bdhSterling*

12 things you must think about before transferring your Final Salary pension

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Introduction

Final Salary pensions are occupational schemes offered by employers. They are also known as Defined Benefit schemes. As a member of a Final Salary scheme, the income you receive in retirement is based on your salary before tax and the length of time with the employer. The exact benefits you receive in retirement will vary from one scheme to another but can be very generous.

The income you receive is guaranteed for life and can be inflation-proofed, increasing every year. If you die before your spouse or civil partner, they will continue to receive an income from the scheme, usually half the pension you were receiving.

The benefits of Final Salary schemes made them popular with employees, and they were commonplace in larger companies from the post-war period up to the 1990s. But rising scheme costs, people living longer and companies unwilling to meet the cost of providing such schemes, has meant that many have now closed to new members, while some have closed altogether, resulting in Money Purchase schemes, which do not guarantee the member's pension in retirement, becoming the scheme type of choice for employers.

In March 2015, the Government introduced 'Pension Freedoms', allowing much more flexibility in the way people can take pension income from Money Purchase schemes, such as Personal Pensions and Stakeholder pensions. Money Purchase scheme members can now take uncapped withdrawals from age 55, principally through a product known as Flexi-Access Drawdown.

These new freedoms have prompted many members of Final Salary Schemes to look at transferring their benefits to a Money Purchase arrangement, and therefore access the income flexibility they now offer. Transferring out can create greater financial flexibility, which could be a key benefit when it comes to lifestyle planning in retirement. It can also create flexibility in tax planning.

However, giving up a Final Salary pension is not a straightforward decision and certainly not one to be taken lightly. The value of your pension could be the biggest asset you have, worth even more than your house. There is no going back, as transfers out of Final Salary schemes are not reversible. So, by transferring, you are giving up a guaranteed lifetime income that will increase each year in line with inflation and the security that comes with it. You'll also be giving up a tax-free lump sum.

It's a big decision with a lot of factors to consider, so we've put together this guide to make you aware of some of the issues you need to think about before you get a full evaluation and formal recommendation. There are 12 things for you to consider, from the value of your fund to the state of your health.

We hope you find this guide useful. If you have any questions or would like to discuss the issues raised here with us, you'll find full details of how to contact us at the end of the guide.

Important notes

Transferring out of a Final Salary pension scheme is unlikely to be the right thing to do for the majority of people. It is essential that you take specialist advice from an authorised financial planner who will help you make the correct decision.

Note – 'Final Salary' and 'Defined Benefits' both describe pension schemes where the benefit is based on earnings and length of scheme membership. For clarity, we've used 'Final Salary' throughout this guide.

1. The value of your pension fund and what you will give up if you transfer

If you're considering transferring out of your Final Salary Scheme, the first thing you'll need to find out is the guaranteed transfer value. The trustees who run the scheme will calculate a value (known as a Cash Equivalent Transfer Value, or 'CETV'). This will be based on a variety of factors, including your scheme membership, your age, how long it is until you retire and the cost of living.

In return for the transfer amount, you will be giving up a guaranteed pension for life, with an automatic increase each year usually in line with inflation. The guaranteed pension will be based on your projected salary had you stayed in the scheme until taking a pension. You will be provided with an estimate of the pension you will be giving up when you get your transfer value.

As well as a guaranteed, inflation-linked pension for yourself, you may also be giving up other valuable assets, such as a similarly guaranteed pension – usually half or two-thirds of your pension, for your spouse or civil partner, if you die before they do.

The transfer value will be valid for three months, which should be plenty of time to get a transfer evaluation carried out, although you should be aware that it will take at least a fortnight for a financial adviser to carry out a thorough review of your circumstances, so you should seek advice as soon as possible after receiving your transfer value.

You should also note that if the transfer value is more than £30,000, independent financial advice is mandatory and you can't transfer without it.

Action

You should ask the trustees of your Final Salary scheme for a current transfer value, as well as full scheme details. If you want to consider transferring, you should speak to a financial adviser as quickly as possible.

Many schemes will charge for providing more than one transfer value in a year – and may refuse to provide a further transfer value until 12 months have elapsed since the original one was issued. So, you'll need to act straight away on receiving the value as it will only be valid for three months from the date of calculation (often referred to as the 'guarantee date'). If the transfer value is over £30,000 that means finding a suitably qualified adviser who can advise you on whether transferring is the right thing to do.

