Drewberry

Making Sense of
Final Salary Pension Transfers

COVER excellence AWARDS

Protection Review FINALIST 2014

Protection Review FINALIST 2015

Rated 4.9 / 5 by our clients on the independent review site Reviews.co.uk

REVIEWS

Welcome to Drewberry

Drewberry Wealth is a thriving advice business that aims to guide clients through every stage of their financial lives. We have a passionate team of financial planning experts in our London and Brighton offices, each of whom is focused on making a difference for our clients.

Tom Conner
Director

We set out to provide the highest levels of customer service in our industry and are proud that over 92% of our reviews on independent reviews website Reviews.co.uk are five-star. No less than 99% of our clients say they'd be happy to recommend us.

The value of pensions and investments and the income they produce can fall as well as rise. You may get back less than you invested.

Transferring out of a Final Salary scheme is unlikely to be in the best interests of most people.

Tax treatment varies according to individual circumstances and is subject to change.

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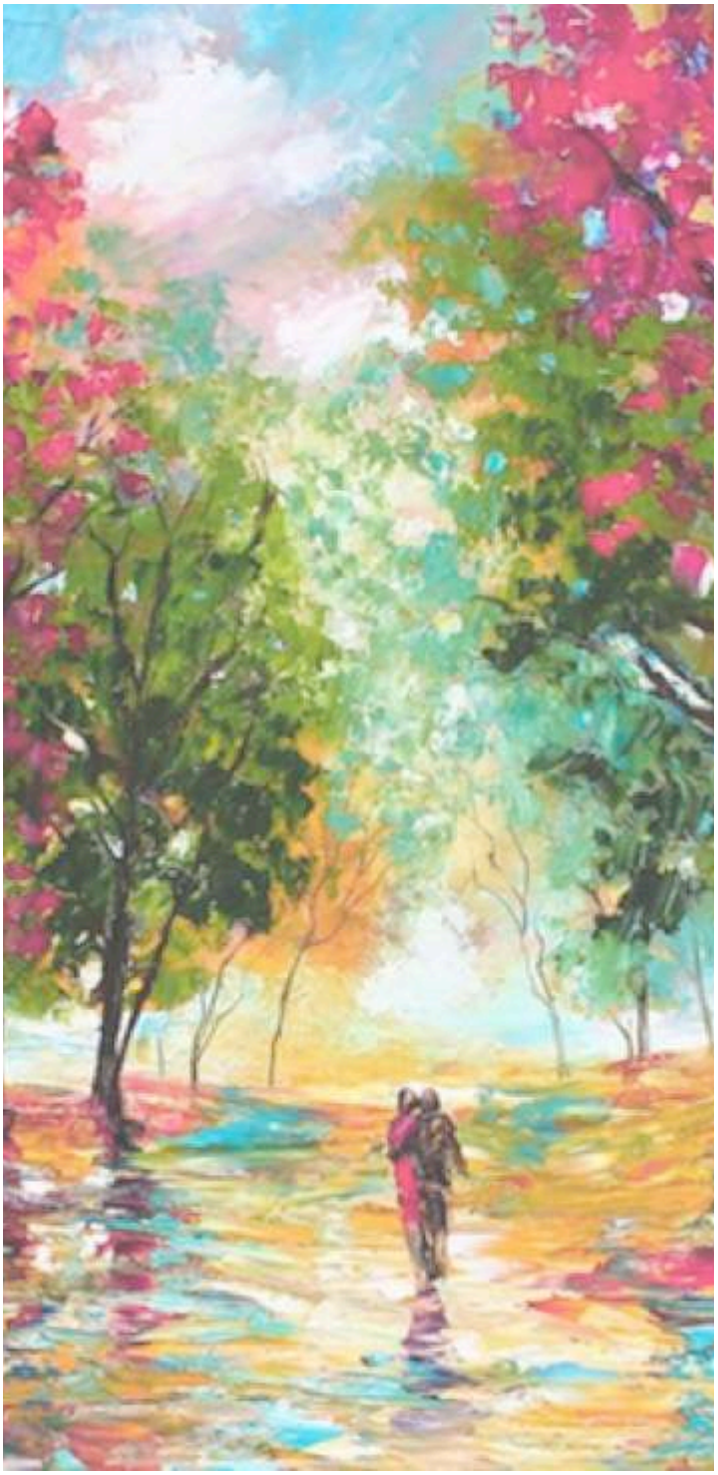

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How Drewberry can help

At Drewberry Wealth we have experts in all aspects of pension investment and planning.

