WEALTH at work

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Press Release

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Is it a good idea for employees to transfer out of a defined benefit scheme?

Since the pension changes we have seen a rise in employees wanting to transfer their defined benefit (DB) pension scheme into defined contribution (DC) pensions, so that they can also benefit from the pension freedoms.

However, transferring from a DB pension scheme can mean that employees will be giving up valuable guaranteed benefits and they might find themselves worse off.

Please see our checklist of 10 important pointers to help employees who are considering transferring their pension;

1. **Is the transfer value offered a good deal? –** One way employees could find this out is by comparing how many years of annual income would be needed to match the transfer value offered. This can be achieved by carrying out a calculation which compares the 'cash equivalent transfer value' (the lump sum the pension scheme will offer in exchange for giving up any future claims to a pension from the scheme) against the 'current' annual pension entitlement payable at the scheme's normal retirement date. For example, if a DB annual income guarantee is £5,000 and the transfer value is £100,000, then the conversion factor would be twenty times (100,000/5,000). There have been some very 'high' reported values with reports of forty times the annual income, or even higher. However, it doesn't mean the transfer value equates to a good deal because the calculation doesn't take into account the annual inflationary increases to the pension in payment. Additionally, by transferring out the member takes on all of the future risk associated with managing the pension fund.

2. **Would they be able to buy an annuity which offers the same benefits?** – When considering if it's a good deal employees could also look at how much it would cost to buy an annuity which offers a similar income as those guaranteed by their DB scheme. For example*, a pension transfer value of £30,000 offered in lieu of a DB scheme valued at £1,500 a year (which also comes with a 50% spouse pension and annual inflationary increases would actually cost £68,000 to buy an annuity with the same benefits.

3. **Is the paperwork misleading?** – Transfer value statements often appear to be confusing and it is difficult to work out whether the 'cash equivalent transfer value' is high, low, or even correct! This can be because pension schemes tend to quote the pension entitlement at the date the member left the scheme. This could have been many years ago and with deferred pensions benefitting from annual inflationary

increases, the actual pension entitlement at the date of the statement could in fact be a lot higher, which may be misleading.

4. **Is the cash really needed?** – If employees are considering transferring to a DC pension to take all of the income as cash, they should make sure they understand the tax implications; usually the first 25% of what is taken out of a DC pension is tax-free but the remainder is taxed at their 'marginal' rate – the rate of income tax paid when all of sources of income are added together. If employees take the money and simply put it in a bank account, it will be subject to inflation risk as the cost of living may be higher than the interest actually payable on the account. That doesn't mean they shouldn't transfer and there are good reasons for some people doing so, for example; if they want to pass money on to dependants, prefer the idea of flexibility, or have other significant sources of secure income. But even these are not definitive reasons for doing so and before employees give up a guaranteed index-linked income (income that will increase in-line with inflation), they should make sure they know what they will need the money for.

5. **What 'perks' could be lost out on?** – Most DB schemes have very good benefits. Often they include 50% for a spouse's/partner's pension (upon death, either before or after retirement), children's pensions and some offer increases of up to 5% on the deferred pension until the point at which benefits were taken (to help keep the values in-line with inflation), and then provide inflation proofing once in payment. Others also have an element of death benefits in payment if the scheme member passes away within five years of receiving benefits. Some DB scheme members may also be entitled to 'scheme protected tax-free cash' higher than the standard 25%. These benefits would be lost in most circumstances if transferred into a DC pension.

6. **Is a partial transfer available?** – Partial transfers could be a good option and middle ground for employees torn between sticking with a guaranteed income and transferring all of their benefits. It should be noted that few schemes presently allow partial transfers but they are under no statutory right to do so.

7. **Are they going through a divorce?** – Pensions can be included as assets in divorce financial settlements. There are several options that couples can take when thinking about splitting their DB pension assets during a divorce. One of these is to transfer the DB pension into a DC scheme so that the income can be fully accessed and split between the two parties. It is important for couples to take specialist advice about this before making any decisions.

8. **Have they ever contracted-out?** – Employees who were contracted out of the 'State Earnings-Related Pension Scheme' (SERPS) between 6 April 1978 and 5 April 1997 should check the Guaranteed Minimum Pension (GMP) value (the minimum pension value which an occupational pension scheme has to provide) if they are considering a pension transfer. The amount is said to be 'broadly equivalent' to the amount the member would have received had they not been contracted out. Employees should make sure that they understand the current value of the income being offered as often it will be quoted at the date they left the scheme and not the uprated value they would get at the scheme retirement date. Depending upon the

scheme rules and when a member left the scheme, increases to deferred GMP can be very attractive, even as high as 8.5% per annum.

9. **What security measures are there?** – Some employees may be worried whether their scheme is secure, and if it will be able to continue to pay out as promised. The PPF (Pension Protection Fund) will generally pay up to 90% of a pension value if the scheme fails, but there is an annual cap of £34,655 (after the 90% level is applied). Transferring out may be something to consider if the scheme is in a precarious financial position but employees shouldn't act in haste and should weigh up all options before making any decisions.

10. **Are they equipped to understand their options without advice?** –Employees who have a DB pension scheme with a transfer value of £30,000 or more will be required to take financial advice if they wish to transfer their pension. But if it's less than this, is it really wise for employees to go it alone? Even Advisers find pension transfer documents unclear, full of jargon, and difficult to understand the value of the actual benefits that will be given up. Advisers that specialise in this are required to have specific qualifications and also rely on specialist systems and tools to work out whether a transfer is in the employee's best interests. As it's so complicated and time consuming, it is likely that Advisers will charge for the service whether the transfer goes ahead or not, so it should be something that is carefully considered. But if after weighing up the points above employees are confident that they have a good reason to go ahead with a transfer, the value of specialist advice should not be underestimated.

Jonathan Watts-Lay, Director, WEALTH at work, a leading provider of financial education, guidance and advice in the workplace, comments; "As we can see pension transfers are complex – there are many things employees should consider before they make any decisions. It's important for employees to get a good understanding of their own personal situation and take advice from a suitably qualified financial adviser who specialises in this type of transfer.

Ensuring employees make the most of their retirement savings should be at the top of every agenda and more support needs be available in the workplace. Leading companies are now recognising that there are specialists providers available who deliver financial education, guidance and advice in the workplace to support employees with making informed decisions to maximise income at-retirement."

Ends

*Exact comparison is difficult as pension schemes use their own mortality assumptions based on the unique make up of their scheme membership, however it is possible to estimate the comparison. £30,000 was calculated through an annuity quote on the Exchange annuity portal on 25 April 17, assuming a healthy 60 year old husband and wife, trying to match £1,500 annual income, 50% spouse pension, indexation, no tax-free cash.

Notes to editors:

WEALTH at work is a leading provider of financial education, guidance and advice in the workplace. This service helps employees make informed decisions to improve their financial wellbeing throughout

their career and to maximise income at-retirement. For more information, visit www.wealthatwork.co.uk

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