2. Other pension arrangements you may have

A transfer of this kind should not be treated in isolation. You should consider your other financial arrangements as part of the decision-making process.

Very few people stay in the same job throughout their working life anymore. So, it's likely you could have other pension arrangements from other employments or personal pension plans you set up yourself, as well as any State Pension you'll receive. These might provide you with the financial flexibility you're looking for and therefore make a transfer out of your Final Salary scheme unnecessary.

Also, consider the pension arrangements that your spouse or civil partner has. These should be taken into account as part of any decision-making process.

Action

Check other pension arrangements for yourself and your spouse or civil partner, as these should be considered when you make your decision.

You can find more details about how to trace your old pension pots on the Money Advice Service website by **clicking here**. You can also find out how much State Pension you'll be entitled to by **clicking here**.

Alternatively, as part of the financial planning process, we can track down pensions on your behalf, and we can also help you work out your State Pension entitlement.

3. Whether you are impacted by the Lifetime Allowance

The Lifetime Allowance is the maximum you can tax-efficiently save in pensions. This figure includes investment growth on your fund, which should be factored into any calculations. The current limit is £1,073,100 (2020/2021), and if the total value of all your pensions, including your membership of Final Salary schemes, is above this figure you will trigger an additional tax.

So when you get the transfer value of your Final Salary scheme, you should consider this, alongside any other pension arrangements you may have, and see if you'll exceed the Lifetime Allowance if you proceed with the transfer.

Whether you transfer or not, you should always take the Lifetime Allowance into account, as you may end up with an unexpected tax bill if you exceed it.

If you exceed it or feel you might do in the future, there are protections you can apply for, as well as alternative pension options, which may help reduce or mitigate completely the tax potentially due.

How we can help

The regulations around the Lifetime Allowance are complex and can lead to large tax bills if action isn't taken.

We can help you understand the implications and plan accordingly, both in terms of potentially exceeding the allowance, and how Lifetime Allowance protection can impact on future pension contributions.

4. Your other financial assets

As well as your pension assets, it's important to consider your other financial assets when you're deciding whether to transfer. For example, if your motivation for transferring is to access a lump sum, you might have savings you could use instead, and therefore leave your Final Salary scheme untouched. Also bear in mind that you'll also get a tax-free lump sum from your Final Salary scheme when you retire and start taking an income.

It's also worth considering the tax implications of transferring your pension, as it may be more tax-efficient to take money from your ISA than your pension, both in terms of income tax and Inheritance Tax (IHT).

How we can help

We'll take the value of other savings you or your spouse might have into account as part of our retirement advice process.

We'll incorporate these into our cashflow forecasting and help you consider how they could be utilised as part of your retirement income planning process.

5. Your plans for retirement

The two key considerations around your retirement are when you actually want to retire, and what you want to do once you've retired. For both these options, there are no correct or incorrect answers; only what's right for you.

In terms of when you want to retire, bear in mind that it doesn't have to be a sudden stop – the days of stopping work on Friday evening and starting your retirement on Monday are long gone. Retirement can be a longer process, maybe involving a gradual reduction in your working hours, or working on a consultancy basis before stopping work.

This leads us on to what you want to do. You may have plans to travel and tick things off your bucket list. Alternatively, you may want to see more of your family and spend time with your grandchildren.

No one has a crystal ball, and circumstances may well change, but an outline plan now will make it more likely that you'll be able to do what you want to do, rather than be driven by external events.

You'll want to carefully consider how much income you'll need to meet your lifestyle plans, as well as your day-to-day essential spending, and then evaluate the best way to provide this income.

How we can help

A key part of our advice process is looking at your cashflow forecasts and helping you put a robust financial plan in place, so you have the best possible chance to achieve your retirement goals.

We'll then regularly review your plan with you, adapting it on an ongoing basis, as your circumstances change in the years leading up to your retirement, and when you finally retire.

6. Providing for your family

You should also take your family circumstances into account when deciding whether to transfer. You could have relatives who may well need your support, including elderly relatives with care provision or younger relatives with university fees, or a deposit on a house. The financial flexibility offered by Pension Freedoms, and therefore transferring your Final Salary pension could prove beneficial in terms of being able to access a series of lump sums from your fund, rather than the single lump sum you'll get from your Final Salary scheme. It can also mean a pension fund being passed down through generations in your family, rather than in a Final Salary scheme where scheme rules will only permit a pension to be provided to your spouse or civil partner on your death.

