Spring 2024

# Equality, Diversity and Inclusion for DB Scheme members

## Are some members losing out?

isio.

## Defined benefit schemes were designed in a different era, typically to meet the needs of a man with the proverbial 2.4 children. Members now expect more flexibility, and most schemes support this. But have schemes looked carefully through an EDI lens to give each member what they need and on fair terms?

Members' retirement choices are critical, with decisions crystallising their benefits for the rest of their life. Lifestyles have changed and individual circumstances are more diverse than ever.  The risk of members getting sub-optimal outcomes is high – particularly if schemes have a one-size-fits all approach to member benefits and options.

> **"There is also a pressing need to address equality, diversity and inclusion."**
>
> **Nausicaa Delfas**
> **CEO of The Pensions Regulator**

## Why should trustees act?

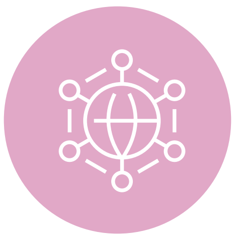


**Trustees' fundamental duty:**
To act in the best interests of members.

**Value for member:**
Members should be encouraged to make decisions that provide best value.



**Fairness:**
Some members may (unintentionally) be getting a better outcome from the scheme than others.



**Equality Diversity and Inclusion:**
As well as being the right thing to do, trustees are under growing pressure to demonstrate their EDI credentials.

# EDI challenges

## The obvious EDI issues are already considered by most trustee boards, for example the relevance of unisex factors. But the indirect EDI risks are harder to spot.

### 1

#### Member decision-making

What are the specific features of your members, and which options are they taking in practice? Do the choices look right for your membership and are there any patterns? For example, are members with small pensions more likely to commute on ungenerous terms?

### 2

#### Generational fairness

Are the terms fair for members retiring at different times? If commutation factors are intended to follow market movements, are factors particularly good or poor value at different times, or do all members get the same deal?

### 3

#### Inconsistencies between options

Are there inconsistencies between “normal” scheme benefits and options including transfers, commutation and early / late retirement? For example members without a dependant – most commonly women - are cross-subsidising others if they draw benefits from the scheme. But the transfer value alternative is usually calculated equally for both single members and those with partners.

**The perfect scenario is where every member can make choices that best meet their needs – and secure in the knowledge that this also maximises their financial outcome through fair financial terms.**

# 1. Member decision-making

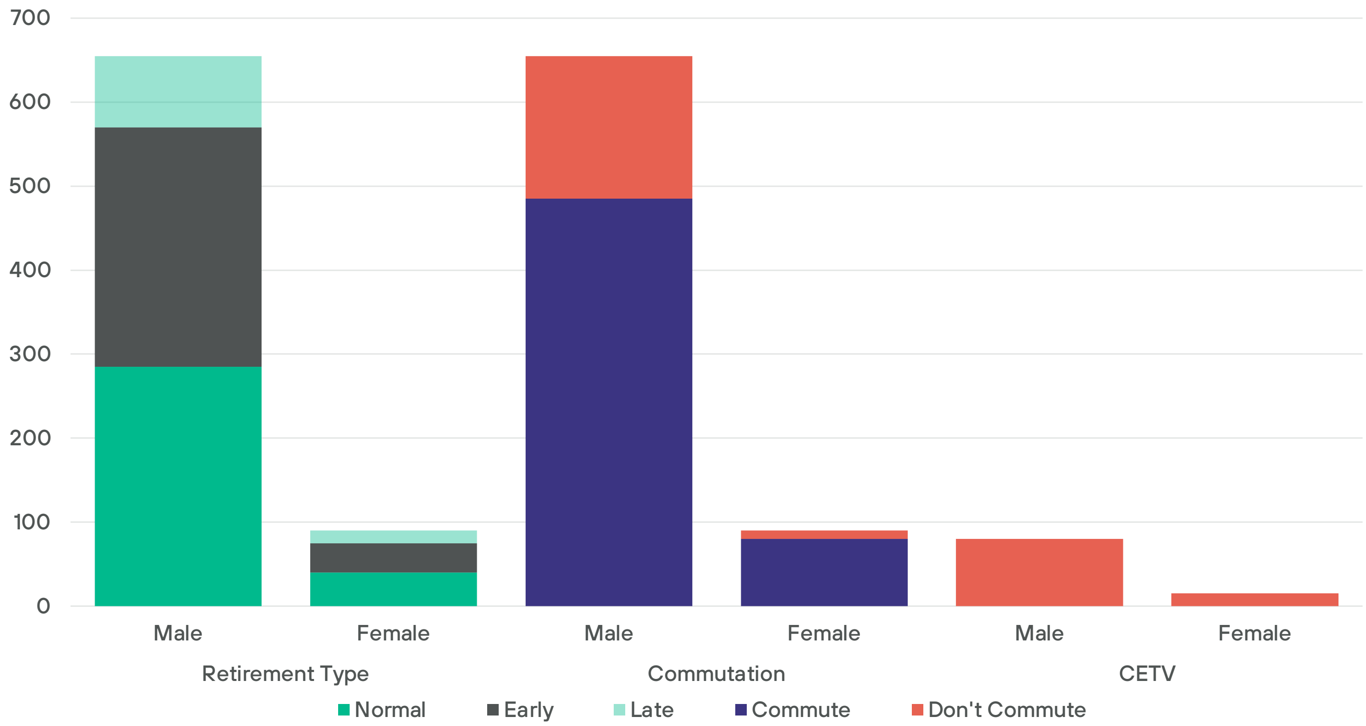
Schemes that have been closed to new members for many years are maturing and the next 5 to 10 years are critical for members' retirement decisions.

