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14 questions you need to ask before transferring your Final Salary pension

In years gone by, Final Salary pensions were the norm for many employees. At the end of their working life a guaranteed, often index-linked pension was payable until they died. Furthermore, if their spouse outlived them a proportion of the pension income continued to be paid. For most people, the thought of giving up an often generous, guaranteed pension, never occurred to them.

However, a combination of the introduction of Pension Freedoms in 2015 and the relatively high transfer values offered by some schemes, has increased the number of people transferring their Final Salary pension into an alternative arrangement.

If you have a Final Salary pension you may be considering the options available to you.

We have therefore written this guide to help you understand the key questions you need to answer before making any decisions.

Before we go any further, we should point out that Final Salary pensions are also often referred to as Defined Benefit schemes. However, to keep things simple, we'll refer to them as Final Salary pensions throughout the rest of this guide.

Why might people transfer their Final Salary pension?

In our experience, the reasons that people consider transfers are:

- They see the chance to "own" a larger sum of money in a pension in their name.
- They see a potential improvement in the size of legacy they may leave to their loved ones.
- They are interested in the ability to draw funds flexibly, as lump sums or income.

However, anyone who does transfer their Final Salary pension will give up a guaranteed and often inflation-proofed annual income and may well be worse off by doing so.

Furthermore, it's not a decision which can be reversed. Once the transfer has been completed the member cannot change their mind. For these reasons, careful consideration must be given to all options before a final decision is made.

The right course of action will be different for everyone, which is why taking independent financial advice is so important. We can't hope to tell you in this guide what's right for you. However, we suggest that no one should transfer out of their Final Salary scheme without first taking advice and answering these 14 questions.

Pension Transfer Gold Standard

We're proud to be a firm that has met the criteria to achieve the Pension Transfer Gold Standard as set out by the Personal Finance Society. By working with a firm that has voluntarily committed to the Pension Transfer Gold Advice, you can be confident that you will receive the best possible advice, service and support when considering transferring out of a Defined Benefit pension scheme.

