DEFINED BENEFIT PENSION TRANSFERS

WHAT YOU NEED TO KNOW

The introduction of pension freedoms has provided a wealth of opportunities to personalise how and when you receive your pension benefits. However, this flexibility is not currently available to owners of Defined Benefit pensions, no matter how beneficial it might be. This factsheet provides an overview of the options available to you and some points to consider regarding pension flexibility and the security of your pension income in retirement.

What is a Defined Benefit Pension?

Defined Benefit, or Final Salary, pensions pay a secure income for the remainder of your life once you reach a specified age. These are also sometimes called safeguarded rights. The level of income provided by the scheme will be based on a proportion of your salary calculated using the following factors:

- Your length of service in the scheme,
- Your salary at retirement,
- The accrual rate.

Length of Service

Known as 'pensionable service', this is the length of time that you were an active member of the scheme and accruing pension benefits.

Salary at Retirement

This can be calculated as your salary on the date you retire ('final salary'), your salary averaged over your career ('career average') or another formula. This will be confirmed within the rules of your scheme and is referred to as 'pensionable earnings'.

Accrual Rate

This is the proportion of your earnings you'll receive as a pension for each year you were an active member of the scheme (such as 1/60th of your pensionable earnings for each year you were an active member).

For example, if you have been an active member of a scheme with a 1/60th accrual rate for 15 years and you retire with a salary of £30,000, your final pension would be:

£30,000 x 1/60 x 15 = £7,500 per year

The benefits offered by a Defined Benefit pension can be extremely valuable and may form a major part of your retirement plans.

However, consideration should be given to whether the benefits offered are able to meet your objectives in retirement or whether an alternative pension arrangement could be better suited to help you achieve your goals.

What Are Your Options?

As you approach retirement, your pension provider will send you details of the value of your pension benefits.

Your provider will also provide you with a Cash Equivalent Transfer Value (CETV) which represents the value in cash terms of your existing benefits. The scheme rules will state how often you can request a CETV and sometimes there will be limitations in the year immediately prior to retirement. CETVs are only guaranteed for a limited time and the scheme may charge you for any extra valuations.

You will then be able to consider the options available to you:

- Receive a guaranteed pension for the remainder of your life: or,
- Transfer the CETV to an alternative pension arrangement to provide benefits in a more flexible way.

Choosing an appropriate course of action depends on the pension in question and your individual circumstances and needs. It is important to give this matter careful consideration and seek financial advice from an appropriately qualified pension transfer specialist as a decision to transfer is normally irreversible.

Does a Defined Benefit Pension Meet Your Requirements?

To understand whether a Defined Benefit pension is appropriate for you, it is important to understand how the benefits would be structured.

- You will receive a guaranteed pension for the remainder of your life which will increase in value in line with inflation each year. This means you may be able to meet your day to day cost of living from this income and have freedom of choice in how you use other savings or investments.
- Should you predecease your spouse, they will likely continue to receive a pension for the remainder of their life based on a proportion of your benefits (50% for example).
- You are unable to pass any of your pension benefits to your children or any

other beneficiaries (some schemes provide children's pensions as a supplement to a spouse's pension where the children are still in full time education).

- You do not have to worry about investment risk as your employer is responsible for ensuring there are sufficient funds to pay your pension. The scheme trustees are also responsible for meeting the running costs.

What Are The Alternatives?

As mentioned previously, prior to retirement you will have the ability to transfer the CETV to an alternative pension arrangement, known as a Defined Contribution (DC) scheme (e.g. a personal pension plan).

The value of your pension will then be invested. The future value of the benefits transferred and any additional contributions you may choose to make will depend on how the investments have performed.

As a result, the level of benefits from a DC scheme is in no way guaranteed and can go down, which is in direct contrast to your existing Defined Benefit (DB) pension. This means that you potentially risk either running out of money in retirement or having to reduce the amount you take from the DC scheme unless you secure an income by purchasing an annuity with some or all of your pension pot.

However, there are various reasons why a DC pension may be better suited to meet your retirement goals:

Flexibility of Income

Under current pension legislation, once you reach age 55, you can access your DC pension pot as you wish. Whilst a Defined Benefit pension will provide a known level of pension income throughout your retirement that increases each year, a DC arrangement allows you to increase or decrease the amount of income that you receive to meet your requirements.

For example, you could reduce your working hours and supplement your income with a small level of pension income. Once fully retired, your pension income could be increased to help achieve any goals in retirement and could also be reduced should your expenditure fall. However, you may also need to reduce the income you take if investment returns are insufficient to maintain it.

Passing Benefits to the Next Generation

Under a Defined Benefit pension, your spouse or civil partner may be eligible for a pension income following your death. If you are not married, those rights may be more limited but this will vary from scheme to scheme. However, when you (and your spouse) die, your pension dies with you, with nothing left to pass on to your heirs and successors.

