Final salary pensions

Stay in, or transfer out?

The April 2015 Budget saw the most radical changes to the pensions landscape for a generation, but the new flexibility on offer is only available to personal pension holders. Members of final salary schemes can only access the new rules by transferring to a personal pension.†

This guide outlines the main risks and benefits of transferring out of your final salary pension scheme.

The transfer value of a final salary pension is based mainly on the yield on government bonds. The relationship is inverse, which means transfer values have been hitting record highs. This situation will last as long as low bond yields remain. Therefore, if you are considering a transfer it makes sense to seek advice soon.

The collapse of BHS has exposed the challenge of paying final salary pensions in the future, especially for schemes with funding deficits. The Pension Protection Fund provides a safety net but only 90% of your pension is protected, with an overall cap of just over £33,500 a year.

For many people leaving their final salary pension untouched is still the right thing to do. But for some, transferring is seriously worth considering.

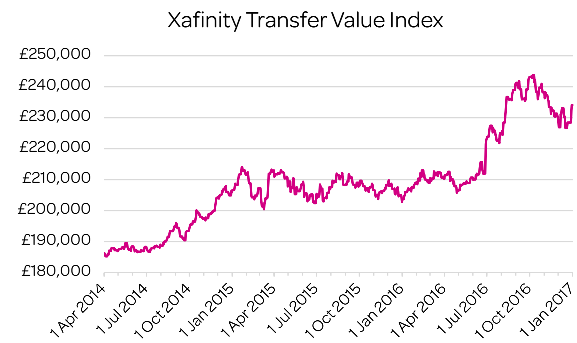
If you are weighing up your options, it is vital that you're aware of the value of your pension rights and that you get impartial, expert advice on whether a transfer is right for you.

John Spiers
Chief Executive

Pension transfer values remain high

Pension transfer values as measured by the Xafinity Transfer Value Index* ended 2016 up 14.9%. The index increased from £203,711 on 1st January to £234,118 on 31st December. Based on our experience some schemes have increased by more. Note that certain schemes (e.g. public sector) cannot be transferred.

You are entitled to request one free transfer value from the scheme administrator in any 12-month period. This will only be valid for three months, so it's best to seek advice beforehand, to ensure there is enough time both to get a clear picture of the situation and to act on any decision.



*The index tracks the transfer value that would be provided by an example final salary ('defined benefit') scheme to a member aged 64 who is currently entitled to a pension of £10,000 each year starting at age 65 (and which increases each year in line with inflation). Source: Xafinity Consulting

This guide is not a personal recommendation. Transferring from a final salary to a personal pension is a complex and irrevocable decision with long term consequences. The value of a personal pension and the income it produces can fall as well as rise, and you may not get back everything you invested. You should seek professional financial advice.

† Personal pensions are sometimes called 'defined contribution' while final salary schemes can be called 'defined benefit'.

Understanding the risks

Are you thinking about transferring your pension?

If the transfer value of your final salary pension is more than £30,000 then you are required by law to seek financial advice.

EQ can undertake a review of your finances and objectives, including your family circumstances and the pension scheme itself, before advising you on whether a transfer is in your best interest.

Our pension specialists are on hand to answer your questions.

Call us on **020 7488 7110** or email **enquiries@eqinvestors.co.uk**

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Running out of money

As a member of a final salary scheme, you're guaranteed to be paid each and every year until your death or the death of a qualifying financial dependant (if later). There is no investment risk as the scheme will make payments for as long as it remains solvent. Should problems occur, the scheme trustees have the option of asking for more money from the employer or failing that moving the pension responsibility to a statutory protected arrangement.

On transfer you are giving up 'guaranteed' benefits for a lump sum with which you will need to decide how to invest. You, rather than your employer, are now the risk taker.

A key concern is the risk of running out of cash later in retirement. The latest figures suggest 80% of people underestimate life expectancy. According to the Office for National Statistics, a 65 year old male has an average life expectancy of 86 (21 years), while a 65 year old female could expect to live to 89 (24 years). Moreover, one in four 65 year olds today are expected to live to 94 (men) or 96 (women), while one in ten are expected to reach age 99 (men) or 100 (women)! With this in mind, couples need to remember that an income will be required until the second death.

Taking responsibility

Not all of us have invested before and it can be difficult to know where to start. Indeed there is comfort in knowing that a final salary scheme will provide a known benefit at a known time, irrespective of the UK's relationship with the EU, or how Asian markets react to the Trump administration. Whilst you may see these as opportunities, others will be happier not having to take responsilbity for these kind of decisions.

Investing can provide opportunities to grow value, but it's not for the inexperienced. One investment is not like another. Accordingly it is important that professional guidance is obtained. At EQ, we offer advice and a professional investment service where we take on the responsibility for the investments in your pension.

Taking investment risk

Within a final salary scheme, you are sheltered from the ups and downs of investing – the scheme still pays your pension unless the scheme defaults. Once a transfer has taken place, your personal pension is now responsible for providing your income. The amount you receive will be reliant upon growth yet to be earned. The rate of growth needed will be determined by a number of factors including the size of the fund, how much income is required, and when payments are to begin.