Please click here to learn more about the Pension Transfer Gold Standard

Pension
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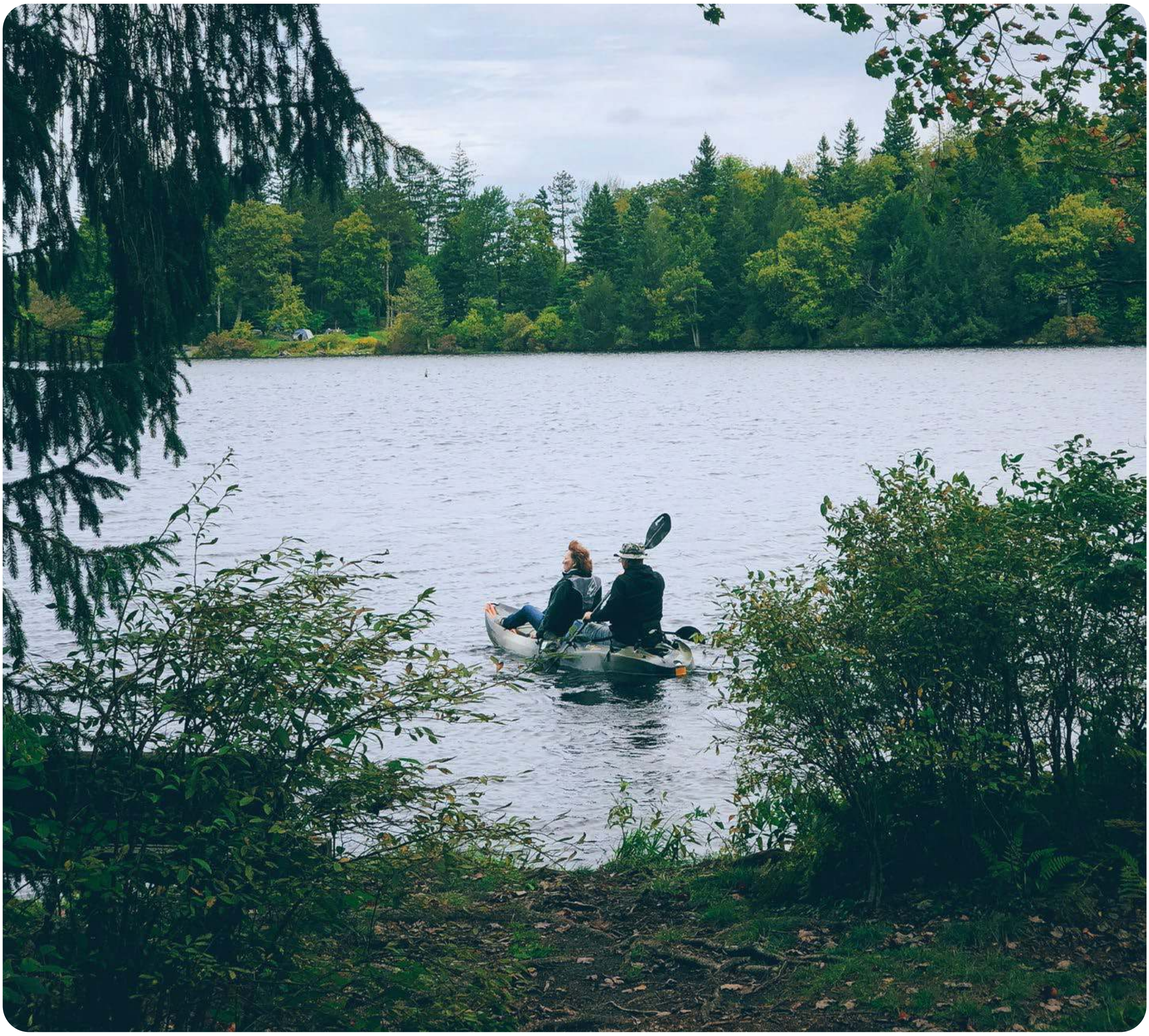


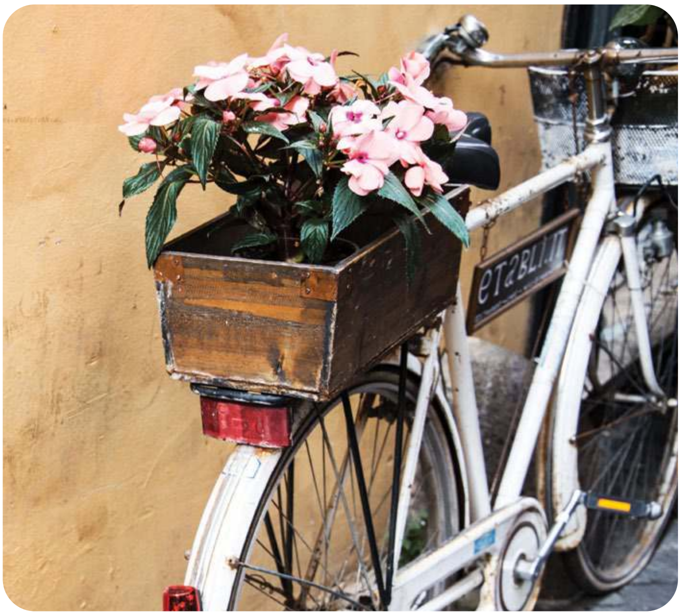
What is a Final Salary pension?

In simple terms, a Final Salary pension is a Workplace Pension scheme, set up and run by an employer.

The pension payable is linked to the salary of the employee. It is guaranteed to be paid for the rest of their life and, if applicable, at a lower level to their spouse or civil partner if they outlive the member.

Furthermore, the annual income has an element of protection against inflation built in.