Because we analyse your pension assets alongside your future income needs, your financial ambitions and those of your family, we can create modern, flexible pension arrangements that are tailor-made to your unique needs.

Unlike a great many financial advisers, Drewberry Wealth is fully certified to conduct pension transfer business and, thanks to our expertise, we're often asked to provide our views on all aspects of pension planning to the national press.

Whatever your circumstances, we can help ensure that you make the most of your hard-earned pension savings

This can include:

- Locating and valuing all of your pension savings;
- Analysing if a pension transfer would be in your best interests based on the latest transfer value, your attitude to risk and your other retirement assets;
- Creating and managing modern income drawdown solutions that are individually tailored to your unique circumstances;
- Consolidating your existing pension arrangements into one cost-effective portfolio that's invested to optimise returns within your risk tolerances; and
- Building an efficient programme of pension savings that makes the most of your pension allowances including 'carry forward'. (This is especially important for higher earners who may now have lost a large part of their annual pension allowance).

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2017: The Year of the Pension Transfer?

A combination of factors has led to record levels of pension transfers in the UK. According to Royal London, there was a 50% increase in the volume of pension transfers in the year ending June 2017 compared with the previous year.[1]

Chief among these is the fact that the transfer values being offered to those with final salary pensions peaked in 2017, but there are also other factors at work.

Among these is a renewed push by final salary schemes to remind their members that they can consider transfers (and so get them off their books for good), as well as the recent arrival of the so-called 'pension freedoms'.

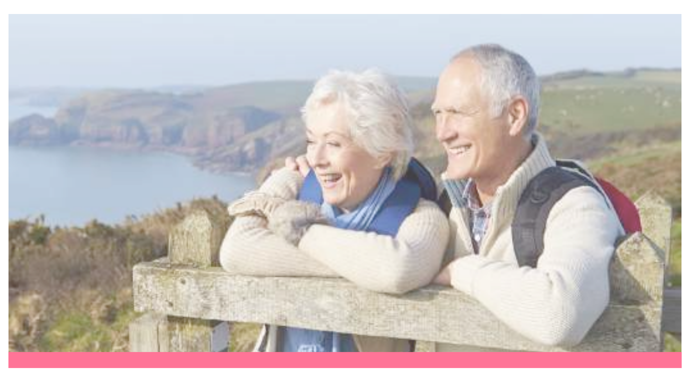
Cry freedom

Until very recently, 'gold-plated' final salary pension scheme benefits were nearly always considered the best option compared to the alternatives. Not least because the risk (or cost) of providing an index-linked income for life rests firmly with your former employer.

For the vast majority of people, this will still be the case and taking on the burden of providing your own retirement income, among other risks, means a transfer won't make sense.

However, for a select few for whom a transfer may be a sensible option, the introduction of the pension freedoms in April 2015 proved one factor that has swayed decisions in favour of a transfer.

[1] Royal London, data correct as at June 2017



2017: The Year of the Pension Transfer?

The pension freedoms

Since April 2015, anyone over the age of 55 can access a money purchase pension or defined contribution pension whenever they like and take whatever level of income or cash lump sums they choose (subject to the tax rules).

The new pension freedoms also abolished the 55% 'death tax'. This allows pension wealth to pass more smoothly between generations than ever before.

The personal pension regime is now therefore one of the most tax-efficient ways in which to pass wealth down through your family, as pension assets have always been free of inheritance tax.

