Defined Benefit (Final Salary) Pension Schemes

Thinking of Transferring? Some things to consider

We're proud to be a firm that has met the criteria to achieve the Pension Transfer Gold Standard as set out by the Personal Finance Society. By working with a firm that has voluntarily committed to the Pension Transfer Gold Standard, you can be confident that you will receive the best possible advice, service and support when considering transferring out of a Defined Benefit pension scheme.

Introduction

The purpose of this document is to identify a number of factors that should be considered when looking at the option of transferring a defined benefit pension (also known as final salary) to a defined contribution scheme (such as a personal pension or SIPP).

The information is intended purely to highlight the factors that should be considered and is not designed to provide you with specific advice or guidance on the most appropriate course of action for you to follow.

Defined benefit pension schemes are often described as "gold plated" schemes due to the guarantees and certainties they provide on the level of income that will be paid to you, your spouse and potentially other dependents.

Whilst each scheme will have its own rules that define the level of pension that will be paid, and from what age, once this has been set your income will be paid to you for your lifetime, irrespective of how long you live.

For most people the pension will be paid in full with any funding shortfalls being met by the sponsoring employer. There are occasions, however, where the sponsoring employer goes into liquidation and a shortfall cannot be made good. Should this happen then a second level of protection is available from the Pension Protection Fund (PPF).

Under the PPF there are several levels of protection but it is generally the case that (up to a maximum level) once your pension is in payment the income will be fully protected. Prior to retirement up to 90% of your pension will be protected. There are maximum levels of pension that qualify for protection and taking benefits early can affect the level of protection and the pension increases in payment may differ. For full details see **https://www.ppf.co.uk/**

In essence a final salary scheme will provide you with a known level of income for your lifetime which has a high level of guarantee attaching to it that is underpinned by a national protection scheme.

However, for some people the fixed nature of the benefits provided by final salary schemes does not fit well with their overall financial objectives and the options available for drawing benefits from a personal pension arrangement may be beneficial (note that most, but not all pension schemes will offer you a transfer value in exchange for you foregoing the benefits you have built up with them).

Whilst the flexibility of benefits under personal pensions can be very attractive, they do inevitably include a number of risks.

It is important to bear in mind that if you transfer from a defined benefit scheme to a personal pension that this is a one-way action and it will not be possible to move back in to the scheme if you later change your mind.

The Financial Conduct Authority recognise that transferring out of a defined benefits pension is a complex matter that has lifelong implications and for these reasons you will be required to take professional advice if the transfer value of your benefits exceeds £30,000.

Comparison of Defined Benefit and Defined Contribution Pensions

The table below summarises some of the difference between defined benefit and defined contribution pensions schemes and the pros and cons of each arrangement.

Advantages of a defined benefit scheme	Disadvantages of a personal pension
Defined Benefit schemes frequently provide: • A **high degree** of income security in retirement. • A guaranteed and index linked pension for life. • Provision for your spouse/partner when you die. • Lump sum death in service payments whilst you are an active member. • Very little risk of your income reducing or running out. • No ongoing costs. • No need for ongoing reviews. • Protection from the PPF.	Personal Pensions Provide: • No certainty or guarantees on the value of any benefits that will be payable • An investment linked pension fund which can fall in value as well as rise. • A pension fund which can reduce and run out altogether if investment returns are poor, you draw too much money or live longer than expected. • Ongoing investment and adviser costs and the need for ongoing reviews. • No ability to switch back to a defined benefit scheme.

Disadvantages of a defined benefit scheme	Advantages of a personal pension
• The returns could be poor value if you and your spouse/partner were to die shortly after the pension started. • No provision for your children to inherit any of the value in the scheme • You will have no ability to vary your income once in payment. • The tax free lump sum can only be taken at outset in a single payment.	• You will have a higher degree of flexibility when managing your income. • In some circumstances you may be able to receive a higher tax-free lump sum payment when you start to take the pension benefits. • The investment returns you receive on your investments could <u>potentially</u> result in a higher income via Flexible Access Drawdown. • There will be no link with your employer, should they become insolvent this will not affect your benefits. • Any residual funds may be able to be passed down to future generations.

Please note the above list is not exhaustive and the relative merits of each type of pension will depend on your individual circumstances and needs.

In order to consider whether a transfer to a personal pension may suit your circumstances it is worth asking yourself a number of questions, such as:

- How much income will I need to have in retirement in order to ensure I can meet my essential outgoings?
- How important will the benefits in this pension scheme be in meeting my core outgoings in retirement?
- Do I have a need for a lump sum payment when my pension starts, if so how much?
- What other sources of income will I have in retirement and what level of certainty do they provide?
- Am I happy to take on the transfer risks myself? (see below)
- Will I be able to absorb any losses in the value of my pension funds, and the income that can be drawn?
- Will I need to access these funds during my retirement?
- How important is it to transfer the value of these funds to my beneficiaries?

Transfer Risks

A transfer from a defined benefit pension scheme to a personal pension involves the movement of a number of risks away from the pension scheme to you as an individual and includes:

Inflation – it is important to consider the impact inflation will have on the purchasing power of your income. Even at low rates of inflation the impact over the 20 or more years your pension may be payable for will be significant. Most Defined Benefit schemes will increase the level of pension some measure of inflation.