The guaranteed nature of the income, coupled with the spouse's pension and inflation protection, make Final Salary pensions attractive and not something which should be given up lightly.



1 What benefits will your existing scheme provide?

The first thing to understand is the benefits the existing scheme will provide.

First and foremost, this means understanding the income which will be paid to you when you reach the scheme retirement age. Next, you need to understand the additional benefits including:

- How the income will be index-linked to help offset the effects of inflation
- The pension payable to your spouse or civil partner should you die before them
- Plus potential pensions for dependents

This information can be obtained from your scheme trustees. However, care should be taken to ensure it is interpreted correctly; for example, the retirement income you have accrued will increase between now and when you finish work due to further accrual and/or inflation-linking.

2 What is the transfer value you have been offered?

All members of Final Salary pension schemes can ask the trustees to provide them with a Cash Equivalent Transfer Value (CETV). This is the amount you can transfer away from the scheme in return for waiving your membership.

The trustees of a scheme will usually provide one CETV per year free of charge. Additional CETVs can be requested, however, a charge may be made.

3 How long is your transfer value guaranteed for?

CETVs are typically valid for 90 days or three months. After which you will have to request an updated value, which you may be charged for, and the value may change.

Consequently, you should ideally find a financial planner before requesting the CETV, giving them the maximum amount of time possible to formulate their advice.

Avoiding financial scams

Financial scams are now rife, with the average victim losing £91,000 (Source: FCA).

Many scammers are preying on members of Final Salary pension schemes, who often have transfer values of hundreds of thousands of pounds.

Everyone should beware of falling victim to a financial scam. Only ever take advice from an adviser authorised and regulated by the Financial Conduct Authority and never after receiving an unsolicited approach via a cold call, email or text.

4 What are your retirement objectives?

The objectives you have for your retirement are intrinsically linked to the decision whether to transfer away from your Final Salary pension.

We encourage our clients to think about four key areas:

- When do they want to retire? Do they have a specific age in mind, or will they finish work when they can afford to do so? If they could retire early would this be attractive?
- How do they want to retire? Do they see themselves finishing work and retiring completely and therefore requiring a relatively consistent income, or retiring gradually by continuing to work part-time or on a consultancy basis and consequently need flexibility of income?
- What income and lump sums do they need during retirement? Understanding the income you need to do everything you would like in retirement isn't necessarily as easy as we might imagine. Furthermore, understanding the lump sums of capital you need also takes careful consideration.
- How important is leaving a financial legacy to their spouse, loved ones or other causes when they die? Who else is dependent on your pension income? Do they want to leave a financial legacy to others, who might not be financially dependent upon them, but who are, nevertheless, important?

5 What other pensions, savings and investments do you have?

Retirement isn't only about your Final Salary pension; to properly plan for the next phase of your life other pensions, savings and investments must be considered.

That includes the State Pension. For most people, it won't pay enough to meet their retirement income needs, but nevertheless provides a very sound financial base.

As a rule of thumb (and it is no more than that) the greater reliance you have on your Final Salary pension to provide your retirement income, the less likely it is to be in your best interests to transfer it elsewhere. The reverse is also true, although the final decision should only be taken after careful consideration and receiving financial advice, more of which later.

6 Capacity for risk

All savings and investments carry some risk; for example, the value of investments in stocks and shares will fluctuate over time and could fall, while the capital value of your savings can never fall.

However, over time we would expect the returns on stocks and shares to exceed the interest you receive on a savings account, which is often below the rate of inflation, leading to a real term loss.

Understanding your capacity for risk, both emotionally and financially, will help you to decide the amount of risk you are prepared to take with your retirement planning. That's important, because transferring your guaranteed, inflation-linked, Final Salary pension into an alternative arrangement will mean taking on significantly more risk.

7 How can you offset the effects of inflation?

Unless you are careful, inflation could erode the buying power of your income.

