2021.

Total amounts quoted and paid out

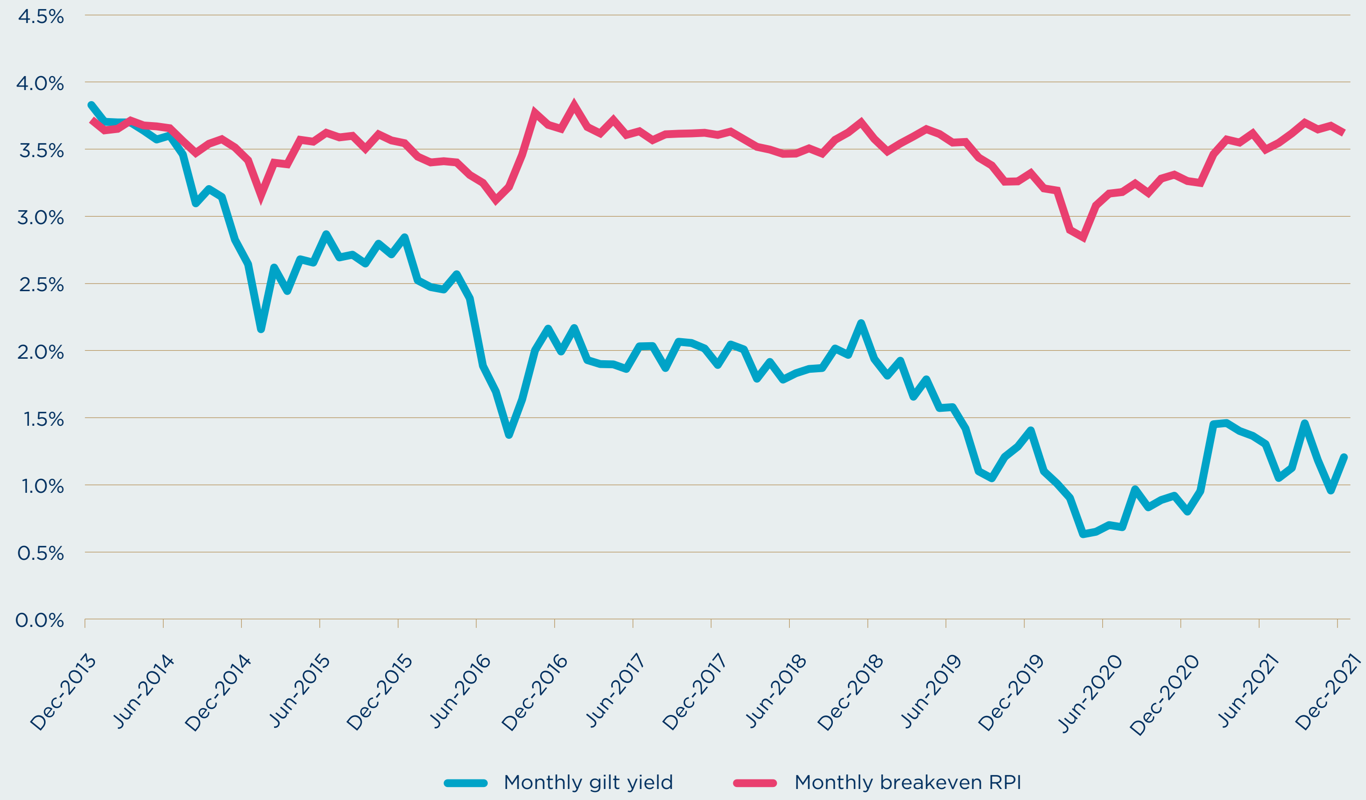


As transfer payment activity for Q4 2021 quotations emerges in the first half of 2022, we will have to see whether this translates into higher average or total payment amounts.

The rebound in quotation rates could simply reflect a one-off dip in Q3 2021 as Covid-19 restrictions were removed, as discussed in our previous issue of this report. The trend towards larger transfers being quoted is harder to unpick, although two possible reasons are as follows:

1. Rising inflation expectations: The key actuarial assumptions affecting the size of a transfer value are the post-retirement mortality assumption, the discount rate and the inflation assumption. Despite the Covid-19 pandemic, long-term mortality expectations have not changed enough to have a significant impact on a typical transfer value basis. Similarly, gilt yields – the underlying basis for most schemes' discount rates – did not move substantially over the course of 2021, despite repeated falls in previous years. However, as shown in the chart below, inflation expectations – measured here as the future rate of increase of the Retail Price Index (RPI) implied by the government bond markets – increased steadily throughout 2021.