You should also carefully consider the respective death benefits, the amount paid to your surviving beneficiaries when you die, of staying in your pension scheme and transferring to another arrangement. The benefits are very different.

If you die as a member of a Final Salary scheme, either before or after you start taking income, a reduced income (usually 50%) will be payable to your spouse or dependents. The statement you receive from the scheme trustees will give full details of this.

If you die after you've transferred out of your Final Salary scheme, the remaining value of the pension fund will usually be paid to your dependents as a tax-free lump sum if you're under 75. If you die after your 75th birthday, the value of your remaining fund will normally be paid out as an income, taxed at the beneficiaries' marginal tax rate.

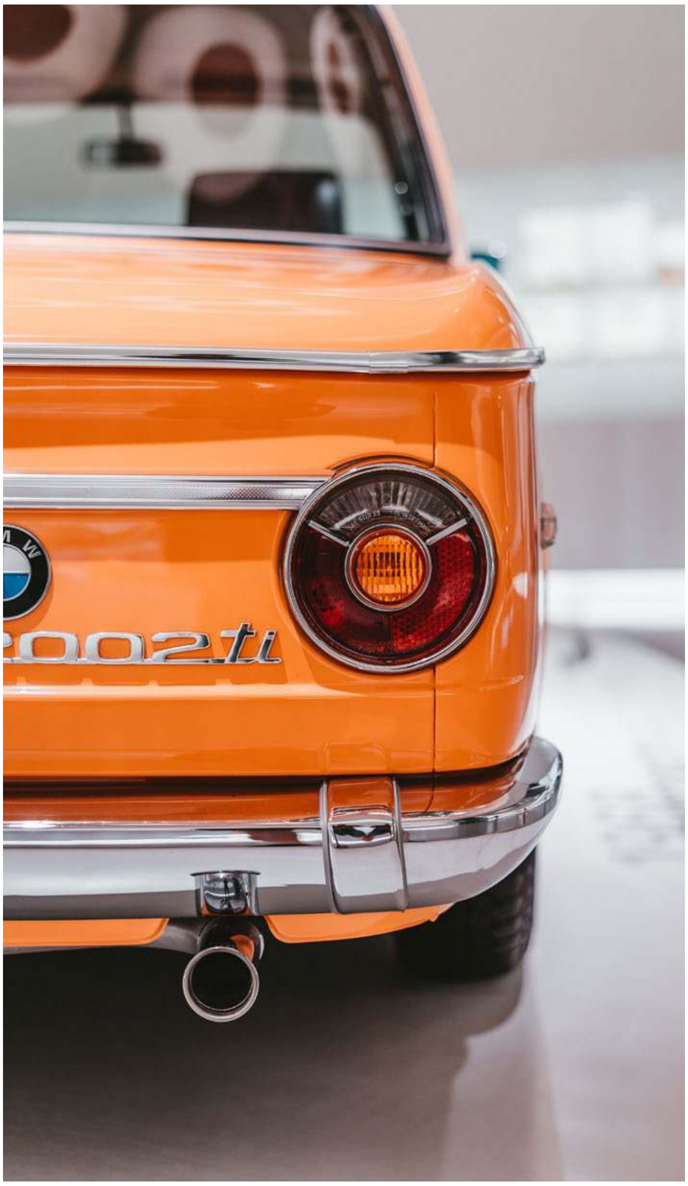
Don't forget, however, that the longer you live the more income you'll be taking from your pension fund, therefore reducing the amount that will be left when you die.