While an inflation rate of 2% may sound innocuous, over a 20 or 30-year retirement it could do serious damage to a fixed income. For example, an income of £10,000 in 1999 would need to have risen to £17,777 in 2019 to keep pace with rises in the cost of living.

That's why the inflation-linking offered by Final Salary pensions is so important. However, most schemes cap inflation proofing at between 2.5% and 5%. Consequently, should inflation be higher than the relevant figure for your scheme over a sustained period, there is a risk that the buying power of your income would be reduced in real terms.

It can, therefore, be sensible to have additional funds invested in other assets, such as equities, which have historically proved to be a good hedge against inflation over the longer term.

Careful consideration needs to be given as to how the effects of inflation can be mitigated during your retirement. This should, therefore, be a key focus for your financial planner.

8 What is your state of health and how long do you expect to live?

Your state of health affects your life expectancy, which in turn dictates the total income you need in retirement. Unsurprisingly, the longer you live the more money you will spend and the greater the income you will need in retirement.

Conversely, if you have a shorter life expectancy or a life-limiting medical condition, you may need a higher initial income to pay for medical expenses or simply to take full advantage of the years you have left.

As unpleasant as it can be to consider your own mortality, understanding your life expectancy is important in general and, more specifically, when deciding whether to transfer your Final Salary pension.

9 What is the financial state of the scheme and the sponsoring employer?

Final Salary pensions promise to pay an income to you based on your service in the scheme and its rules. To do this the scheme has assets which are invested by the trustees. Furthermore, the sponsoring employer has additional obligations to ensure the income can be paid and the promises met.

In recent years, several factors have meant that some schemes are underfunded and, in the future, might be unable to meet these promises. The sponsoring employer has a legal obligation to address the problem.

In the worst-case scenario, when the sponsoring employer becomes insolvent (goes bust), the Pension Protection Fund (PPF) steps in. Understanding the financial position of the pension scheme as well as the employer is challenging. Comparing the benefits offered by the existing pension scheme with those of the PPF is difficult too, making expert advice crucial.

10 What is the opinion of your financial planner?

When Pension Freedoms were introduced in April 2015, a new rule was introduced compelling anyone wishing to transfer a Final Salary pension worth over £30,000 to take independent financial advice.

The rule was designed to stop people with valuable Final Salary schemes from making knee-jerk decisions, which they may regret or leave them financially worse off in years to come.

First and foremost, to advise on Final Salary pensions your planner must have the relevant permission from the Financial Conduct Authority (FCA). You should always check out your existing or a potential financial planner on the FCA Register, looking for 'Advising on Pension Transfers and Pension Opt-outs'. You can see our entry on the Register by clicking here.

Next, careful consideration needs to be given as to whether you have found the right planner. Our free checklist, which you can download by clicking here will help you do just that.

Finally, we encourage you to listen to your financial planner. Your planner should use sophisticated financial modelling software to consider the impact of different events which may occur in the future. For example, they will consider the effects of inflation and taxation, as well as your need for capital and what you want to happen to your pension when you die.

Having considered different possibilities they will make recommendations which are in your best interests.

Remember too, this will probably be the first time you have considered transferring a Final Salary pension, whereas they will have advised many people in a similar position to you. That experience, knowledge and skill are important. It will help you plan your retirement, which could last for 20, 30 or even 40 years and avoid short-term temptations, which could ultimately lead to you making an expensive and irreversible mistake.

Choosing a financial planner

Finding the right financial planner isn't easy, especially when it comes to such an important decision; whether to transfer your Final Salary pension.

We believe there are 12 key questions you should ask when choosing a financial planner. You can find these by clicking here and downloading our free checklist.

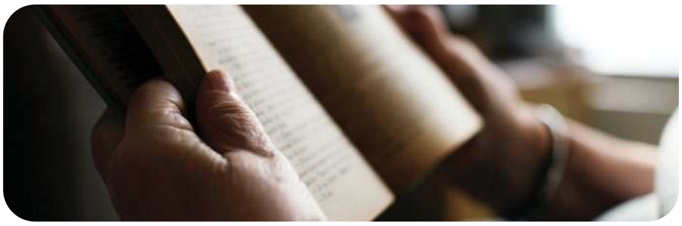
11 How is your financial planner charging you?