Annualised 25-year gilt yields and breakeven RPI



These increases have come despite the planned change to the RPI formula in 2030, which – all else being equal – is expected to lead to lower RPI increases after this date. As more schemes allow for this planned change in their transfer value basis, the value of benefits linked to the Consumer Price Index (CPI) are likely to see even bigger rises than for RPI-linked benefits. Another contributing factor to higher transfer values is likely to be higher observed inflation: in the second half of 2021, actual inflation grew to the highest levels seen so far in the 21st century.

Overall, since our analysis began in 2014, the chart above shows a widening gap between gilt yields and RPI expectations. This implies a downward trend in the net discount rates used in pension valuation calculations, including transfer values. This would have been a key driver of the long-term trend towards higher transfer values, culminating in the highest average transfer value quoted in Q4 2021.

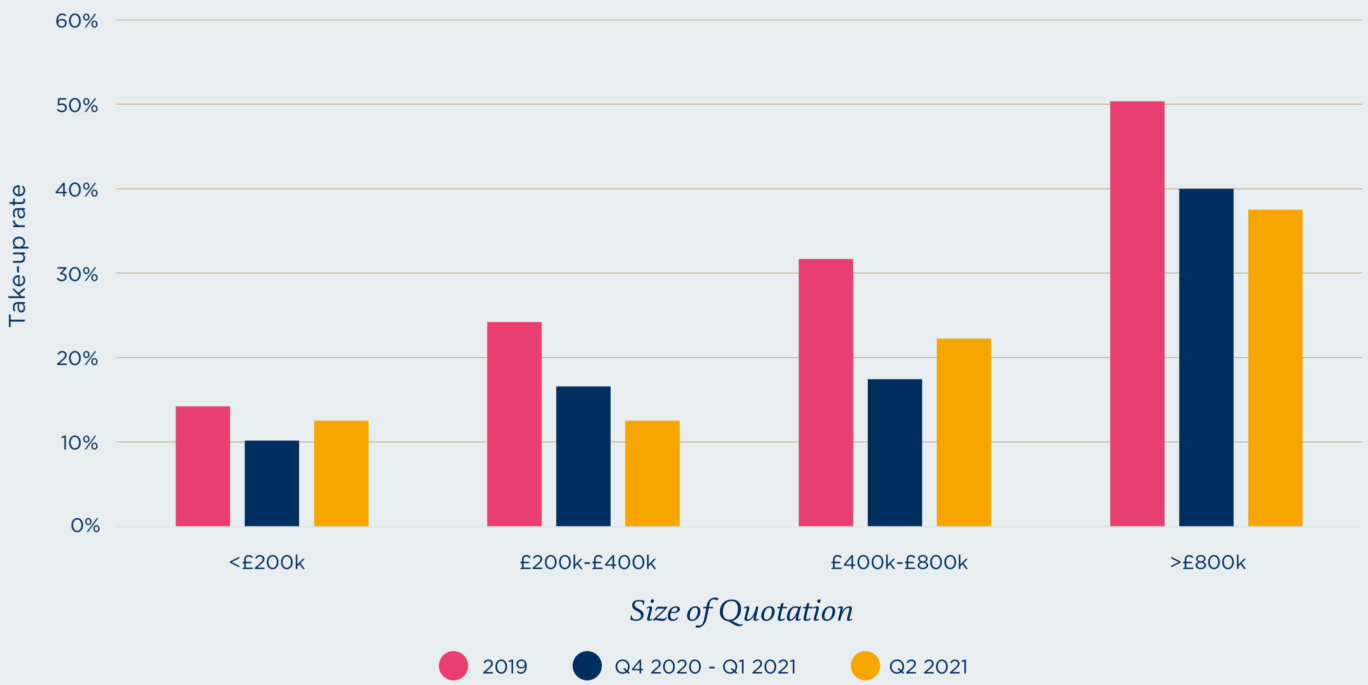
2. Knock-on effects of the contingent charging ban: As discussed below and in previous issues of this report, the ban on contingent charging implemented on 1 October 2020 has had an unequal impact on take-up rates for transfers of different sizes. Take-up rates have decreased across the board, but by less proportionately for the largest transfers, suggesting that members with smaller benefits might be being deterred by high up-front advice fees. Until now we have not seen a similar trend among quotation rates. However, the latest rise in the average transfer value quoted might suggest that, as more advisers leave the market, it is becoming harder for members with smaller benefits to obtain affordable advice prior to the quotation stage.

