MANNING & COMPANY
Independent Financial Advisers

FIVE GOOD REASONS TO TRANSFER OUT OF YOUR COMPANY PENSION.. AND FIVE NOT TO.

Here we highlight the pros and cons of making a transfer of this sort, prior to you contacting us for advice about your individual circumstances.

Because of the attractive features of DB pensions, as IFAs we are advised by the Financial Conduct Authority (FCA) to start from the assumption that it is not in people's interests to exchange their DB pension rights for a cash alternative.

Growing numbers of people are being offered very large cash sums in exchange for giving up all of their rights in their DB pension scheme. These cash sums can be used in two main ways:

• transferred into a personal pension where it will be invested for those who are still saving for their retirement
OR
• for those who want to start living off the proceeds of their pension, it can be transferred into a drawdown account, where some of the money is invested and some is taken out either in lump sums or as a regular income.

In both cases, there is no guarantee as to the future level of income, and the only thing that is defined is the contribution going in to the scheme. For this reason, such arrangements are known as defined contribution or DC schemes.

Two particular factors have led to a growing interest in converting DB pension rights into cash lump sums which can be invested in DC pension arrangements.

First, in 2015 new pension freedoms were introduced which give you more choice over what you can do with your DC pension pots. Instead of having to buy an annuity which would provide you with an income for life, you can now choose to access your pension pot and draw an income from it when you need it. As part of these reforms, the inheritance tax treatment of money held in DC pension pots was made much more attractive.

Second, the low interest rate environment of recent years has meant that the transfer values being offered in exchange for DB pension rights have soared to record levels. This mainly reflects the fact that it is now costing DB schemes a lot more to meet the pension promises that they have made.

For all of these reasons, interest in DB to DC transfers is increasing, with advisers and schemes reporting growing numbers of scheme members asking for valuations and seeking advice.

There are a few things to be aware of at the outset.

• DB to DC transfers are irrevocable – you cannot change your mind a few months or years later even if you wish you hadn't made the transfer.

• In general, once you have started receiving benefits from your DB pension scheme you cannot then give them all up in return for cash. However, occasionally a scheme will offer you a deal where some of your pension benefit can be given up in return for a lump sum.

• There are some types of DB pension schemes where cash transfers are not possible. These are mainly public sector schemes such as those for nurses, teachers and civil servants. The reason for this is that there is no pension 'fund' – the pensions of today's retired workers are paid for out of the contributions by today's workers and their employers.

The law requires that if you wish to transfer a DB pension pot valued at £30,000 or more you must seek financial advice before doing so. These are valuable pension rights and they should not be given up lightly. Any decision about what to do with them should be made on an informed basis and few individual savers would have the necessary expertise to make that judgment. So we strongly advise that you take advice before giving up significant DB pension rights.

The aim of this document is to help you in the early stages of considering a DB to DC transfer by familiarising you with some of the key issues that you will need to take into consideration.
This will hopefully lead to a more informed conversation with your adviser if you decide to proceed to the next stage. The aim is neither to encourage nor to discourage such transfers, but rather to set out in a balanced way the pros and cons of retaining your DB pension rights as compared with taking a transfer.

HERE ARE FIVE REASONS WHY YOU MAY WISH TO TRANSFER

FLEXIBILITY - instead of taking a set pension on a set date, you have much more choice how and when you take your pension; many people are choosing to 'front load' their pensions, so that they have more money when they are more fit and able to travel, or to act as a bridge until their state pension or other pension becomes payable;

TAX-FREE CASH - many DB pension schemes offer a pretty poor deal if you want to convert part of your DB pension into a tax free lump sum; although the tax-free cash is in theory 25% of the value of the pension, you often lose more than 25% of your annual pension if you go for tax-free cash; in DC, you get exactly 25% of the pot as tax-free cash;

INHERITANCE - generous tax rules mean that if you leave behind money in a DC pension pot it can be passed on with a favourable tax treatment, especially if you die before the age of 75; in a DB pension, whilst there may be a regular pension for a widow or widower, there is unlikely to be a lump sum inheritance to children etc.

HEALTH - those who live the longest get the most out of a DB pension, but those who expect to have a shorter life expectancy might do better to transfer if this means there is a balance left in their pension fund when they die which can be passed on; note that HMRC may challenge this for those who die within two years of a transfer

EMPLOYER SOLVENCY - whilst most pensions will be paid in full, every year some sponsoring employers go bankrupt; if the DB pension scheme goes into the PPF, you could lose 10% if you are under pension age, and may get lower annual increases; if you have transferred out, you are not affected.

However you will need to weigh up what works for you and the points above need to balanced against the following…**FIVE REASONS NOT TO TRANSFER**

CERTAINTY - with a DB pension, you get a regular payment that lasts as long as you do; with a DC pot you have to face 'longevity risk' - not knowing how long you will live.

INFLATION - a DB pension has a measure of built-in protection against inflation, but with a DC pot you have to manage this risk yourself, which can be expensive.