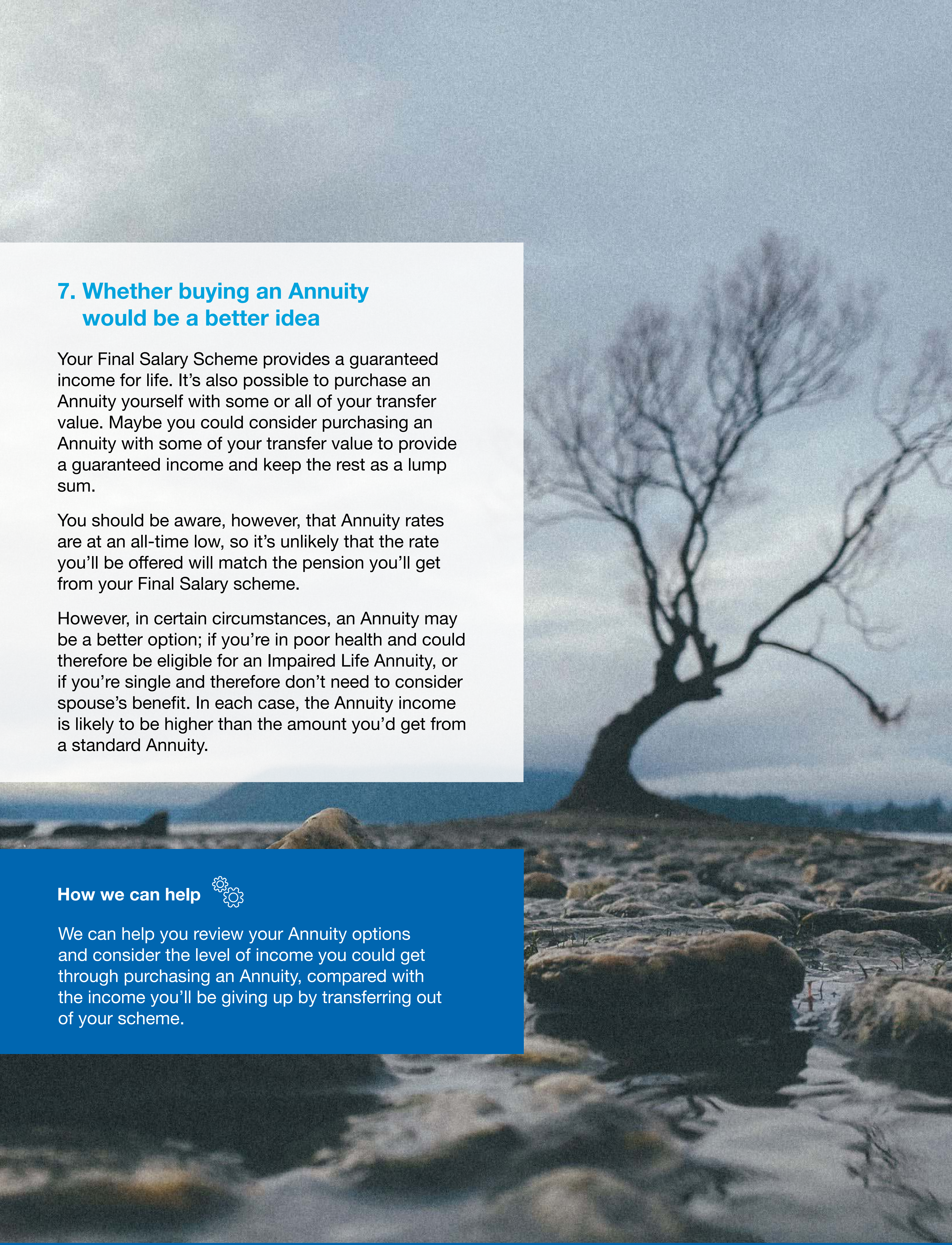
Death benefits should be a key consideration when you're thinking of transferring from your Final Salary scheme, and as you can see from this section, it's not a straightforward decision. A financial planner will be able to outline all the options, so you're making an informed decision.

How we can help

Providing for your family, especially when it comes to what happens after you die, is a crucial part of the Final Salary transfer decision process.

We can help you understand the different options and potential outcomes, and recommend the right course of action.