Taking control

Final salary schemes typically provide a spousal pension to a deceased member's widow(er), although often this is reduced from the income enjoyed by the member.

The ease with which a money purchase pension can now be handed down the generations, however, means that the balance of a transferred final salary pension can be passed on to your loved ones, free of inheritance tax, when you die.

Naturally, the attractions of such a freedom have exerted a strong pull on those with final salary scheme pensions.

The fear factor

Meanwhile, many Britons are, understandably, anxious about the security of their hard-earned final salary pensions. This follows recent high-profile collapses of companies such as British Steel and British Home Store (BHS) and the impact this had on these firms' final salary schemes.

Fortunately, in such situations the government's Pension Protection Fund (PPF) steps in to underwrite the defunct scheme's pension promises. Although for most people entering the PPF is the best option for them should their employer fail, you may not get your full pension entitlement from it.

If you have an annual statement from your final salary pension scheme or a cash equivalent transfer value (CETV), use Drewberry's Final Salary Calculator to find out if a transfer makes sense for you and your family.

Ask a professional...

"Your pension arrangements are as individual as you are. A final salary transfer won't be right for everyone, so talk to a Drewberry Wealth adviser about whether a pension transfer is right for you."

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Why transfer values reached record highs…

The record low yield on UK government bonds and rising longevity have pushed annuity rates to record lows, making the cost of providing an equivalent pension income to your final salary scheme far more expensive.

Thanks to the combination of our ever-longer life spans and the record low yields on government bonds, UK annuity rates are now at their lowest levels of all time.

This is crucial as the same factors that drive annuity prices also drive the valuation of final salary benefits. The cash equivalent transfer value (CETV) offered by your final salary pension scheme is meant to represent the cost of buying a pension income on the open market similar to that your scheme would have provided.

Thanks to record low annuity rates, the average UK retiree now needs far more in their pension pot to achieve the annuity incomes enjoyed in yesteryear.

Although CETVs fell back as 2017 drew to a close, they reached record highs that year on the back of rock bottom annuity rates.

On the rise…

Transfer values spiked in 2016 when the already meagre yield on UK government bonds halved to below 1% (for the first time in history) following June's Brexit decision.

When the Bank of England responded in August by cutting interest rates to just 0.25% (pushing down government bond yields still further), transfer values rose once again, although have since softened as the economy recovered and interest rates returned to 0.5% as of November 2017.