All financial planners will produce a report outlining their advice and then work with you to implement the recommendations. There are generally two ways they charge:

1) Some undertake this work for free. Only making a charge if you implement their recommendation to transfer your Final Salary pension. This is known as a contingent charging model.
2) Others will charge you for the report containing their advice. Then charge for implementing their advice.

It may be tempting to select a planner who will undertake the initial work for free. However, we believe it may create a potential conflict of interest, as planners working to this model only get paid if they recommend a transfer. Indeed, this so-called "contingent charging" will be outlawed on 1 October 2020.

We believe it is better to work with financial planners who charge for their advice and expertise and avoid potential conflicts of interest.



12 Why are you considering a transfer?

When you see the transfer value offered by the trustees of your Final Salary pension, your eyes might light up; many are large and for some people, it feels like they have won the lottery.

Final Salary pensions are a hot topic and there's bound to be conversations between work colleagues about the best thing to do. Some people may have even transferred their pensions already and be enthusiastically discussing the benefits of doing so. However, that transfer value, along with other income sources, needs to meet your expenditure for the rest of your life and that of your spouse.

Giving up the guarantees offered by the Final Salary pension after a conversation with work colleagues, reading press articles or following a cold call are dangerous reasons to transfer. Instead, we advocate working closely with your financial planner, who will be experienced, knowledgeable and skilled in these matters.

A good financial planner will help you understand your objectives and goals as well as your needs. Occasionally, they may even challenge your conclusions if your objectives conflict with your needs. Once these have been agreed your financial planner will use that information to make their recommendation.

13 How are you affected by the Lifetime Allowance?

The Lifetime Allowance is the maximum you can build up in pension funds before which a tax charge may become payable.

Set at £1,073,100 as of April 2020, it covers all pensions, including Money Purchase Schemes (Personal Pensions, Stakeholder Pensions, Self-Invested Personal Pensions etc) as well as Final Salary pensions. Those with pensions worth more than the Lifetime Allowance could face tax charges of between 25% and 55%, depending on whether money is withdrawn as an income or a lump sum. Calculating the value of Money Purchase schemes in regard to the Lifetime Allowance is straightforward, but when it comes to final salary schemes the rules are more complicated and care needs to be taken.

Many members of Final Salary pensions are unwittingly caught by the Lifetime Allowance and potentially face large tax bills, which could be avoided if they understood the Allowance, the protections available and how a transfer away from the scheme all interact.

Your financial planner will help you understand whether you are caught by the Lifetime Allowance and the options you have for reducing any tax potentially due.

14 Are you sure you are making the right decisions?

The average Final Salary transfer value is over £250,000 (Source: FCA). That's a significant amount of money.

There are many reasons why transferring your Final Salary pension might be the right thing to do.

However, for most people transferring away from their scheme is a mistake and will leave them worse off. Remember too, this is a decision which can never be reversed. Once a transfer has been made, there's no going back.

That's why taking your time, thinking about these 14 questions and taking advice is so important. Getting it wrong could be an expensive mistake.

Deciding what's best to do with your Final Salary pension means considering a huge range of factors; some of which are relatively straightforward, others far more complex.

We are here to help

If you have a Final Salary pension and would like our advice to help you understand your options, we are here to help.

Our Chartered Financial Planners are all experienced in working with members of Final Salary pensions, as well as those considering their retirement options. We'll work to understand your objectives, goals and needs, and then make a personalised recommendation. If we recommend that transferring your Final Salary pension is the right thing to do, we will also advise you on the type of pension you should transfer to and the investment approach you should take.

Please get in touch with us for an initial conversation about how we work and your requirements.

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Enquire online: Click here

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