Thinking about transferring your defined benefits?

A guide for employees

AVIVA

How this guide can help you

Our guide is a first step to understanding the pros and cons of making a transfer. It gives you information about what you should consider and stresses the importance of taking the decision.

What we've written is not advice and, if you think a transfer may be right for you, the next step is to seek financial advice. Please be aware that tax benefits are subject to change and their value depends on your individual circumstances.

The law requires you to take advice. If you are given a DB transfer value of over £30,000 you must receive advice from a suitably authorised adviser before the scheme trustees can release the transfer value payment. For values under £30,000 advice isn't required, but we recommend that you do seek it.

Your current pension scheme may already provide access to a financial adviser. If you do not have a financial adviser you can contact one at **unbiased.co.uk.** You may be charged for this advice.

Quick recap

Defined benefit (DB) pensions

- The amount you get back in retirement is set, it's 'defined' by the rules of the scheme.
- It's usually based on how many years you've worked for your employer and the amount you've earned. People sometimes call it a final salary scheme.
- It's your employer's responsibility to make sure there's enough money to pay you a secure income for life from the day you retire. So you're not affected by the ups and downs of the stock market. DB schemes must include inflation protection and can include a benefit for a spouse, civil partner or other dependants if you die.
- A DB scheme will usually allow you to take a tax free lump sum as part of your benefits.
- With a DB scheme there are usually no charges on members' funds.
- Schemes may vary, but these are the general principles.

Defined contribution (DC) pensions

- Your pension contribution is 'defined' and your pot depends on the amount of money paid in, the investment performance and any charges incurred.
- Usually it's built up through contributions from your employer, maybe you pay in too. If you do, you'll get tax relief from the government on your contributions.
- The retirement income you get depends on how much was paid in, how well the investments have performed and the cost of providing an income. These will affect the amount you get back. That's because its value is based on investment performance, so it can go up and down. You could get back less than you transferred over.
- You can choose to take the money as a regular income, a one off lump sum, or ad hoc smaller lump sums - with 25% of your pot tax free.
- The pension provider applies a charge as a management fee, this may vary.

Transferring – what you need to know

When a transfer may be right

There are potential advantages that could come with a transfer from a DB to a DC pension.

1 Flexibility

Before you think about transferring it's a good idea to look ahead to what DB and DC schemes offer you, when you want to access your money.

DB scheme

They pay a guaranteed income which increases each year and may provide a pension for a spouse, civil partner or other dependants if you die. It's usually paid from a set retirement age, or from an earlier age at a reduced rate.

DC pension

Pension freedoms (available from when you are 55) make it possible to shape your income around the lifestyle you see for yourself in retirement. With pension freedoms your options are to:

- Buy an income for life (annuity)
- Take money whenever you need to
- Withdraw all your pension money
- Leave your money where it is.

Here are some thoughts:

- However you decide to take your pension benefits they will be subject to tax rules.
- Are you looking to retire gradually? If so, the inability to take your DB benefits over time in several stages may be frustrating. But with a DC pension there's a risk that income will run out if you take too much out, too soon.
- If you are not married or your spouse, civil partner or other dependants has their own retirement provision, you may not need to fund a pension for them at retirement.

2 Health

Your anticipated state of health at retirement, may play a role in your decision on whether or not to transfer from your DB scheme.

DB scheme

DB schemes are based around the cost of providing the pension to an average member. It will pay out for as long as you live, often with a pension paid to a spouse, civil partner or other dependants after you die.

If you live into your 80s or 90s, it's likely you'll get your money's worth from the scheme. But if you have poor health or a life-limiting condition and die relatively early, you may not have had the chance to receive the full value of your pension.

If you ask for a transfer value, it's likely to reflect average life expectancy. So if yours is below average, you may get more money than it would have cost the scheme to pay your pension, if you had stayed in and died relatively early.

DC pension

If you meet certain criteria based on your answers to general questions about your health you could buy what's called an enhanced annuity. This may provide a higher regular income than other types of annuity from a DC scheme.

You could take money whenever you decide to, called drawdown, in the knowledge that what's left may be paid to your beneficiaries. If you don't have any, you could leave a legacy to a charity or organisation of your choice.