Under a DC scheme, any remaining value within your pension is available to be passed on to your beneficiaries. If you die before the age of 75, the remaining fund value can be received by your beneficiaries free of tax.

Even if you die over the age of 75 then whoever inherits your pot only has to pay income tax in the usual way when they make withdrawals. Furthermore, if your successors do not draw on this inheritance then it can be passed on to subsequent generations.

DC schemes also have the additional benefit of being able to nominate whoever you like as a potential beneficiary for your pension fund which may not be the case for a more restrictive Defined Benefit pension.

Health

If you expect to have a shortened life expectancy due to ill health, you may gain more benefit from the flexibility offered by a DC pension than from the guaranteed lifetime pension available through a Defined Benefit scheme. Some annuity providers offer improved rates of income where you have below average health. These can be significant for serious health issues. DB schemes do not generally offer enhanced incomes on the basis of health.

Concerns about the Solvency of the Sponsoring Employer

Should the employer sponsoring your Defined Benefit pension become insolvent, there is a risk that the scheme may be unable to meet the commitment to pay your pension in full.

Should this occur, your pension may be transferred to the Pension Protection Fund (PPF), an insurance scheme for failed pension schemes, which may reduce the level of pension available to you but typically 90% of the promised benefits would be paid with the exception of those with very large entitlements.

By transferring your pension, you will be unaffected by any future problems with your previous employer. However, you will be accepting all the investment risk and have to meet the costs and charges of managing the DC arrangements throughout the rest of your life. You may receive lower overall benefits by transferring out of your DB scheme depending upon how long you live. If you have a DC arrangement you also run the risk of outliving your money.

Comparison of Features and Benefits

	Defined Benefit	Defined Contribution
Investment Risk	• Resides with your employer and is controlled by the scheme Trustees. The scheme suffers the investment losses and the employer covenant exists to ensure the scheme remains solvent.	• Resides with you and means that you bear the impact of any investment losses.
Retirement Income	• A known amount based on a proportion of your salary.	• Dependent upon the fund value at retirement which is not guaranteed.
Duration of Income	• Guaranteed for the remainder of your life.	• Until the value of the pension fund has eroded.
Pension Increases	• Increases annually normally in line with inflation as defined by the scheme rules.	• Flexible income available, but its sustainability is dependent on investment performance.
Death benefit	• Lump sum death benefit in some circumstances and / or dependant's scheme pension.	• Potential tax free payment of entire fund value if death before 75 and after this age any remaining funds can be passed to successors and nominees but some tax loss may arise.
Additional Risk	• Your employer may not be able to meet their future obligations.	• The pension fund may be insufficient to generate the income you require throughout your lifetime so you may run out of money before you die or have to reduce your standard of living.
Tax Free Lump Sum	• You may be entitled to a separate lump sum or you may have to accept a reduced pension income to receive the lump sum available.	• 25% of the pension fund value.

WHAT YOU NEED TO CONSIDER

It is important to recognise that the benefits offered by Defined Benefit pensions can be extremely valuable and for many, retaining these benefits is likely to be in their best interests.

However, the introduction of pension freedoms, along with recent changes to financial conditions leading to higher CETVs, means that it is important to review all your pension options in consideration of your broader needs and long term retirement goals.

There may appear to be strong reasons to transfer out, but first you need to fully understand the risks and any disadvantages of doing so. **In most cases the decision to transfer is irrevocable and must not be taken lightly**.

Your financial adviser will be able to compare your existing benefits with those you may potentially receive by transferring into a new pension scheme. They will also be able to provide a summary of the advantages and disadvantages to you of transferring your pension and provide you with a personal recommendation.

The Cash Equivalent Transfer Value (CETV) you receive from your existing scheme will only be valid for a short period of time. Additionally, the research required in order to review your situation and provide you with a personal recommendation can take several weeks to complete due to the complexity. It is therefore important to engage with an appropriately qualified financial adviser at your earliest opportunity. Where your CETV is £30,000 or more, legislation requires you to receive advice on the transfer of benefits before a transfer can proceed.

You need to think about what value for money means to you and how you might feel about managing the various risks associated with moving to a DC arrangement, particularly if the value of your pension fund goes down. The cost of advice at outset and where required on an ongoing basis, can be significant due to the complexity and risk associated with pension transfer advice. You need to ensure that you fully understand all the costs involved and how they are calculated. Your adviser will provide you with full details and confirm your understanding before providing their services to you.

The information above is based on our current understanding of pension and tax legislation which are subject to change. Tax treatment is based on individual circumstances and may be subject to change in the future.