Why transfer values reached record highs…

Multiple reasons to transfer

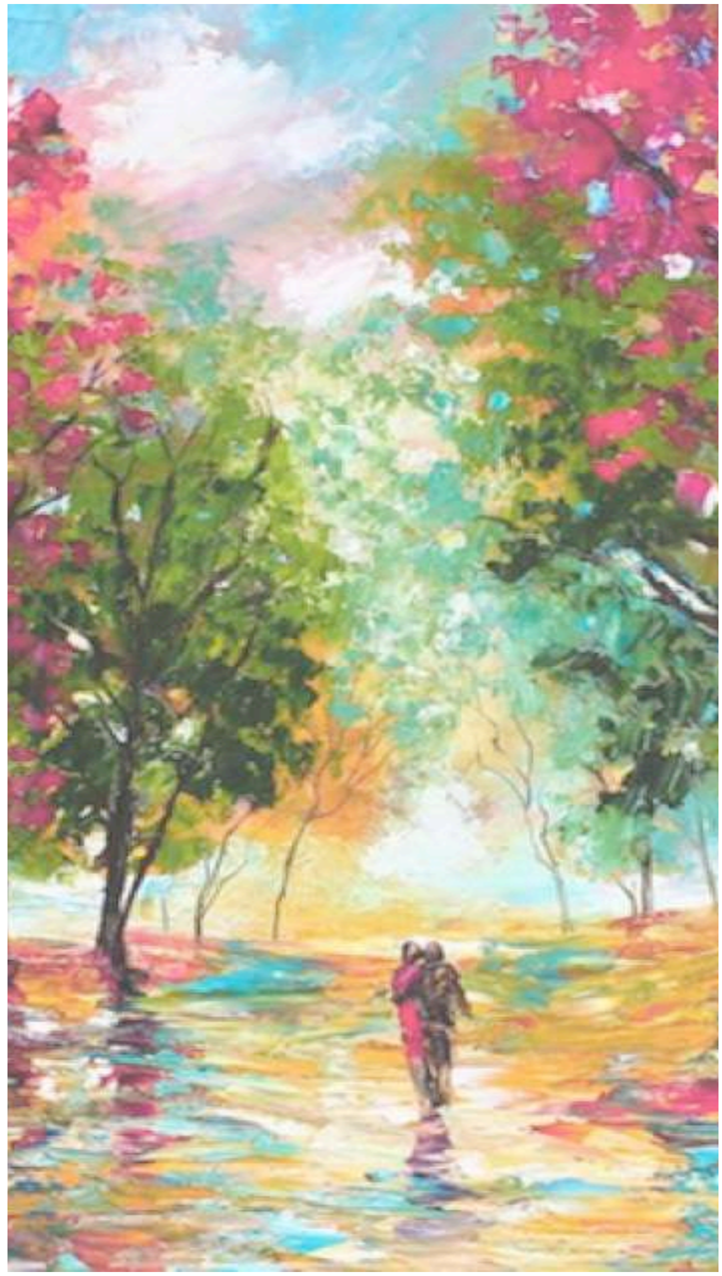
Even so, at the start of 2017 we were still seeing clients with improvements of 25% or more in their transfer values over the previous year.

Historically, the industry 'multiple' tended to float at around 20 (meaning a £10,000p.a. pension would equate to a transfer value of around £200,000). However, multiples in the 30s, 40s and even 50s are now being noted.

This said, there's little consistency between company schemes, even those in the same industry. Just because one employer is offering a high transfer value doesn't mean its peers are.

A good example was the difference in multiples being offered by BT's final salary scheme and that of Cable & Wireless at the start of 2017. While the former offered a muted multiple of 20, the latter was offering a multiple of above 50.

At the time, this meant someone with a £10,000p.a. Cable & Wireless pension who was suited to a final salary transfer could cash it in for a transfer value well in excess of £500,000.



Ask a professional…

"While transfer values are currently at record levels, a high transfer value is far from the only factor indicating someone should transfer their pension."

Neil Adams
Head of Pension Planning
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How the new ‘pension freedoms’ changed the game

Under the new rules that were introduced in April 2015, everyone over the age of 55 with a personal pension can access it as they wish – regardless of their total pension wealth.

This means that most investors aged 55 or over now have complete freedom to take whatever level of income or cash lump sums they choose (subject to the tax rules).

Savers who transfer to personal pensions now have the freedom to:

- Take their whole fund as cash with 25% paid tax free and the remainder taxed as income;
- Take smaller lump sums whenever they please, with 25% tax free and the remainder taxed as income;
- Take up to 25% tax-free and use the remainder to generate a regular taxable income – through drawdown or an annuity – either immediately or later down the line.

Other important changes

One of the most far-reaching changes introduced by the pension freedoms was the abolition of the 55% ‘death tax’ on pension assets that are passed to your beneficiaries.

As pensions have always been free of inheritance tax liability (because they’re held in trust outside of your estate) the removal of these charges means that personal pensions are now one of the most tax-efficient ways in which to pass wealth from one generation to the next.

The benefits of a pension transfer

Does a defined benefit pension transfer make sense for you?

1. Taking advantage of today's record transfer values

Low yields on government bonds (gilts), meagre interest rates post-financial crisis and the upheaval caused by the Brexit referendum colluded to push up transfer values. In many cases, transfer values are more than 200% higher than they were a few years ago.

Although far from the only factor indicating that a final salary transfer makes sense, a particularly high transfer value is a key component of any positive transfer recommendation.

