



## Are you going to pine for your pension?

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**If you have deferred benefits in a defined benefits occupational pension then you could be forgiven for thinking that the recent economic turmoil hasn't affected those benefits and that your pension is safe.**

The purpose of this article is to explain why that view might be misplaced and the benefits of taking professional advice on your options and the factors that may influence that advice.

### **Many transfer values have risen recently**

Transfer values for many pension scheme members have been rising. This means that those considering exchanging their accrued pension benefits for their own pension investment pot may need to obtain a lower return on those funds than might have been the case a few years ago. With investment markets currently well off their historic valuation highs, matching or exceeding the return required to match the benefits given up might be more achievable over the next 10-20 years.

There are a number of reasons why transfer values have risen and the following is a broad summary of the main factors:

#### ***Introduction of scheme basis transfer values***

In simple terms this means that the rate of return used to calculate the present day value of the pension entitlement (known as the 'discount factor') must reflect the actual investment strategy employed by the pension scheme, rather than the past practice of assuming that it will invest entirely in equities. If the scheme holds asset classes, such as fixed income, which have a lower expected return than equities, then, since 1 October 2008, the discount factor must now reflect that fact.

Therefore, if a scheme holds, say, 50% in fixed income and 50% in equities, it would have a lower expected return than a scheme that holds 20% in fixed income and 80% in equities. This lower expected return means a lower discount factor which in turn leads to a higher transfer value today. So if the scheme of which you are a member invests less than 100% in equities and you have more than 10 years until the normal retirement date (NRD) then the chances are the current transfer value will be higher than it might have been a few years ago, over and above that which would have occurred as a result of yearly revaluations.

#### ***Scheme funding and financial viability***

This provision, which has been in place for some time now, means that the employer's contributions must be calculated based on the actual investment strategy being used, rather than the old approach of assuming a return based on 100% allocation to equities. Occupational pension schemes are only required to carry out a review of their funding every three years (known as the triennial review). This fact, coupled with the significant falls in equity markets over the past 18 months, is leading to many more schemes having fewer assets than they need to provide the guaranteed benefits to their members.

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The need for employers to make higher levels of contributions to plug this funding gap is likely to see a rapid acceleration of the closure of defined benefit schemes. In some cases scheme trustees are offering an enhanced transfer value to encourage members to transfer out and thus reduce the potential funding gap in the scheme.

### ***Equalisation of benefits between sexes***

Historically it was common for schemes to offer a different retirement age for men and women, but this was outlawed a few years ago and schemes have been equalising the retirement age, usually upwards, for men and women. As a result, in some cases, transfer values for women have risen to reflect the higher cost of pensions for women, given their higher life expectancy compared with men.

### ***Company insolvency***

There have been a number of high profile cases in recent years in which the sponsoring employer of an occupational pension scheme has gone bust leaving the pension scheme with unfunded pension liabilities. This led to the creation of the Pension Protection Fund (PPF) in 2005, to provide financial support to underfunded schemes whose sponsoring company had ceased trading. However, the scheme has a cap on the amount of benefits it can provide, and this is currently around £28,000 per annum. Those with significant benefits in an underfunded pension scheme are, therefore, highly vulnerable in the event of the financial failure of the employer.

With the rather bleak current economic outlook, it is highly likely that greater numbers of companies will go bust, leaving already underfunded pension schemes to apply for protection from the PPF. Delays in settling claims to the PPF, which are already taking several years, are likely to increase considerably. The implication for those pension schemes whose employers do survive is that they will probably have to pay higher levies to the PPF, to pay for bailing out those schemes whose employers don't make it.

In this context some retirees might be happy to receive, say, 85% of an expected £70,000 annual pension, from their own personal pension plan, whether as an annuity or directly from the fund, than wait in line for several years for £28,000 per annum from the PPF. If a scheme has started the process of claiming from the PPF then the option to transfer out benefits is extremely limited. In some scenarios doing a transfer now might make sense if the sponsoring employer appears financially vulnerable.

