Pension de-risking

Pension Increase Exchange (PIE)

PIE exercises provide the opportunity and flexibility for scheme sponsors and scheme members to reach a mutually beneficial arrangement. Such arrangements can provide members with a pension income, which better matches their needs - leaving the sponsor less exposed to longevity and inflation risks.

What is PIE?
One way to reduce pensions risk is to transform the pension promise through a Pension Increase Exchange (PIE). The concept behind PIE is to offer pensioners and members reaching retirement an immediate increase in the pension they receive in return for agreeing to give up some, or all, of their future entitlement to annual pension increases. Only those pension increases which are provided in addition to the legal minimum can be exchanged (statutory pension increases cannot be given up).

What are the main benefits?
For corporate sponsors:
- A PIE improves the longevity, inflation, and longer term investment risk profile of the scheme
- Increasing pensions are expensive to provide and insure whereas buy-out costs are relatively cheaper
- Provides a good voluntary option for members. The exchange can be structured to lead to a funding actuarial gain (resulting in a requirement for full individual member advice)
- No immediate cash is required from the employer apart from paying for the exercise

For trustees and members:
- Many members prefer a higher initial pension as illustrated by the choices made by UK defined contribution retirees
- Many pensioners have a more active earlier retirement than later retirement – a PIE may suit this retirement pattern
- Some members may consider they have a shorter than average life expectancy
- A higher initial pension may lead to a higher tax free cash sum payable on retirement

How does it work?
Mandatory inflation protection was introduced for benefits accrued after April 1997. There is no statutory requirement to provide inflation protection for pension benefits accrued before April 1997 other than, for contracted-out schemes, those benefits covering Guaranteed Minimum Pensions (GMPs).

There is no legal requirement setting out what the revised higher pension amount should be in return for the future pension increases being exchanged. However, the pensioners will have the ability to either accept or reject the offer; the higher the initial pension amount on offer, the higher the likely take-up rate.

The exchange can be cost neutral, of equal value (or better) with guidance or structure to lead to a scheme actuarial gain with full independent ‘advice’, as defined by the pensions industry code of good practice. Employers are required to finance any individual advice.

![Graph showing time and pension increase](image-url)
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PIE offers may be made to members before retirement, at the time of retirement, or to current pensioners already receiving their pensions. It is quite common to make such offers at the time of retirement by adding PIE options to the existing range of choice for members at retirement. This reduces risk over time as members retire. To achieve a risk reduction at the outset, the PIE offer can be made as a group exercise to current pensioners.

The largest design choice is whether to construct an offer deemed to be of at least equal value, or an offer of less than equal value. If the value of additional pensions is deemed to be less than that of the pension increases being exchanged, there is a potential initial financial gain as well as risk reduction. This has to be balanced against the requirement for full independent advice for such offers, and the impact of the offer amount on the take-up rate of members who accept the offer.

What are the costs?
- Costs for providing independent financial advice, communication with members, and project management

How Xerox HR Consulting Can Help
We have models to assess the potential benefit for schemes and the experience to help construct and implement PIE exercises. We are also able to provide independent financial advice to members.

Contact Us
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