DEFINED BENEFITS PENSION TRANSFER

All information contained within this document is based on current legislation, which may change in the future.

What is a defined benefit pension scheme?

A defined benefit (DB) pension is one type of workplace pension scheme.

It is a type of pension plan in which an employer promises a specified pension payment, lump sum (or a combination of both) on retirement. The benefits payable are predetermined using a number of factors, typically including: an employee's earnings history, tenure of service and age, as opposed to relying directly on individual returns. This type of pension scheme is also commonly known as a 'final salary' scheme. A typical DB pension scheme usually continues to pay a pension to your spouse, civil partner or dependants (for a restricted period) when you die.

Transferring your benefits from a defined benefit pension scheme

Our regulator, the Financial Conduct Authority (FCA), is clear that we should start by assuming that a transfer would not be expected to be suitable. This is because of the promised level of income provided by the scheme.

You cannot transfer from a DB pension scheme if you are already taking your pension. There are also some types of DB pension schemes where transfers are not possible, for example, public sector schemes for teachers, nurses and civil servants.

If your pension savings are worth £30,000 or more, you will be required to seek financial advice.

If you leave your defined benefit pension scheme, the benefits you've built up still belong to you and they can remain there until you retire or you can transfer them to a different type of pension scheme if the scheme rules allow:

- If you are still saving for your retirement – monies can be transferred into a personal pension plan where they will be invested until you choose to draw on them (no earlier than 55, rising to 57 from 2028, unless suffering from serious ill-health)
- If you have reached age 55, or 57 from 2028, and want access to your pension fund – monies can be transferred to a flexible personal pension plan which offers a flexi-access drawdown account where some of the money can be taken (either in lump sums or as regular income) and the rest, invested
- If you have reached age 55, or 57 from 2028, and want to access your pension fund by purchasing an annuity (guaranteed income for life) you must still transfer to a personal pension plan to enable the purchase of the annuity

Most DB pension schemes will allow you to transfer the pension you have built up to another pension scheme which could be a new employer's workplace pension scheme, a personal or stakeholder (SHP) pension scheme or a self-invested personal pension (SIPP).

You can normally transfer your pension benefits after you have left the employment it was associated with, to a new pension scheme at any time up to one year before the date when you would be expected to start taking retirement benefits under the DB pension scheme.

If you are considering a transfer, the first step is to request your cash equivalent transfer value (CETV), also known as the transfer value. The transfer value must be the cash equivalent of the guaranteed benefits being given up, a complex calculation is used to work out the CETV which is an estimate of the cost to the scheme of providing the deferred benefits for you at your normal pension age.

This information will be provided by the scheme administrator or pension provider and will be sent to you direct.

You may be offered a financial incentive from your employer to transfer out of a DB pension scheme. This is typically in the form of an enhancement to your scheme benefits (this is referred to as 'enhanced transfer value').

The pension provider or scheme administrator will then provide you with a Statement of Entitlement. If you are eligible for a CETV this must be provided within three months of you asking for a transfer value. It's a written document that sets out your transfer value, together with details of the benefits you have built up under the scheme, and information that your new pension scheme provider will need, if you decide to proceed with the transfer.

Where your Statement of Entitlement relates to benefits held within a defined benefit pension scheme, the transfer value is guaranteed for three months from the date of issue. Therefore, if the transfer process is not complete within the three month period, the actual amount transferred may be higher or lower than the amount shown in the Statement of Entitlement.

If you decide to transfer to a new pension scheme, your pension provider or scheme administrator must pay the benefits across to the new pension scheme within six months from the start of the transfer process.

A comparison of the benefits likely to be paid under your DB pension scheme and those provided by the product recommended, will be made. This is typically made via an Appropriate Pension Transfer Analysis (APTA) and a Transfer Value Comparator (TVC) – which you may need to pay for.

If relevant, any decision you make will probably affect your spouse / civil partner, so it is recommended that you discuss your intentions with them.