New payment pattern emerges following contingent charging ban

The Financial Conduct Authority's ban on contingent charging by financial advisers for DB transfer advice was announced on 5 June 2020 and implemented on 1 October 2020. The most recent payment data, relating to transfers quoted in Q2 2021, revealed a take-up rate of 21%. This is above the previous take-up rate of 17% for quotations issued in Q1 2021 but remains below the average take-up rate of 25% over the last five years.

The chart below shows a breakdown of take-up rates by size of quotation. We have compared take-up rates in the latest three quarters (with Q2 2021 split out) against those in 2019 – a period of relative stability in the market before the Covid-19-induced volatility of early 2020 and before the June 2020 announcement of the contingent charging ban.

Take-up rates before and after contingent charging ban

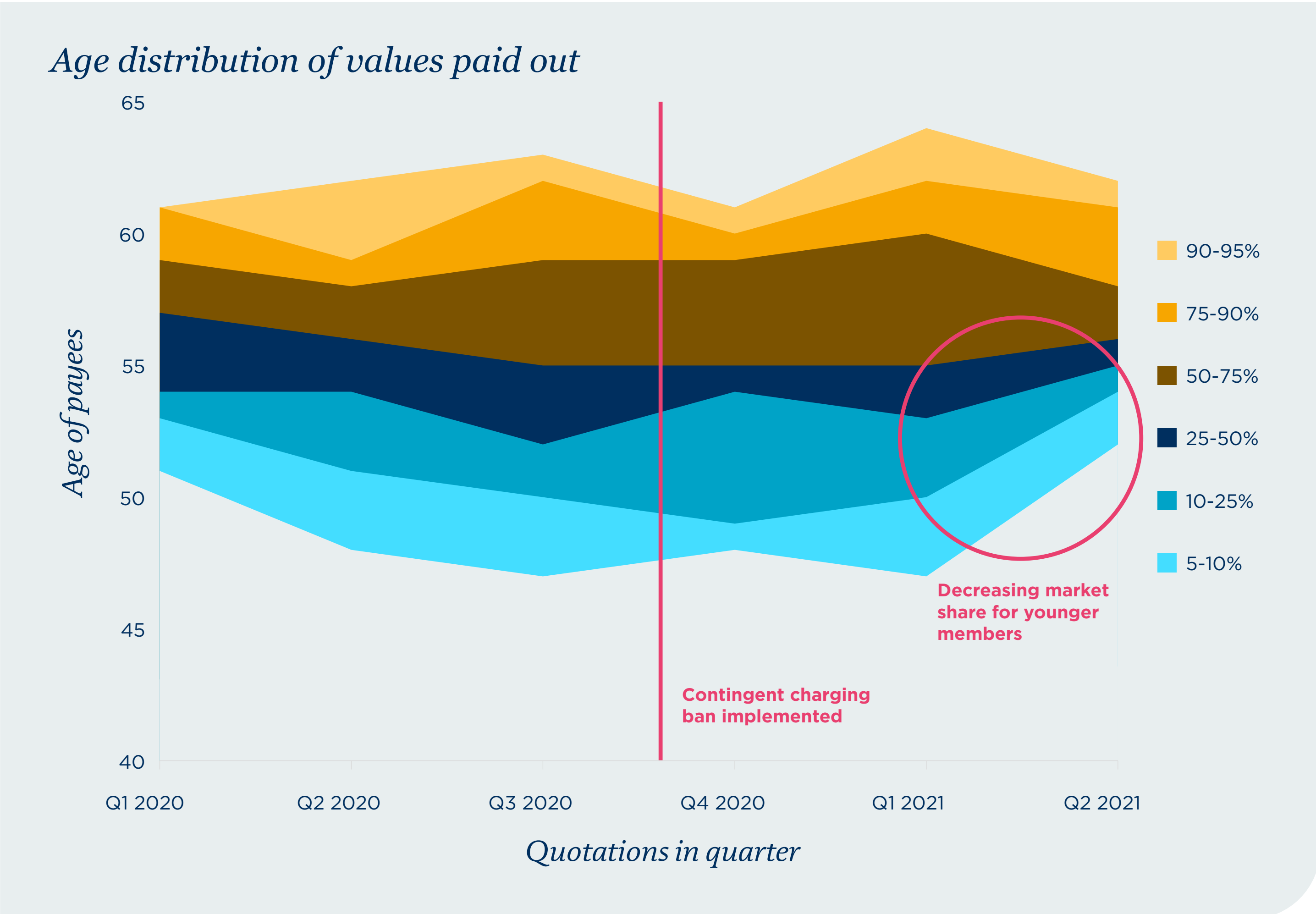


Note that we have removed a small number of schemes from this part of our analysis, where we have reason to believe that the take-up rates in 2019 would not be comparable with the more recent rates (for reasons other than the contingent charging ban). This has caused some of the figures for 2019 and "Q4 2020 – Q1 2021" to differ slightly from those stated last quarter, but we do not believe it alters our conclusions.

The picture for Q2 2021 quotes remains largely similar to the previous two quarters, with take-up rates down across the board compared to 2019 but less so for transfers over £800,000, which make up roughly the top 10% of the transfer quotations market. One notable change this quarter is that the take-up rate in the upper mid-range of the market (transfers between £400,000 and £800,000) increased to 22%, perhaps suggesting a slight recovery in the range that saw the biggest proportionate drop-off in the first two quarters following the ban. However, with three quarters of credible data, there is now a clear picture emerging of lower take-up rates across the board and an even heavier weighting towards the largest transfers.

How does this link to advisers' charging structures? Following the ban on contingent charging, many advisers would have had to increase their up-front fees to cover their costs. Members with the largest benefits might be prepared to pay high advice fees regardless of the outcome, but across the rest of the market these fees would now appear very large compared to the size of the transfer, potentially deterring many members from transferring. This is discussed in more detail in a previous release of this report.