The number of people for whom a final salary transfer is the best decision remains very much a minority. However, given the strong performance of CETVs in recent years, transfers have made sense for notably more people than has previously been the case.

This is one of the reasons behind the current boom in the volume of transfers.

2. More favourable treatment of inherited pensions under money purchase rules

When a member dies, although final salary pensions typically offer a spouse's pension to a surviving partner, there's no value in the pension after the death of the spouse and the member.

The benefits of a pension transfer

By contrast, a pension transfer 'monetises' your final salary benefits by translating them into a notional cash value.

When you transfer this to a personal pension arrangement, your pension savings become an asset that can usually be passed onto your loved ones and their descendants free from inheritance tax.

3. Consolidating your existing pension arrangements into one streamlined portfolio

There are a number of advantages to consolidating all of your different pension arrangements into one low-cost wrapper. Not least are the opportunities to reduce charges and greatly improve investment choice.

Creating one large portfolio also increases the chances of generating a higher level of income than if your pension was divided across several smaller pots.

Perhaps most importantly, consolidating your pensions puts all of your retirement savings where you can see them.

4. The chance to reduce your tax bills when you retire

Many members of the UK's 6,000 or so final salary schemes have accrued benefits that are well in excess of the current lifetime allowance (LTA) of £1 million. Those in this position who are drawing an income of more than £50,000p.a. will find themselves subject to LTA charges of 55% tax on any lump sums and 25% on any income in excess of the LTA, plus income tax (40%/45%), deducted at source.

However, a transfer to a money purchase arrangement allows such LTA tax charges to be deferred to age 75.

There won't be any lifetime allowance charge to pay so long as the value of the benefits taken remains below the LTA limits up to age 75. Only when the value taken exceeds the LTA limit (or otherwise at age 75) will a lifetime allowance charge be made.

Given that the pension pot has grown in a tax-efficient environment for the intervening years, this can seriously reduce the total value that's eventually lost to tax.

Similarly, a transfer from a final salary arrangement will deliver far greater flexibility when it comes to drawing income. This can potentially allow you to remain within specific income tax bands, thus reducing your tax bills.

Tax treatment varies according to individual circumstances and is subject to change.

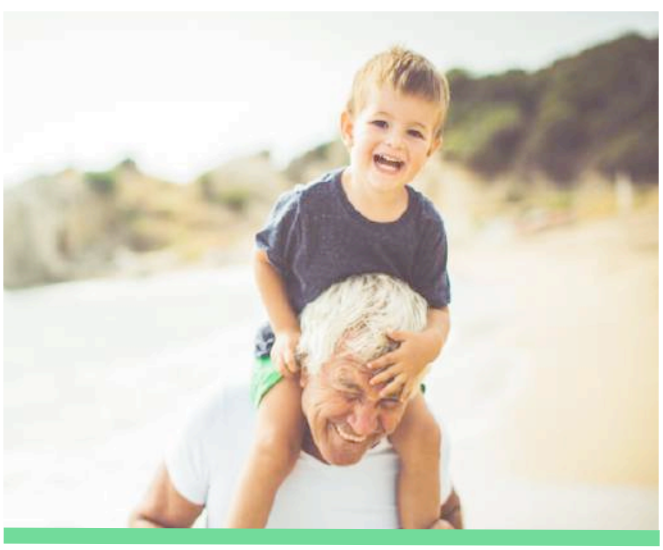
The benefits of a pension transfer

5. The opportunity to benefit from stock market growth in the decades after you retire

With a final salary pension, once you've selected your retirement date and received any tax-free lump sum, the pension income you subsequently receive will only ever grow in line with inflation (assuming an index-linked pension).

Moving to a money purchase pension allows you to keep your pension invested throughout retirement, therefore potentially benefitting from any investment growth.

Note that, as with any investment, the value of your new money purchase pension could fall as well as rise and you may get back less than you paid in.