But scheme profiles will be very different in the mix of their membership, including income levels and demographics such as gender. A scheme in the retail sector with many part-time workers will look different to its manufacturing counterpart.

Looking at actual member decisions can provide further insight – and identify areas where there might indirectly be different treatment of groups of members. For example if commutation terms are poor value (compared to the pension) and disproportionately used by women and those with small pensions, does that raise concerns about diversity and/or inclusion?

**Value for member: Schemes may provide fair value from their perspective, but members will assess value differently – most members won't meet the Scheme Actuary "average" and will make decisions in the context of their overall income and spending needs.**

Example analysis of Scheme experience



# 2. Intergenerational fairness

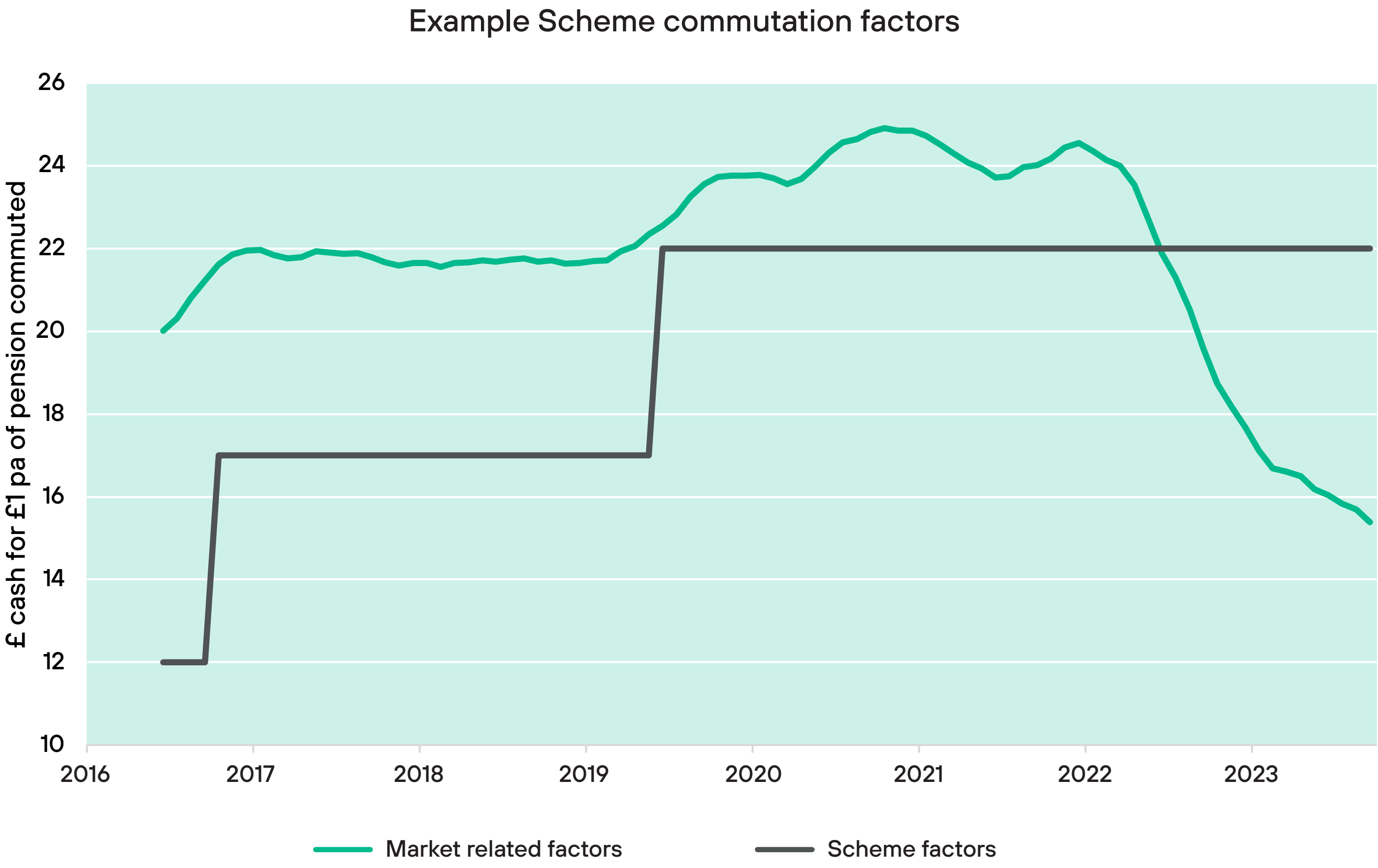
**Consistency over time is difficult to define and implement. Factors that are hard-coded and remain unchanged provide stability, although transfer values will remain the exception as they have to be market-related.**

Some schemes link all their factors directly to market conditions, updating them monthly.  Most schemes are somewhere in between, updating factors perhaps every three years.