7. Whether buying an Annuity would be a better idea

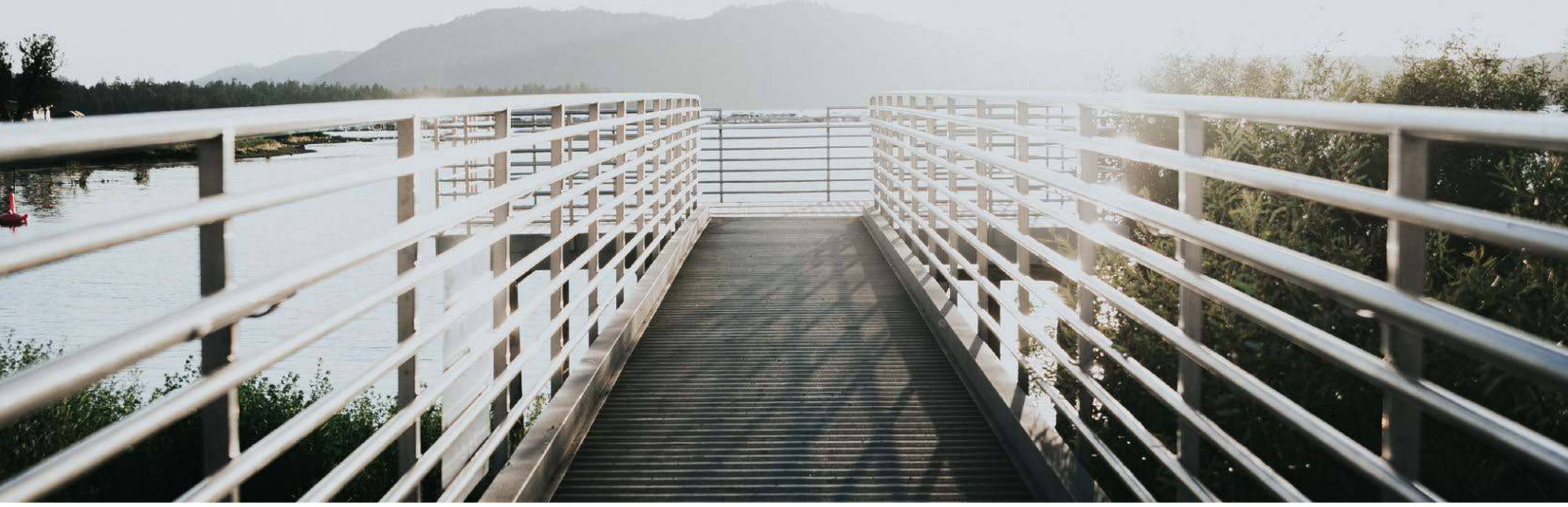
Your Final Salary Scheme provides a guaranteed income for life. It's also possible to purchase an Annuity yourself with some or all of your transfer value. Maybe you could consider purchasing an Annuity with some of your transfer value to provide a guaranteed income and keep the rest as a lump sum.

You should be aware, however, that Annuity rates are at an all-time low, so it's unlikely that the rate you'll be offered will match the pension you'll get from your Final Salary scheme.

However, in certain circumstances, an Annuity may be a better option; if you're in poor health and could therefore be eligible for an Impaired Life Annuity, or if you're single and therefore don't need to consider spouse's benefit. In each case, the Annuity income is likely to be higher than the amount you'd get from a standard Annuity.

How we can help

We can help you review your Annuity options and consider the level of income you could get through purchasing an Annuity, compared with the income you'll be giving up by transferring out of your scheme.



8. Your attitude to investment risk

If you decide to transfer your Final Salary pension to an alternative arrangement such as a Personal Pension or Flexi-Access Drawdown, the money you transfer will be invested and the value of your fund will be dependent on the increase in value of the fund or funds you are invested in.

It is essential you are comfortable taking on this responsibility.

We will work out the level of risk you are comfortable taking and make investment recommendations accordingly. It's very likely your attitude to risk will change as you get older and closer to retirement, so your investments should be regularly reviewed, at least annually, for them to remain relevant and appropriate.

Remember, the value of investments can fall as well as rise; unlike having a Final Salary scheme, your Defined Contribution pension will be directly affected by stock market value variations and the strength of national and international economies. If you're a risk-averse investor, staying in your Final Salary scheme, with a guaranteed income for life, is likely to be the best option.

As we've seen very recently with the Covid-19 virus, stock markets can be negatively impacted by the most unexpected events, so it's worth thinking very carefully how you would feel if the value of your fund suddenly dropped by over 20%, as many stock markets did during March 2020, and how this would impact on your plans for retirement.

How we can help

Attitude to risk is often measured on a scale, for example, 1 to 5, with 1 being 'very risk-averse' and 5 being 'high tolerance for risk'.

We can help you identify your attitude to risk, along with other criteria such as capacity for loss, and take these into account when making our final recommendation.

If you do transfer, we will tailor your investment portfolio so that it matches your risk rating, and stays in line with it throughout your retirement.