Your DB pension scheme may offer a partial transfer, so depending on your specific objectives and needs, and if allowed, you may not need to transfer the whole of your benefits.

Advantages of a DB pension scheme

- Your pension lasts as long as you do. Therefore there is no risk of you having no pension income.
- Although each scheme varies, there will be something for your surviving spouse / civil partner / dependants. Typically a survivor's pension is half of your pension income and will be paid for the duration of your spouse's / civil partner's lifetime, however, a dependant's pension may only be paid for a limited period for example until they reach the age of 23.
- Some protection against inflation is provided to help you maintain your spending power.
- Your pension does not rely on the 'rise and fall' of the stock market.

Disadvantages of a DB pension scheme

- The death benefits of a DB scheme are extremely rigid – If you are not married and have no financially dependent children, your benefits may die with you.
- If you are concerned about your life expectancy, your DB pension scheme may offer you a poor total capital return.
- It is not possible to vary the level of income you receive from the scheme.
- If your employer becomes insolvent there may not be enough assets in the pension scheme to pay your pension. The Pension Protection Fund may however provide compensation. Please see section below for more details.

Lump sum allowance and lump sum and death benefit allowance

From 6 April 2024, two new pension allowances have been introduced to limit the amount of tax free lump sums that can be taken from pension schemes, both during your lifetime and on your death.

For those with no protection, the lump sum allowance is £268,275 and the lump sum and death benefit allowance is £1,073,100.

If lump sums are taken that exceed your available allowances, income tax is payable on the excess.

Retirement options

When transferring your DB pension benefits to access your pension, you will have the option to transfer to one of the below products:

Flexi-access drawdown

Drawdown pension is a method of withdrawing benefits from your pension fund without purchasing a lifetime annuity.

Holders of money purchase pension plans can defer taking their pension in the form of an annuity and instead make withdrawals directly from the pension fund. With flexi-access drawdown the amount of income that can be taken from the fund is not subject to any specific limits therefore this method offers great flexibility. This can be useful for tax planning or where other sources of income are available. You will be taxed at your marginal rate(s) of income tax on any withdrawals you make. You can usually take 25% of your fund as a tax-free lump sum (pension commencement lump sum), either all in one go or a portion each time you move some funds into drawdown.

Uncrystallised Funds Pension Lump Sum (UFPLS)

You can withdraw a single lump sum (or a series of lump sums if the product allows) from your pension without the need to move the funds into a drawdown plan first. 25% of the lump sum is usually tax free with the balance taxed at your marginal rate(s) of income tax. If you don't have sufficient Lump Sum Allowance left, your tax free element will be reduced or unavailable.

Pension annuity

A lifetime annuity pays a guaranteed income for your life or for a specified period from the funds you have built up in your pension plan. Your annuity provider will pay you a regular income taxed in the same way as earnings. The amount of income payable is dependent on your age and health, the size of your pension fund, economic factors, the type of annuity and the options you select. You should also be aware that, once purchased, most lifetime annuities can't be cashed in or altered. The precise terms of the annuity should be confirmed. You can usually take 25% of your pension fund as a tax-free lump sum before using the balance to buy the annuity.

Pension protection fund

DB pension schemes are protected by the Pension Protection Fund.

What does this mean?

Whilst you are a member of your final salary pension scheme, if your employer becomes insolvent and there are not enough assets in the pension scheme to cover the level of compensation that the Pension Protection Fund would provide, the Pension Protection Fund may compensate you in the following ways (provided the pension scheme is accepted by the Pension Protection Fund):

If you are over your scheme's pension age:

If you have reached the normal pension age set by your pension scheme or, irrespective of age, are either already in receipt of a survivor's pension or a pension on the grounds of ill health, the Pension Protection Fund will generally pay a level of 100% compensation. This normally means a starting level of compensation equal to 100% of the pension in payment immediately before the assessment date. The part of this compensation that comes from pensionable service on or after 6 April 1997 will be increased each year in line with inflation capped at 2.5%. This could, potentially, result in a lower rate of increase than the scheme would have provided.