INVESTMENT RISK - with a DC pension you have to handle the ups and downs of the stock market and other investments; with a DB scheme you don't need to worry - it's the scheme's problem.

PROVISION FOR SURVIVORS - by law, DB pensions have to offer minimum level of pensions for widows/widowers etc., whereas if you use a DC pension pot to buy an annuity, it dies with you unless you pay extra for a 'joint life' policy.

TAX - DB pensions are treated relatively favourably from the point of view of pension tax relief; those with larger pensions could be under the Lifetime limit (currently £1.03m) inside a DB scheme but the same benefit could be above the limit if transferred into a DC arrangement.

To clarify, we are neither promoting DB to DC transfers nor seeking to discourage them.
The FCA is clear that a sensible starting point is the assumption you are likely to be worse off if you transfer

out of a defined benefit scheme. This presumption should help to ensure that you appreciate the value of what you already have by way of guaranteed pension rights in a DB arrangement.

For some people, the arguments in favour of transferring may be particularly compelling. Those who want to maximise their tax-free cash, do not expect to live long in retirement, are thinking about how best to pass on unspent pension to their heirs, are willing and able to take on the investment risk associated with their pension and/or are worried that the ex-employer standing behind their pension might not be there in years to come, could all find the current terms on offer to be attractive.

On the other hand, those who value the certainty which a DB pension provides may well wish to stay put. If they do so, they will know that their pension will last as long as they do, that they have a measure of insulation against inflation, that they are less likely to breach tax relief limits, that they do not need to worry about the ups and downs of the financial markets and that there will be a pension there for a widow or widower when they are gone.

Ultimately, the decision about whether to transfer should be made after a conversation with a regulated adviser. The adviser can take account of your personal circumstances and preferences. Whilst such advice is not binding on the individual, we hope that you are aware of complexity of the choice involved.
We also believe that ongoing advice through retirement is of value, particularly if a transfer is made. With the large sums that are now being offered to many people to transfer out of DB pension rights, skilled management of the resultant investment pot is of the utmost importance. This will help to mitigate against some of the risks identified in this document.

Notes

THE CURRENT SYSTEM

At present, if you are a member of a DB pension scheme you have the right to ask the scheme to offer you a cash lump sum in exchange for your entire DB rights. This lump sum is known as a cash equivalent transfer value (CETV).
If the transfer value is more than £30,000 you are required to seek independent financial advice before deciding whether or not to proceed with the transfer. This advice must be provided by, or at least checked by, a specially-qualified pensions transfer specialist.

The Financial Conduct Authority has recently updated its rules about how advisers are to assess whether a transfer is a good idea
As part of this process, from Autumn 2018, advisers will be required to present you with a 'Transfer Value Comparator' (TVC). In simple terms this is a measure of how the money you have been offered by your pension scheme compares with the value of the pension you are giving up.
In brief, the adviser has to work out the sum of money that would be needed today, if it were to be invested up to your retirement on a 'risk-free' basis, that could buy you a pension (through purchase of an annuity) that matches the pension you are giving up.

So, for example, you may be offered a transfer value of £400,000 to give up your pension, but the TVC calculation may say that you would need £500,000 invested in the way described to be able to replicate the pension you are giving up. The closer the amount you are being offered is to the capital sum that emerges from this calculation, the better value you are being offered. But this calculation on its own will rarely lead to a definite 'yes' or 'no' as to whether you should transfer.

Advisers will often talk about assessing a potential transfer with reference to a critical yield. The critical yield is the investment return that would be needed on the transferred sum to build up a large enough pot at retirement to buy retirement benefits at least as good as the DB pension given up. In many cases, to achieve a pension pot large enough to buy an income for life of equal value to the DB pension foregone will require a relatively high rate of return which in turn would imply taking a high degree of investment risk.
Whilst this is not an absolute bar to an adviser recommending a transfer, many advisers would be nervous about recommending a transfer in such a situation.
However, this is not the only consideration – or even necessarily the most appropriate one – when deciding whether or not a transfer would be in your interests.
If an adviser concludes that a transfer is not in your interests, this is not necessarily a barrier to the transfer taking place.
If you are insistent that you wish the transfer to go ahead, some advisers will implement the transfer in any case, stressing that this is not in line with their advice and that you need to accept responsibility for this decision.
Others will simply decline to facilitate the transfer and you will need to go elsewhere. This is something worth exploring with your adviser before starting the process. Of course, there is still likely to be a cost for the work that has been done even if the recommendation is not to transfer.
In this case, if the consumer proceeds on an 'insistent' basis, the adviser fee can be deducted from the value of the transfer or the consumer can pay a fee directly to the adviser.
If the consumer accepts the recommendation they will have to meet the cost of the advice from their own resources. The prospect of paying from one's own pocket may act as a further incentive towards going ahead with the transfer. In the next two sections we consider some of the reasons why turning DB pension rights into cash might be a good idea for some, and then some of the reasons why others might be better advised to keep their pension rights where they are.