9. The impact of inflation

The income provided by your Final Salary pension will usually increase each year based on the rate of inflation or cost of living.

Currently, a 65-year-old man in England could expect to live on average to almost 84, while a woman could expect to live on average to 86. (Source: Office of National Statistics) However, both have an approximately 25% chance of reaching their mid-90s, while 1 in 10 will reach 100.

So if you're thinking of retiring at age 60, you should be considering having to provide an income from your pension fund for at least 25 years. An inflation rate of 3% over 25 years will result in prices doubling over that period, so if you're considering transferring your Final Salary pension to an alternative arrangement, you should consider how any income in retirement will keep pace with inflation.

You should also consider 'pensioner inflation'. This is a figure sometimes cited as the overall rate of inflation that is impacting on someone in retirement rather than someone still working. 'Pensioner inflation' is often higher than the standard rate, as the price of essential goods, such as fuel and food which often make up a disproportionate amount of the spending of someone in retirement, tend to increase at a higher rate than other items.

Action

Think about how inflation will impact your financial position in retirement, and what action you might want to take to protect against the impact of this.

Current levels of inflation are historically low, but that may not always be the case, so you should factor in the impact of higher inflation rates and rising prices on your retirement income planning.

10. The state of your health

One of the most important factors to consider, if you're thinking of transferring your Final Salary pension, is the state of your health.

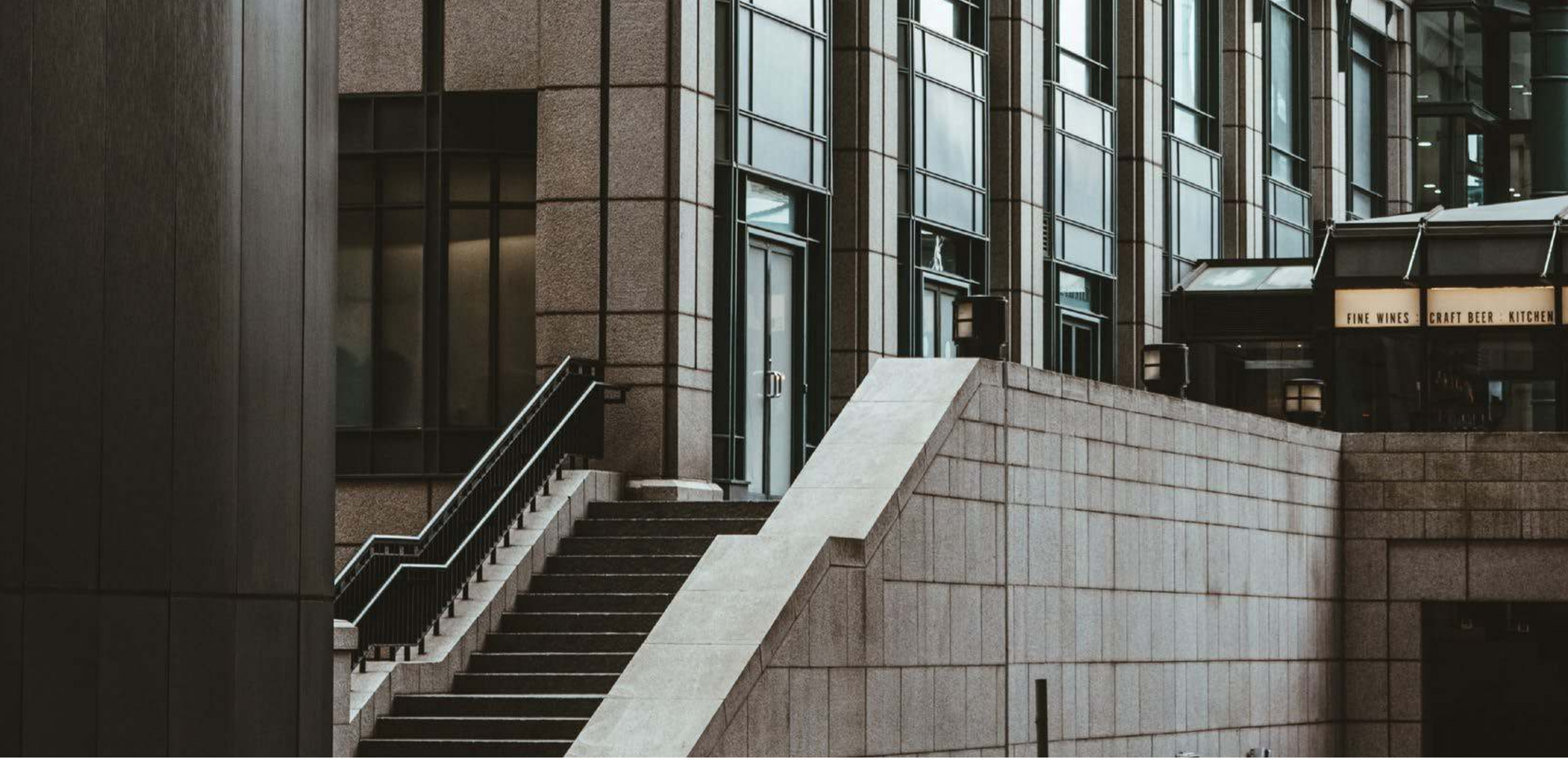
Poor health can also impact on the decision you make. For example, you may not be able to work for as long as you'd planned and may therefore have to take income from your pension fund sooner than you'd thought.