3 Inheritance

When considering transferring from a DB scheme to a DC pension, you might want to consider what will be payable to your beneficiaries when you die, for each case.

DB scheme

- They normally pay a percentage of your pension to your spouse or civil partner.
- If you're not married or in a civil partnership, the benefits payable to an unmarried partner or children will vary according to the scheme rules. So it's a good idea to clarify this with your scheme trustees.

DC pension

Pension freedoms open up more choices for inheritance planning.

- For example, if you take income drawdown your beneficiaries will have the choice of taking your remaining pension pot as a lump sum, continuing to take drawdown income, or using it to buy a lifetime annuity – usually free of inheritance tax. These payments are tax free if you die before age 75 and taxed as income at the beneficiaries marginal rate if you die after age 75.
- Your beneficiaries aren't limited to your spouse or civil partner. You can include children or other relatives should your scheme support it.
- If you purchase an annuity it could provide for your spouse's or civil partner's pension for a guaranteed period. Although this would reduce the initial income payable.
- You should take financial advice on what's best for your circumstances and your beneficiaries.

4 Tax free cash

A tax free cash sum is an important pension scheme benefit. With most pensions you could take 25% as tax free cash. For both a DB and a DC scheme this will reduce the income you receive.

DB scheme

Here some people explore whether they can take a lower initial tax free lump sum, to get a higher income.

The rate of giving up part of your pension for cash and the conditions for doing this depend on your scheme rules.

Under your DB scheme you may also benefit from a protected tax free cash sum of more that 25%, this protection would be lost on transfer.

DC pension

Generally, you can take 25% of your DC pension pot as a tax free cash lump sum, from age 55. However unlike a DB scheme where the remainder provides you with a reduced regular income, you could keep your pension pot invested until you're ready to use it, so it has the potential for further growth, though it could fall in value.

Things to consider for both schemes:

- Everyone's circumstances are different, so your adviser will help you work out the best tax-solution for you.
- Tax rules may change in the future, when you decide to take your retirement income, so it's sensible to take ongoing reviews of your situation.

5 Sponsoring employer's solvency

In a DB scheme, the scheme rules and the employer who backs the scheme, guarantee to pay a set level of income when you retire – for life.

If the sponsoring employer goes out of business (becomes 'insolvent') the scheme will potentially need to rely on the Pension Protection Fund (PPF).

You can find out more at:

Pension Protection Fund

pensionprotectionfund.org.uk

For information about what happens if the financial services firm providing your DC scheme fails please see:

Financial Services Compensation Scheme

fscs.org.uk

When a transfer may not be right

We have already touched on some of the risks but it's important to think about what impact these might have on your retirement income. Here are some specific risks you need to think about.

1 Taxation

The government sets a limit on the value of benefits which can be taken from all pension schemes you are a member of – known as the Lifetime Allowance (LTA). It is currently £1 million (2017/18). If you go above this, you will normally incur a tax charge called the Lifetime Allowance Charge (LTA charge).

DB scheme

- An LTA charge is triggered when the first year's level of income goes over £50,000.

DC pension

- An LTA charge is normally payable once £1 million has been withdrawn or allocated to fund a pension in some way. Any benefits not withdrawn or allocated to provide a pension income are measured against the LTA limit at age 75.
- If you plan to take a one off lump sum from your DC pot, the first 25% will be tax free and then you will be taxed at your highest rate. If you're still a taxpayer at this time, you could move into the 40% or even 45% income tax bracket. This will depend on the amount you take added to any other income you have at this time. You may under pay tax and would have to pay more tax later. It could be that you are taxed at an emergency rate and you would have to claim that back at a later point.

2 Guaranteed income for life

One of the key benefits of a DB scheme is the promise to pay a guaranteed income for life. What alternatives could a DC pension offer?

DB scheme

DB schemes will pay you a guaranteed income for life. After this, many schemes also provide an income for your spouse, civil partner or other dependants. There is also some protection against inflation too (see point 3 below).

Considering giving up this guaranteed income for life, by transferring out of the scheme, is an important decision.

