Insights

Pension freedoms 10 years on: the impact on defined benefit savers

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The advent of pension freedoms transformed how members could access their savings – and that includes savers in defined benefit (DB) schemes.

Let's step back to a different time … David Cameron has just won the general election for the Conservatives, your cutting-edge iPhone 6 has 16gb of data, the Great British Bake Off is still on the BBC and you can't escape Uptown Funk all summer. But for us in the world of pensions, 2015 was all about pension freedoms.

Introduced on 6 April that year, pension freedoms gave people more control over what to do with their DB pension at retirement. Savers could take lump sums, flexi-access drawdown became a viable option for lots of people, and it looked like annuities were going the way of the Blackberry. Remember those?

There's been a plethora of articles in the pensions press marking a decade of pension freedoms, usually discussing the effect on defined contribution savers. But I wanted to look at this in a different way – at how pension freedoms affected members of DB schemes. And the implications for how we as an industry look after these members.

Would DB members embrace the new flexible world?

My hypothesis was this: I wanted to see if more DB members were transferring out after the advent of pension freedoms, and whether more members swapped their pension for life for this new flexible dawn.

So, I created an index. I looked at a cohort of people each year and their marginal rate to transfer versus their marginal rate to take a DB pension at retirement. My cohort were members with DB pensions who chose to access their benefits in a given calendar year, who made their decision between the ages of 55 and 70, and whose benefits excluded them from taking a trivial lump sum from their scheme. It's not a perfect cohort, but looking at it each year allowed me to see if behaviour changed over time.

And behaviour changed. A lot.

Transfers rose – until Liz Truss's mini-budget

Going back to 2014, typically less than 10% of this cohort would transfer, and over 90% would retire in the scheme. This crept up slowly after 2015, but by 2018 it shot up – one in four members were now choosing to transfer their DB pension to access pension freedoms.

It's worth noting that pension freedoms were not the only thing going on here. Over the same period, the average transfer value we paid on behalf of our DB clients jumped from about £110,000 to over £300,000. A combination of these factors meant that, by 2018, schemes were paying out nine times more of their cash as transfer values than they were in 2014.

After the peak of 2018, the rate of transfers slowly declined to 17% in 2019 and settled at 14% between 2020 and 2022. After three consistent years, it looked like we'd landed on a new baseline. Enter Liz Truss and Kwasi Kwarteng with their mini-budget of September 2022.

The economic uncertainty at the time led to a collapse in the average transfer value paid, from £300,000 to nearer £100,000. And we saw historically low transfer rates of 6% in 2023 and 2024, as 94% of members decided to keep their DB pension for life.

This made me reflect on a number of things. Policymakers foresaw the appeal of the pension freedoms and so brought in the pension advice requirement to make sure the people making these decisions took regulated financial advice.

Did this lead to better member outcomes for DB members? The answer is it's too early to tell. It will be some years yet until we know if those people who chose to transfer have got a good deal, or if they are starting to run out of pension pot.

How should we respond to changing behaviour?

For DB pension trustees, or insurers who have bought out deferred DB pensions, I think the message here is that member behaviour can change significantly over time. These changes can make a difference to a wide range of things that the people responsible for looking after DB pension schemes think about.

For example, changing behaviour means members making different demands from the pension scheme. They may want different information and different tasks done. Pension schemes need to react to these new demands, by responding to members directly but also looking at the way they proactively provide information and asking: are we still giving members the information they need?

In addition, the people running these schemes need to think about how changes in member behaviour affect other areas of the scheme. A DB scheme relies on assumptions about member behaviour that underpin how it values its liabilities and plans for future cashflows. If member behaviour can change markedly over time, what are people doing to make sure these assumptions are still valid?

Keeping track of how this is changing for the members we look after, and also looking at the wider trends in our peers, can help us respond to these shifts as an industry. After all, you wouldn't really want to be the only one in the room still trying to read the messages on your Blackberry.

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