Ill health may well mean a restricted life expectancy. In this event, you may be able to take your Final Salary scheme benefits early, and receive a higher income than originally forecast. Alternatively, you might want to take advantage of the new-found flexibility through Pension Freedoms or leave a lump sum for your dependents when you die; something which may not be possible with your Final Salary scheme. You also may be able to purchase an Impaired Life Annuity, which would provide you with a greater income for someone of the same age who is in good health.

As we said, your health and life expectancy are significant factors to consider when deciding whether or not to transfer your Final Salary pension or remain in the scheme. A financial planner will take these into account when making their recommendations.

How we can help

We'll take the state of your health, and expected longevity, into account when we advise you on whether you should transfer your Final Salary pension.



11. The funding position of your current scheme

A couple of years ago you may have heard in the news about the closure of British Home Stores (BHS) and the collapse of their pension scheme. This was a Final Salary scheme that was ‘underfunded’, which meant that there wasn’t enough money in the scheme to provide all the pensions due to the scheme members.

There is a Pension Protection Fund, run by the Government, which protects members of schemes that do collapse in the way the BHS scheme, and others, have done. However, there are limitations to the protection offered and it’s possible that you might not receive the full amount that you would have received had the scheme still been running.

In this circumstance, you could be left out of pocket in retirement and may have to reduce expenditure or find a different source of income, such as continuing to work for longer than anticipated. That said, a lower income may still be better than the Defined Contribution alternative if you are a risk-averse investor.

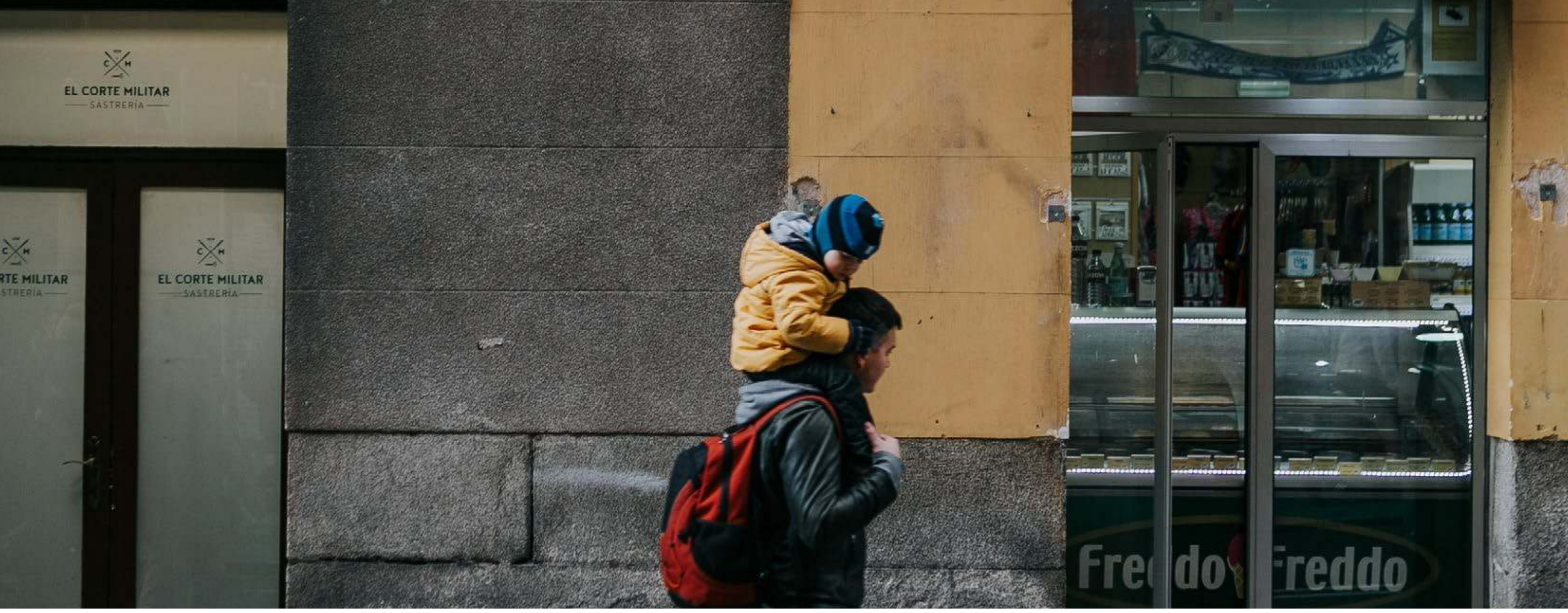
If you do transfer your Final Salary pension to a Defined Contribution scheme, the full value of insured fund investments will be protected, but other funds and investments may well be subject to the Financial Services Compensation Scheme (FSCS) compensation limits.