6. Doubts as to your longevity

As the income paid by a final salary pension is priced on average life expectancy, those expecting a shorter innings may not receive as much back as someone with a longer life expectancy.

Consequently, transfers have a particular appeal to those in poor health.

In other words, because a transfer converts your pension benefits into a cash value based upon normal life expectancy, all else being equal, an ill-health transfer should be worth more to your family than your previous scheme benefits.

This means that arriving at an informed decision about whether a transfer makes sense for you requires you to take a view on your own life expectancy.

7. Doubts as to the health of your previous employers

Don't forget that many defined benefit pensions are significantly underfunded.

The precarious position of the UK's 6,000 or so private sector final salary schemes was illustrated in August of 2016 when the Bank of England's 0.25% rate cut added an estimated £100 billion to their existing £610 billion of deficits over the course of a single month.

The benefits of a pension transfer

If your former employer fails, you could find your pension is in the hands of the Pension Protection Fund. From 1 April 2017, someone aged 65 will receive 90% of their benefits capped at £38,505.61 (ie £34,655.05) per year, while future increases will also be reduced.

While this could represent a major loss of benefits for those who enjoyed relatively high earnings during their working life, it's important to realise that entering the PPF will be more favourable for most people than embarking on a defined benefit pension transfer.

If you have a good reason to consider a transfer, find out if your scheme is willing is to make it worthwhile with [Drewberry's Final Salary Calculator].

Ask a professional…

"You can request a transfer value yourself. But beware. Valuations are only guaranteed for three months.. A pension transfer is one of the most important and complex financial decisions you'll ever make, so don't try to make it in a rush."

The risks of final salary transfers

Although a transfer enables you to take advantage of the new pension freedoms and to create and manage your own pension 'pot' that can be passed to your beneficiaries, it's important to appreciate what you'll be giving up in return.

If you choose to carry out a transfer of your final salary pension benefits, you'll lose:

1. Any guarantee as to the level of income you receive in retirement

A transfer passes the investment risk that accompanies the provision of a lifetime income from your former employer to you (and you can't transfer back again should you change your mind).

Outside of a final salary pension, the only way to effectively guarantee an income for yourself in retirement is by buying an annuity. However, with annuity rates now at all-time lows, an annuity will only deliver a fraction of the income that you would receive if you remained in your former scheme.

A transfer means taking on investment risk as you'll need to invest your pension pot in a range of different 'risk assets' such as equities and bonds. There are no guarantees whenever investment performance is required.

It's also worth noting that many final salary schemes offer an index-linked pension, which will mean your pension income will maintain pace with inflation over time. There's no guarantee your money purchase investments will perform sufficiently to keep up with inflation, unless you use them to buy an index-linked annuity.

The risks of final salary transfers

2. Any guarantee that you won't run out of money in retirement

Ultimately, there are no guarantees that your new pension portfolio will generate a higher level of income than the one your previous scheme was offering.

Hand in hand with this is the risk that if you fail to manage your withdrawals correctly, you could exhaust your pension pot before you reach the end of your retirement. There's no such risk with a final salary arrangement.

That's why you'll need to find an adviser who can produce a 'cashflow model' which will illustrate just how well your new pension pot will need to perform in order to at least match the level of income you would have received from your final salary pension.

Ask a professional…

"Once we receive an up-to-date transfer value we produce a detailed cashflow model which shows how well your new pension pot will need to perform to at least match the income from your former arrangement.

"This is central to making an informed decision about whether a transfer is right for you."

If the numbers don't stack up at this stage, it's unlikely a transfer is the best option for you. Remember, even the best cashflow models are only projections, not guarantees of future returns.

3. Any guaranteed widow's pension

Typically final salary schemes will offer a reduced (50%) widow's pension to your spouse once you die.

Although you can leave a money purchase pension pot to your spouse (or anyone else) free from inheritance tax, they won't receive any guaranteed income from the fund. Just as when you were alive, returns will be dependent on investment performance.