If you want to take charge of your own personal savings, it's important to bear in mind the following:

Attitude to risk

Different people are naturally comfortable taking different levels of risk. It is important to check that the rate of growth you need from your portfolio is achievable, given how much investment risk you are willing to take.

Capacity for loss

Investment returns will not be linear. Some years will be better than others and indeed for some years there will be investment losses. It is important to check your capacity to sustain a fall in income, before financial difficulties start to occur. Ultimately if investments do not perform well over a period of time, you may have less to live on in later life.

Tax and the Lifetime Allowance

Under current tax rules, you can build up pension rights worth £1 million over your lifetime, for both final salary and private pension owners. If the Lifetime Allowance is exceeded, an additional tax bill is payable from your pension pot.

The rules relating to the Lifetime Allowance are complex and too involved for this guide, but if you are considering a transfer then it is crucial that they are checked in detail. Understanding the tax implications is part and parcel of working out whether a transfer is in your interest.

Losing additional benefits

Beyond a guaranteed pension, most final salary schemes provide additional benefits, like inflation or family protection.

Inflation protection

Many final salary pensions have in-built inflation protection, which means the value of your income will keep pace with increases in the cost of living (although this may have a maximum limit). If you do transfer your pension you will lose this protection and you will be in charge of guarding against the eroding impact of inflation.

Over a retirement that could last 40 years, the value of having an income protected against rising prices could be very valuable indeed.

Family protection

If you die as a member of a final salary scheme, an ongoing pension is provided for your surviving husband, wife, or registered civil partner. This taxable pension is payable immediately after your death for the rest of their life. If you have children under the age of 23, further temporary pensions may be payable. A one-off payment may also be made.

If there is no qualifying beneficiary, no other benefit is payable. Any surplus value remaining is retained by the scheme and used to offset future costs of the scheme.

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Weighing up the benefits

Speak to an expert

Our financial planning team can help you assess your retirement options.

Everyone's circumstances are different so it's vital to get impartial advice. Transferring out of a final salary pension should only be considered based on a careful analysis of the facts. In many cases 'staying put' is the right decision.

The easiest way to find out how we can help you is to book a free, no-obligation initial meeting.

Call us on **020 7488 7110** or email **enquiries@eqinvestors.co.uk**

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Flexible access from age 55

It is now possible, once you reach the age of 55, to use your personal pension as you wish. There is no longer any need to buy an annuity or have pension income capped at government imposed limits (although anything above 25% of the fund will be taxed at your marginal rate of income tax).

Final salary pension schemes by design are more restricted. They have a fixed 'normal retirement age' determined by the scheme's sponsoring employer which usually sits between age 60 and the prevailing state pension age. There is no scope for a member to change the scheme's normal retirement age, although most schemes will allow 'early retirement' (usually requiring trustee/employer approval). Where this option is available, it is normal for your pension to be reduced and this reduction can seem significant.

Tax-free lump sum

Personal pensions allow you to take out a tax-free lump sum (usually 25% of the value) as cash. The potential uses of this cash are extensive, from paying down a mortgage to helping the next generation onto the property ladder.

Moreover, this lump sum does not need to be taken all at once. Receiving the cash in instalments has a double advantage. Not only do you retain a larger sum within your personal pension (which is usually free from Inheritance Tax) but the instalments are not added to your other taxable income. This can keep your tax bill lower than would otherwise have been the case in future years.

Most final salary schemes allow a member to draw a one-off tax free lump sum. However, the calculation method often means you get less than 25%. Sometimes this lump sum is offered at the cost of receiving a smaller starting pension. For other schemes the lump sum is automatically offered in addition to your guaranteed pension income. Once you have selected your choice of pension benefits, you cannot change your mind in later years.

Leaving an inheritance

Before the pensions changes introduced in 2014 and 2015, the ability to pass wealth to others efficiently via a pension was limited. Now the owner of a personal pension can nominate anyone to receive the remaining value in their pension when they die. This is called a 'death benefit', and is usually paid as a lump sum to the beneficiary, free from Inheritance Tax.

This favourable tax treatment means it can make sense to draw an income from alternative sources in retirement, leaving the full value of your personal pension(s) to your loved ones. So long as it remains invested, the capital within the pension can even benefit from tax-efficient growth.

This is not possible with final salary schemes. In these schemes, any value remaining in the pension when you die is usually absorbed back into the scheme itself.

Managing your income tax bill

Like a final salary scheme, personal pensions can provide an income and/or a tax free lump sum. But here the similarities stop.

A personal pension owner is able to increase, decrease or indeed stop the income from it at their discretion. The level of pension income and lump sum is not reliant upon a formula agreed by an employer and based on service and earnings. Instead you can take whatever level of income you feel is appropriate.

This flexibility allows you to efficiently manage your tax liabilities. If you do not require the extra income, you can reduce the amount you take and save the income tax. At a later date, you can change your mind and increase it again. If you are managing multiple sources of income, this flexibility can be extremely useful.