The level of protection provided by some other schemes is more complex. Your financial planner will outline the differences as part of your advice process.

Understanding the financial position of your employer (or previous employer) and the Final Salary pension itself can be tricky. While the funding position of the scheme may be a contributing factor when making your decision whether or not to transfer, it should be remembered that the PPF provides an attractive ‘lifeboat’ for many thousands of members of Final Salary pensions which have run into difficulties.

How we can help

As part of our advice process, we’ll outline all the implications of your current scheme failing and how it moving into the Pension Protection Fund would affect your retirement income.



12. Where are you transferring your Pension to?

So far we have referred to transferring your pension to another UK pension. If you are considering retiring in another country, for example, Australia, there are other considerations such as the pension system and taxation there.

In some cases, transfers from a Final Salary scheme to another country's pension scheme can be very tax-efficient – in some cases almost no tax on withdrawal. The case for transfer can be very financially compelling. It is often a complex process so professional help is a must. The rewards can be significant as the value retained is high and many of the benefits of transfer outlined prior are achieved.

Key points to notes

- In our view, a Defined Benefit pension transfer should only be considered as part of a holistic review of your overall circumstances and objectives. At the end of this process, we would only advise on a transfer if we believe that it is suitable and we can clearly show it's in your best interests.
- We will be required to review the proposed destination and investment considering both your attitude to transfer risk and investment risk. We are also required to make sure the potential returns and all relevant charges have been considered in our transfer analysis.
- Whilst transferring to a more flexible arrangement may be attractive, we will need to consider whether there are alternative solutions that could meet your needs and objectives, either with less risk or without giving up the safeguarded benefits.

Warning - Pension scammers ⚠

Pension scammers are currently targeting people with Defined Benefit pensions schemes. They will often cold call, phone or text without invitation – all of which are illegal.

Always take your own steps to verify the identity of those contacting you such as their caller id or the email address

We urge all our clients to be on the look out for scammers. To find out more about how to recognise a possible scam call, the Pension Regulator has produced a guide called 'How to spot a scam', You can access it here.

We're the experts and here to help

It's essential that you take specialist financial advice to ensure you make the right decision regarding your Final Salary scheme. Remember too, if your transfer value is more than £30,000, taking advice is a legal requirement.

That's where we come in.

We will carry out a full and thorough evaluation of your financial circumstances and establish your objectives, before tailoring our recommendations.

By ensuring that you've considered all eventualities and possible outcomes if you transfer, and if you don't, we'll help you come to a decision which is in your best interests. This means that whether you transfer or not, you'll have a robust financial plan in place to help you move forward to retirement with confidence.

We're here to help so call us on **01372 724249** or email **infouk@bdhsterling.com** to arrange an initial discussion.