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The risks of final salary transfers

4. You'll be subject to the money purchase annual allowance

The money purchase annual allowance (MPAA) is a cap placed on how much you can contribute to your pension and claim tax relief if you're already flexibly drawing a money purchase pension.

This limit has been slashed to £4,000, which means that anyone who's accessing a defined contribution pension scheme can only put this much into any other pension pots they have.

The money purchase annual allowance doesn't apply to those with a final salary pension scheme; such individuals can continue contributing up to their maximum annual allowance in retirement.

5. There is no guarantee of investment returns

Perhaps one of the major risks of transferring out is that you're reliant solely on your own investment decisions (or those of your adviser) to generate an income.

With a final salary pension, there's no investment risk to you personally.

If you transfer to a money purchase pension, there's no guarantee that your pension will grow sufficiently to provide you with the income you desire. What's more, the value of your investments could fall as well as rise in line with market performance and you could therefore end up with less – and less income – than you initially invested.

Advantages of Final Salary Transfers	Disadvantages of Final Salary Transfers
Transfer values have rarely been so high	Only a minority of people are suited to a transfer
Pass down pension lump sums free from inheritance tax	A large transfer could tip you over the threshold and make you subject to the Lifetime Allowance Charge
Flexibly access your pension, potentially therefore reducing income tax in retirement	You're giving up a guaranteed income for life, for you and (usually) your spouse
Potentially benefit from investment growth post-retirement	The value of investments can fall as well as rise, meaning you may get back less than you paid in
Removes concerns regarding the future health of your employer and its pension scheme	Even if your employer does collapse, the Pension Protection Fund steps in, which is likely to be a better option for most people than a transfer
If your life expectancy is shortened, a transfer could offer more from your pension	You become subject to the money purchase annual allowance

Partial transfers: the best of both worlds

Too few pension savers realise that pension transfers aren't always a question of 'all or nothing'.

It's not widely known, but some schemes will offer a partial transfer. This allows some of your pension to remain in the final salary scheme while also providing you with a money purchase fund.

A foot in both camps

For final salary scheme members, considering a partial transfer means they can still enjoy a set level of guaranteed, index-linked income for life from their employer.

But it also means they can benefit from the added flexibility, investment opportunities and inheritance options that come with a personal pension.

The need for professional advice

At Drewberry Wealth, we often deal with clients who have numerous existing pension plans including both money purchase and final salary arrangements.

Ask a professional…

"At Drewberry Wealth, we take a holistic approach. We analyse every aspect of your finances to make sure that a move will improve your circumstances; we'll never sign-off on a transfer unless we're confident that it's in your best interests."

By building up a detailed picture of each client's unique financial ambitions and analysing each pension contract individually, we can advise our clients on which pensions might be worth transferring and which ones should stay where they are.

Pension transfers are a complex and nuanced process. This explains why it's now a legal requirement to seek professional financial advice (which carries a fee) on any pension transfers from a final salary pension scheme worth over £30,000.

Remember, both your existing scheme and your new pension provider will require evidence that you've received this advice before they'll authorise a transfer.

Speaking to a qualified adviser is the first step to checking whether a pension transfer is right for you. Remember, record transfer values and the new pension freedoms alone aren't always enough for a positive transfer recommendation.

If you're one of the 6 million or so Britons with a deferred final salary pension, the best way to find out whether your old scheme is offering a good deal on a potential transfer is to use Drewberry's Final Salary Pension Calculator. This free tool will tell you everything you need to know from the outset when exploring a potential transfer.

Drewberry Wealth regularly updates all of its 'Making sense...' guides to ensure that we offer only the most up-to-date information available. We've taken every care to ensure that this information is correct and in accordance with our understanding of the law and HM Revenue & Customs practice, at the date of publication: 12 January 2018.

The information contained in this guide does not constitute advice and Drewberry Wealth accepts no liability for any use you may choose to make of it. We always recommend that readers seek professional advice before taking any financial decision.

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