It should be remembered that a private pension does not provide a guaranteed income. If the money runs out, so does your income.

Control of your investments

One of the major differences between a final salary scheme and a personal pension arrangement is the responsibility for investing the money. For the former, scheme trustees receive professional guidance and pool together member and employer contributions, with a view to covering current and future pension payments. Investment performance does not affect your pension, unless it is so bad that the scheme defaults.

With a personal pension, you take control over the investment selection. We've noticed a significant number of people asking for their pension funds to be invested ethically. This is not possible for a final salary scheme, but is for your own private pension. At EQ, over 40% of funds investing in our Positive Impact Portfolios fund are held within a personal pension.

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Case studies

EQ has advised on pension transfers from £250,000 to in excess of £5 million. The following case studies have been anonymised, but otherwise describe our advice to real clients.

If you are considering a pension transfer out of a final salary scheme, it is essential that you get qualified financial advice based on your individual circumstances.

To speak to a pension specialist call 020 7488 7110 or email enquiries@eqinvestors.co.uk

1 Advised to transfer

Mr & Mrs Taylor are married with two children in their early 20s who are about to leave the family home. Mr Taylor is thinking about retiring early and wants to know if he can afford it. He has a final salary pension and an existing personal pension, while Mrs Taylor is in receipt of an annuity. Jointly, they also have rental and investment income. They need to make sure that their retirement income is sufficient but also want to leave something to their children.

After reviewing their expected retirement income with an EQ adviser, they found that the final salary income would be surplus to their needs. It would also force Mr Taylor to remain a higher rate tax payer in retirement. If they did not use the extra income then it would also add to their IHT liabilities, ultimately leaving less for their children.

Together they conclude that Mr Taylor can afford to retire early, and does not need the guaranteed income from his final salary scheme. He transfers this into his existing personal pension, from which he draws an income each year as required. This allows the income tax paid by the couple to be managed efficiently. In the future, the personal pension will provide their children with a significant inheritance free from IHT.

2 Advised not to transfer

Mrs Williams is approaching 60 and currently works part time. She has a final salary pension from a previous job that will start paying out after her 60th birthday. Her husband is retired, and his pension will provide most of the income that the couple need to retire on. However, Mrs Williams wants to supplement this with an income of her own to ensure they are can both lead the life they want in retirement.

The couple then receive what looks like a very generous transfer value for her pension, so she discusses this option with her EQ adviser.

Mrs Williams has no other source of income or assets to fall back on. This makes the security of income from her pension a priority. The couple do not need to take a tax-free lump sum from her pot. Moreover, when our technical team analyse her pension valuation, we calculate that it will pay out a higher annual amount than she expects. This makes the transfer value look less attractive.

Taking all these factors together, our advice is that Mrs Williams leaves her final salary scheme in place. The guaranteed income from it will provide just the right contribution to help her and her husband achieve their goals for retirement.

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Introducing EQ

EQ is an award-winning boutique wealth manager acting for private clients, small companies and charities all around the UK.

At EQ we think financial planning is all about:

- ✓ Understanding your goals, objectives and priorities
- ✓ Working out whether your financial provisions will help you get there
- ✓ Putting a plan in place and reviewing it regularly

Advising clients on how and where to invest is at the heart of what we do.

Most people fail in their financial planning because they fail to plan

To find out more please visit:
eqinvestors.co.uk

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Beware of scammers

There have been several pension transfer scams where investors have lost all their pension money. It's never been more important to protect yourself from scammers, so please bear the following tips in mind:

- ✓ Only seek professional advice from a pension transfer specialist that is authorised and regulated by the Financial Conduct Authority (FCA)
- ✓ Always check the organisation you're dealing with is legitimate. Use the FCA register: register.fca.org.uk
- ✓ Be wary of cold calls and unsolicited emails
- ✓ Avoid overseas investment 'deals'
- ✓ Avoid offers to access pension cash before age 55 (the minimum pension age)
- ✓ Check the FCA's list of known scams: scamsmart.fca.org.uk
- ✓ If you are unsure, contact Pension Wise or The Pensions Advisory Service for guidance.

Pension wise
Your money. Your choice.
Backed by HM Government

www.pensionwise.gov.uk
0800 138 3944

The PENSIONS Advisory Service

www.pensionsadvisoryservice.org.uk
0300 123 1047

Important information

This guide has been produced to provide general information on final salary pension transfers. It has been prepared based on EQ's understanding of current pension rules and tax treatment, which can change from time to time. **It is not a personal recommendation in any way.**

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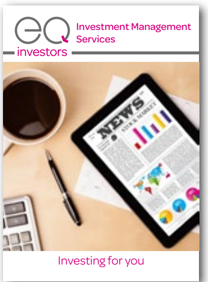

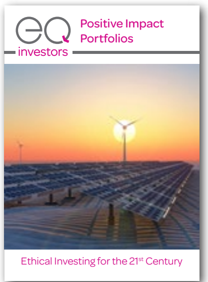

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