DC pension

You could achieve a guaranteed income for life by buying an annuity after transferring to a DC pension. If you do this, the annuity you buy may be lower than you would have got under the DB scheme.

A DC pension can let you choose your own level of income, with the option of income drawdown.

- You will need to take a balanced approach as to how much you take from your pot. Take too much and you run the risk of running out of money. Take too little and you may not enjoy the standard of living you could afford.

3 Inflation protection

Although inflation rates are low at the moment it wasn't always the case, and it may change in the future.

If we assume a pension of £1,000 per month covers costs now, inflation at 2% will mean that those costs will be £1,485 in 20 years' time.

DB scheme

The level of inflation provided by a DB pension will depend on the scheme rules, but it could prove valuable.

You may still need a good level of income in 20 or 30 years' time. For example, as well as your immediate needs, you may need to pay for care.

DC pension

If you're thinking of transferring out of your DB scheme, the cost of inflation protection will be built into the calculation of the transfer value that is offered to you. But once the transfer value is paid into a DC pension it is up to you how you choose to take the money from 55. If you do want to help protect against the effects of inflation and you purchase an annuity, this will reduce your initial income and you can purchase an annuity that does this, so reducing your initial income.

4 Investment risk?

What is your attitude to risk? Are you willing to accept potential losses in pursuit of higher returns? Could you make ends meet if you suffered an investment loss?

DB scheme

The investment risk sits with the employer. It's likely to be invested in a range of assets, with the aim to provide the promised level of benefits at retirement. Regardless of the performance of the assets, the scheme has to pay the benefits.

If your sole income is your DB pension scheme it is more risky to transfer than if your DB pension is a relatively small proportion of your total income in retirement.

DC pension

Once transferred to a DC scheme investment risk sits with you. Your fund value could go up and down and you could get back less than you transferred.

With any investment there is a risk of potential losses, but you can choose to invest in low risk funds however they're more likely to deliver lower returns.

If you are unsure about investments, you can seek professional advice. The cost of advice and the impact of any additional advice charges on returns is an important consideration.

5 Dependants

If you have a spouse, civil partner, or other dependants it is important to consider how they would fund their lifestyle if you were to die. So it's important that their needs are taken into account when making a transfer decision.

DB scheme

There will be provision for a pension for your spouse, civil partner, or other dependants which will be paid for by the scheme, although the precise rules will vary from scheme to scheme.

DC pension

It's possible to provide benefits for your spouse, civil partner, or dependants, but these would need to be paid from your pension pot, not by the provider of the scheme. This would reduce the level of your initial income.

Considerations – choosing a DC pension

If you decide to transfer there are some important considerations when deciding on the scheme you would like to transfer to:

- The investment range that is available, the level of income you will receive from your transferred benefits will be impacted by investment returns.
- The level of charges in the pension scheme, lower charges mean that you get to keep more of your money.
- The retirement options available to you. If you decide that flexibly accessing your benefits is a reason to transfer you need to be sure that the scheme you plan to take your DC benefits from offers the flexible options you need.

Your adviser should be able to advise you whether a transfer to your workplace pension scheme is appropriate for you.

Transferring – a simple overview

- Generally you have the right to ask about transferring your DB benefits to a DC pension.
- The trustees of the DB scheme will calculate the cash equivalent transfer value of the DB benefits.
- You should seek financial advice to check that the transfer is 100% right for you. This is a legal requirement for sums over £30,000.
- If you go ahead, the cash amount calculated by the trustees will be transferred to your DC pension scheme.
- Once you transfer benefits to a DC pension the risk of investment returns sits with you, not the scheme. The value can go up and down and you can get back less than you transfer.
- You'll lose any guarantees you held under your DB scheme.
- The income you receive in retirement will depend on investment performance, charges taken out and how you decide to take your money from your scheme.
- Depending on how you decide to provide your retirement income, the amount you receive may not be guaranteed to last for the whole of your life.

Next steps

If you're thinking about transferring from a DB scheme to a DC pension, we strongly recommend that you speak to a financial adviser. They will be able to look at your personal circumstances and make recommendations based on your situation. If you haven't got an adviser you can find one at **unbiased.co.uk.**

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