### ***Meagre death benefits***

Many schemes offer no or very limited lump sum death benefits to deferred members. This position can be increased significantly by transferring to a personal pension, at the expense of losing surviving spouse's/civil partner's and/or dependants' pensions. There are several reasons why this might be attractive to some members:

No spouse/civil partner or financial dependants – in this case the pension benefits are lost  
Spouse/civil partner financially independent – whether they have sufficient pension provision of their own or other financial assets, in this scenario the survivor does not need or want additional taxable pension income, but would prefer to have a lump sum.

Non dependant adult children – where it is desired to pass a tax free pension lump sum death benefit to children or grandchildren, either outright or via a special pension trust, a transfer will permit this.



## Do I need advice?

You will probably benefit from taking professional advice if any of the following apply:

- Your transfer value is in excess of £250,000;
- Your scheme is underfunded;
- You are concerned about the sponsoring employer's financial viability and have annual pension benefits in excess of £31,000;
- You wish to improve the lump sum death benefits on offer and are happy to forego or cannot utilise any spouse's/civil partner's and/or financial dependants' pensions;
- You are single and would prefer to have a higher starting pension annuity at the expense of inflation protection (current rates suggest it would take nearly 20 years for an RPI linked annuity to exceed the annual payout of a level annuity and about 33 years to equal the total payout);
- You have at least 10 years until you wish to take benefits and you would like to determine your own investment strategy, either with or without the assistance of a professional investment manager, and think that current investment markets represent good value for money.

The key is to look at your deferred pension benefits in the context of an overall financial plan, ideally incorporating a lifetime cashflow analysis and an objective assessment of your tolerance for and need to take risks. This will allow you to assess the relative merits of transferring the cash equivalent of your defined benefit pension and make an informed and considered decision.

Worthwhile professional financial advice isn't free and you will, therefore, need to pay a sensible fee for such guidance. Pension transfer advice is a specialist area which requires firms to have enhanced pension and investment knowledge, specialist pension qualifications, rigorous processes and special authorisation from the regulatory authority. Many firms active in this area usually offer a fixed fee basis to provide personalised advice, and you can expect to pay between £1,200 to £4,000 plus VAT depending on complexity and fund size. However, it is common for firms to provide an initial feasibility assessment for about £250 plus VAT, to determine whether you are likely to get value for money in having a full analysis carried out. The good news is that with the recent reduction in VAT those fees are now 2.5% lower. If you do end up transferring to your own pension plan then the advice fees will be exempt from VAT, but that shouldn't influence the advice or your final decision on whether to transfer.

## Your New Year pension planning resolutions

With 2009 almost upon us you might wish to review our suggested resolution checklist below and make sure that your pension arrangements are all sorted. Then you can stop worrying and spend your time on more productive and interesting pursuits.

In 2009 I will.....

- Check out the position in relation to any deferred defined pension benefits and obtain an initial assessment from a suitably qualified independent adviser to see if I need to look into the matter in more depth;
- Well before the 5<sup>th</sup> April 2009 deadline check that I have obtained any transitional protections that I am entitled to, so as to protect any pension benefits in place prior to 6<sup>th</sup> April 2006;
- Check who I have nominated as my preferred beneficiary(ies) for the death benefits on all my pension arrangements;



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- Find out whether it would be more tax efficient and preferable to direct any pension death benefits into a special pension 'by pass' trust;
- Determine whether it makes sense for me to make additional pension contributions either by way of cash or transfer of existing investment assets that I already own or 'sacrificing' some of my salary/bonus (possibly getting the benefit of any saving in National Insurance added to that contribution);
- Review my existing investment strategy, taking into account pension funds/benefits and when I am likely to take those benefits, in the context of a strategic financial plan which includes a lifetime cashflow analysis.

If you do all that, or get a professional to do it for you, you can pat yourself on the back and consider it a job well done. And one thing's for sure - you certainly won't be pining for your pension!

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