> Assuming inflation averages 3% per year over a 20 year period then a non-indexed income of £10,000 at the start would be worth nearly 50% less (£5,536.76) in 20 years' time.

Longevity – Many people underestimate how long they are likely to live. It is important to understand that "average" life expectancy is drawn from a range of different ages and it may better to consider the probability you have of reaching say age 100. The Office for National Statistics provides a useful tool in this regard entitled "How long will my pension need to last"

The following example is for a man aged 65 for who average life expectancy is 85:

You can find the life expectancy chart for your own age at:

https://www.ons.gov.uk/peoplepopulationandcommunity/healthandsocialcare/healthandlifeexpectancies/articles/lifeexpectancycalculator/2019-06-07

Investment – investment returns will vary over time and there are no guarantees on the level of the benefits that can be supported by the pension fund.

In addition taking money out of an investment at a low-point in the markets can have a long term detrimental effect on future values.

- Who will be your investment manager?
- What credentials do you, or your manager have in this complex field?

Whilst everyone's circumstances will be different there are some general scenarios that will make transferring benefits from a defined benefits pension scheme more or less likely to be of benefit:

Scenarios where a transfer might be beneficial

- If you are in Ill health and have a shortened life expectancy (although there are potential Inheritance Tax Implications if you were to die shortly after making the transfer).
- You have other sources of income that will meet core outgoings in retirement.
- The pension scheme and sponsoring employer are in material difficulty but the transfer value offered still meets the full value of your benefits.
- If being able to alter the level of income you receive will be of benefit, for example:
    - You are considering going part time before you retire fully and would need some, but not all of the pension, from the scheme.
    - A higher level of income is required in the short term (i.e. until the state pension commences).

> “ Transfer? – Mary is in receipt of her teacher's pension and state pension which covers all her outgoings. An old defined benefit scheme came to light that she had forgotten about. She did not need any more income and wanted to use this money in the short term as a bit of a treat.

Scenarios where a transfer is unlikely to be beneficial

- If you are under age 55 or a long way from your planned retirement age it is unlikely you will be able to accurately assess your income needs in retirement and, therefore, the role this pension will have in meeting them.
- You are looking to transfer in order to take a higher level of income than the scheme provides.
- You do not have other assets that can be used to meet your core expenditure in retirement.
- Investment losses would mean that core income needs may not be met.
- Your need for flexibility in income can be met from other assets such as ISAs and savings.

> “ Don't transfer? – John is age 50 he has a friend he used to work with in his early career who told him that he had transferred his pension from the old company scheme as the transfer value was very good. John does not intend to retire until probably state pension age and has not thought about how much income he will need in retirement.

Other matters – costs of transfer analysis.

Due to nature of the work involved in fully assessing your pension transfer options you are likely to have to pay for an analysis of the pros and cons of your scheme compared to the option of taking a transfer value.

Where the transfer value of the pension benefits exceeds £30,000 you will be required to obtain advice from a specialist adviser who has the appropriate skills, qualifications and authorisation from the Financial Conduct Authority (FCA) to provide pension transfer analyses.

The cost for a suitably authorised adviser to provide you with a full analysis of the pension scheme (including whether the transfer value the scheme is offering in lieu of the benefits is fair) and a personalised recommendation as to whether you should transfer or not will vary, but as a guide Bluesky Fees would be £2,500, in addition to our normal investment charges shown below

Base Investment advice fee	2%	first £250,000	Example transfer £400,000	
	1.5%	£250,001 - £500,000	Analysis fee	£2,500
	1.0%	£501,000 - £1 million	Base Fee	£7,250
	0.5%	over £1 million	Total Fee	£9,750

Please note that our total fees for providing the initial advice are capped at £15,000.

If we conclude that it is not in your best interests to transfer from your defined benefit scheme we will advise you accordingly. The fee for the transfer analysis will still be payable and we will not facilitate the transfer should you wish to go ahead with it contrary to our recommendation.

Some advisers may offer a less in depth review of your pension benefits, known as “abridged advice” which will indicate whether your existing pension benefits are suitable for your needs and objectives and will either say that you should retain your benefits or that it is unclear whether you should do so or not, in which event a full transfer analysis is required. This initial assessment does not include an analysis of the transfer value and the cost is likely to be much lower.

You should be aware that the FCA is concerned about the advice being given to consumers (and potential scams) when transferring from the “certainty” of a defined benefit scheme. The FCA requires advisers, when asked to assess a potential transfer, to start their analysis by assuming that a transfer would not be expected to be suitable. However, they do recognise that there are some circumstances where a transfer represents the best course of action but the advice will need to clearly identify real tangible benefits.

The information on this document outlines generic matters and considerations and should not be taken as advice to follow a particular course of action.

It is important that you give full consideration to your personal circumstances, needs and tolerance of risk when thinking of transferring from a defined benefit pension scheme and not just whether the transfer value being offered represents a fair value for the benefits that would be given up.

Notes and Questions

Further info. Contact BlueSKY