If you are not yet at your scheme's pension age:

For the majority of people below their scheme's normal pension age the Pension Protection Fund will generally pay a 90% level of compensation. This generally means 90% of the pension accrued (including revaluation) immediately before the assessment date and revaluation in line with the increase in the inflation rate between the assessment date and the start of the compensation payments (revaluation is capped at 5% compound per annum for compensation relating to pensionable service prior to 6 April 2009, and capped at 2.5% compound per annum for compensation relating to pensionable service on or after 6 April 2009). Once compensation is in payment, the part that relates to pensionable service on or after 6 April 1997 will be increased each year in line with inflation, capped at 2.5%. Again, this could result in a lower rate of increase than the scheme would have provided.

In addition, there will also be compensation for certain survivors.

Once you transfer out of your final salary occupational pension scheme, your benefits will no longer be protected by the Pension Protection Fund. Instead you will **typically** be covered by the Financial Services Compensation Scheme (FSCS) should the relevant pension provider become insolvent.

If you are still building up your pension pot (that is, you haven't yet used your pension fund to purchase an annuity or placed the fund in pension drawdown) 100% of your pot will be protected if it's directly managed in a life insurance contract – this protection applies where the product provider fails and not in the instance of bad advice.

Where external funds are held in addition to or instead of the insurance company's own directly managed funds, there is no cover under the FSCS should an external fund fail. This is because the insurance company purchases the external funds not the policyholder and insurance companies are classed as large companies and as such are not allowed to claim under the scheme.

Where pension funds are invested directly in other investments the £85,000 investment protection would usually apply in the event of an investment provider failing.

The FSCS can pay compensation if the advisory firm concerned has failed and cannot return your investments or money owed, and you lose money because of:

- Bad or misleading investment advice
- Negligent investment management
- Misrepresentation or
- Fraud

They do not pay compensation if your investment has not performed as well as hoped.

Risk considerations

Transferring from a DB pension scheme is an important decision, so ensure that you fully understand the implications before doing so.

There are a number of risk considerations that you need to take into account when transferring from a DB pension scheme. It is important that you are aware of these.

- This type of transaction is irreversible – it is not possible to 'undo' a transfer and revert back to your original DB pension scheme should you change your mind.
- When benefits are transferred from a DB pension scheme, all the valuable benefits / guarantees that would have been provided, are lost. For example, you will be giving up a guaranteed, inflation proof income and a guaranteed spousal income.
- If the transfer is not completed within three months of the date of your Statement of Entitlement, a new transfer value will need to be requested and the revised figure may be lower than the original figure. Your DB pension scheme may also charge you for this new calculation.
- You may not be able to obtain the same level of life cover to replace your DB pension scheme's lump sum death benefits.
- If your DB pension scheme is protected by the Pension Protection Fund, you will lose this protection (please refer to the 'Pension Protection Fund' section above for more details).
- In view of the fact that transferring pensions can be a lengthy process, the transfer value and the pricing of the funds to which the transfer is to be made may fluctuate during the process and you may suffer a loss as a result.
- The level of benefits that may be obtained from the purchase of a future annuity is uncertain – which may result in your eventual income at retirement being less than if you had remained within your DB pension scheme.
- Once transferred, your pension funds will be exposed to investment risk.
- At the time you decide to take your pension, there may be a lack of available annuity types to replicate the benefits being given up.
- Any recommended solution with regards to the investment of your pension funds following a transfer, will often require you to become actively involved in the ongoing investment choices of your funds and ongoing reviews will be important.
- Your eventual income in retirement may be less than the pension which would have been available under your DB pension scheme.
- Should you die within 2 years following the transfer and were knowingly in ill-health at the transfer date, it is possible that a value could be included in your estate for inheritance tax purposes.
- People do not typically know how long they will live, so there is a risk that you may run out of money prematurely.

There is no guarantee that your eventual income in retirement will keep pace with future inflation.

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