The latest quarter also saw a decrease in take-up rates among younger members, with only 8% of quotations issued to members below 50 being taken up, which compares with 12% in the previous quarter and is the second lowest figure since we began our analysis in 2014. This led to very low payment volumes for younger members, as less than 1% of the total value of quotes paid out was paid to members below 50. The following chart shows a breakdown of market share by age for transfers paid out.



The blue sections of the chart show that, in the first three quarters of 2020, an increasing share of the transfer amounts paid out went to younger members. Since then, and especially in the latest quarter, younger members have had a shrinking share of the market. In particular, less than a quarter of the total value paid out in the latest quarter went to members below 55. While this trend is not yet clear-cut, there are a few possible explanations for this:

- Similar to the above findings relating to size of transfer, it might be that younger members with less savings are finding it harder to justify paying large up-front advice costs.
- Under the 2015 Freedom and Choice regulations, members can start drawing down their retirement savings from age 55 after transferring into a DC-style arrangement. This suggests that, all else being equal, transferring is more likely to be in the best interest of a member over age 55 than one below age 55. If the contingent charging ban has reduced the incidence of unscrupulous advisers recommending transfers that are not in members' best interests, this might provide a reason for more transfers being taken by older members.
- Similar to the above point, members over age 55 might be less concerned about paying up-front advice costs if they are able to gain flexible access to their retirement savings immediately after transferring.

Long-term trends in transfer activity

In the 12 months to 31 December 2021 our administration teams provided transfer value quotations to just over 5% of deferred members, with a value of £537m in total. This compares to just over 5% and £536m in the 12 months to 31 December 2020. While there has been significant volatility in demand for quotations during the Covid-19 pandemic, overall transfer quotation activity remains significantly lower than the peak in activity seen in 2017 when almost 8% of deferred members requested transfer quotations with a total value of £778m.

The total value of payments in respect of quotations provided in Q2 2021 decreased to £37m with an average size of £434,000; this compares to the peak for quotations provided in Q1 2017 (£92m paid out with an average size of £627,000) and is the second smallest total value paid out since Q2 2016.

Have take-up rates changed?

The take-up rate for quotations made in Q2 2021 was 21%; this represents an increase from the previous quarter (17%).