Taking commutation factors as an example, this means that scheme factors often lag behind market related factors. In the example below, the terms have swung from being 25% below market prices to now being 35% higher than the market!

It could be argued that this is unfair to different age cohorts of members. Some will receive poor value relative to market rates and others good. There is no right answer, but terms which are more permanently fixed or market-related could avoid this challenge.

In practice changes in regulation and practice mean that factors are likely to evolve anyway.  But trustees should be considering what outcome they are trying to achieve and how that remains fair over time.



# 3. Inconsistencies

Historically trustees may have focussed on the optional nature of member choices. Trustees will also rightly point out that the sponsor sets the rules for scheme benefits, their job is to administer them.

But increasingly there is an expectation across the financial services industry that members (or customers) will be supported and that “bad choices” shouldn’t be made easy. For example, why should a member in serious ill-health be forced to take advice about a transfer to get the best benefits from the scheme?

It’s common to see schemes with factors that are set in different ways. Transfer values are probably updated monthly based on market conditions, early / late retirement terms might be fixed, and commutation terms perhaps updated every 3 years. Members may be faced with a decision (whether they realise it or not), where one choice is financially superior to the other.

Common examples that we see are the treatment of single members, and inconsistency in late and early retirement terms - particularly for Barber equalisation windows.

# Single members

The value of a DB pension for a male with a dependant could be 15% higher than for a single male. While the value differential is lower for female members, statistically speaking they are more likely to be single. Perhaps single members should look to transfer benefits out of the Scheme to unlock this value?

Trustees might also consider whether single members should have better options available within the scheme. For example introducing an option to sacrifice the dependant's benefit in return for a higher member pension. This could increase an average pension from £8,000 to over £9,000 overnight – although care is needed between men and women and the impact on Scheme finances.

The chart illustrates the difference in value for members yet their transfer values may well be identical.

# Challenges

## Rules changes

Trustees are constrained by scheme rules and legislation, and in some cases have no power to make change (without employer agreement). A stronger corporate EDI agenda might make amendments easier, given that the default benefits were historically designed for a typical married male. Even if changes aren't made, the trustees are in complete control of communication to members.

## Financial implications

Whether it's a rule change or simply changes to factors, trustees and Scheme Actuaries may be concerned about financial impacts or selection risks.

Some changes may result in additional costs, but often this is relative to a particular valuation measure. For example, if the actuarial valuation anticipates "profits" from certain member options such as commutation.

Better education of members and informed decision-making could also increase costs in the same way. In practice this is a risk that schemes already have, and it is difficult to justify profiting at members' expense.

With improved funding positions this may be less of a concern and not a barrier to doing the right thing for members.

# Actions for Trustees

## 1 Understand your members and their behaviour

Analysing actual scheme demographics and experience can add insight. What do members do in practice at retirement – commute, draw pension, transfer out? Do members typically draw benefits at normal retirement age or early / late? And how does that vary by gender, age or pension size for example.

## 2 Adopt a consistent set of factors

Unisex factors might be the right first step towards EDI , given that sex is only one of a number of factors influencing life expectancy.

A coherent and consistent set of factors goes a long way to avoiding unfairness. There are often surprising differences in value between member choices and variations over time. The answer could be market-related factors, but stable terms are equally valid provided they are genuinely consistent.

## 3 Review the options that you provide

Does the scheme make the right choices available to meet a diversity of needs? Does the scheme profile suggest that many have little need for a dependant's pension and would prefer an alternative? Or would members also value other options such as pension increase exchange or bridging pensions?

## 4 Provide the right member support

Communication needs to be accessible and inclusive even if the content is complex. As well as clear written communications, schemes can consider other channels such as videos or regular messages in the lead up to retirement.

Where members have key decisions to make, increasingly schemes are providing more individual guidance or even fully-funded financial advice.

# Conclusions

The vast majority of schemes try to treat members fairly and already consider EDI.  But when you dig deeper there are often areas which are less clear-cut, and some groups of members may not be making the most of their  benefits.

Some actions might involve levelling up or increased risk of members "selecting against" the scheme, i.e. making smart decisions which the scheme hadn't anticipated in its finances.  But this shouldn't stop trustees understanding the issues, and stronger funding levels may make it easier to make improvements.

With more thought trustees have an opportunity to make a deliberate and positive EDI impact, better reflecting the individual needs of members.  And, this leads to better outcomes for members who can make the most of their scheme benefits to suit their individual circumstances.  Real value for members.

isio.

# Contact

**Mike Smedley**
Partner
07920 181 110
mike.smedley@isio.com

**Ellie Dobson**
Senior Manager
07468 369 536
ellie.dobson@isio.com