Transfer value quotations in year to 31 December 2021

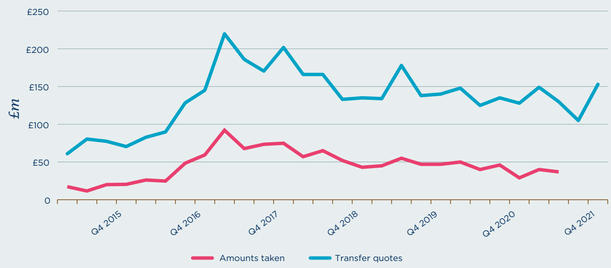
Quotation rates continue to be highest for those aged 55 and over. Just over 7% of members aged 55 and over requested a transfer quotation in the 12 months to 31 December 2021, compared to less than 3% of members under 50.

Transfer values taken in year to 30 June 2021

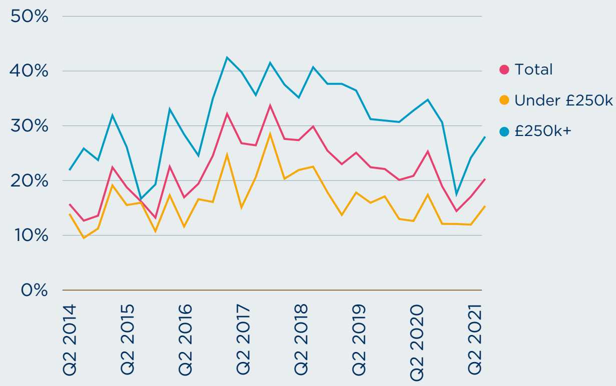
Around 22% of quoted transfer values proceeded to payment for those members aged 55 and over, compared to 18% of all transfer values quoted in the 12 months to 30 June 2021. Only 10% of transfers quoted to members under 50 were taken over the same period. As a proportion of all quotations in the year which were then paid, 66% were paid to members aged 55 and over and 11% were paid to members under 50.

The average transfer value taken in respect of quotations in the 12 months to 30 June 2021 was £508,000, over twice the average price of a house in the UK during this period.

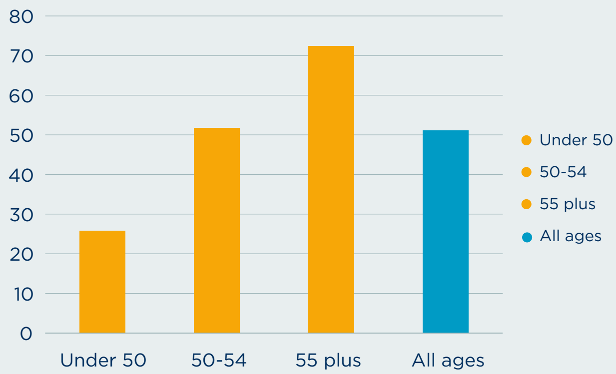
Total amounts quoted and paid out



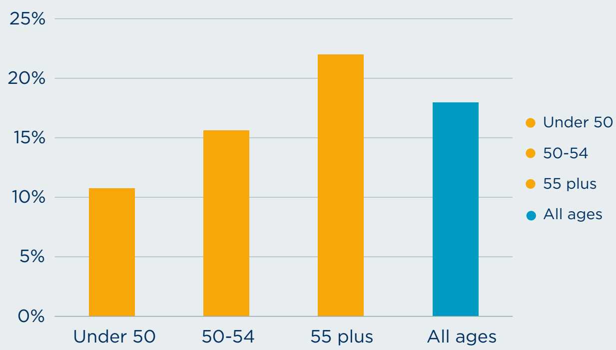
Proportion of transfers taken over and under £250k



Number of quotations per 1,000 deferred members in each age group



Proportion of quotations that proceed to payment in each age group



Contact us

If you would like further information, please contact your usual LCP adviser or one of the people below.

Bart Huby
Partner
bart.huby@lcp.uk.com
+44 (0)1962 872711

Jim Little
Partner
jim.little@lcp.uk.com
+44 (0)1962 873363

Andrew Pijper
Associate Consultant
andrew.pijper@lcp.uk.com
+44 (0)1962 673011

Avneet Gill
Associate Consultant
avneet.gill@lcp.uk.com
+44 (0)1962 454433

At LCP, our experts provide clear, concise advice focused on your needs. We use innovative technology to give you real time insight & control. Our experts work in pensions, investment, insurance, energy, financial wellbeing and business analytics.