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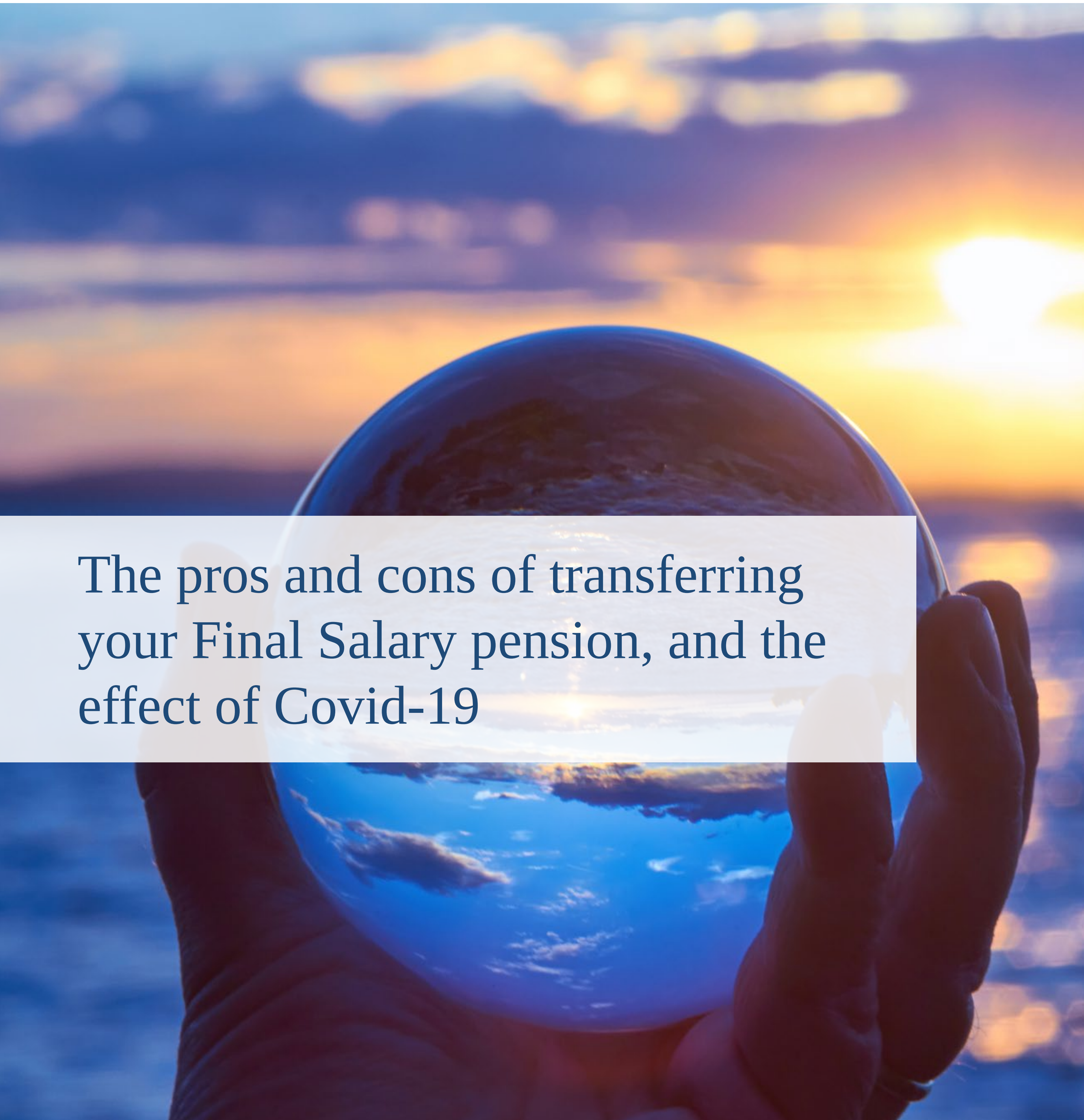

The pros and cons of transferring your Final Salary pension, and the effect of Covid-19

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In years gone by, Final Salary pensions were the norm for many employees. At the end of your working life, you would receive a guaranteed, often index-linked, pension until you died. Furthermore, if your spouse outlived you, 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, especially in the light of the Covid-19 pandemic.

In this guide you'll find useful information about:

- The effect of coronavirus on your Final Salary pension
- Why you might consider transferring your Final Salary pension
- The pros and cons of a Final Salary pension transfer
- Some important information regarding pension allowances and tax
- Why it's so important to take professional advice

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.

Note: Transferring out of a Final Salary scheme is unlikely to be in the best interests of most people.

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 your salary. It is guaranteed to be paid for the rest of your 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.

The effect of Covid-19 on your Final Salary pension

In recent months, global stock markets have experienced significant volatility. In mid-March, both the FTSE 100 and Dow Jones suffered their biggest one-day fall since 1987 as the world economy struggled to come to terms with the impact of the coronavirus pandemic.

One of the main benefits of a Final Salary pension is that any investment risk is borne by the sponsoring employer. Unlike a Defined Contribution pension, where the performance of your investment is determined by the fund you are invested in, there is no such risk with a Final Salary scheme.

Your pension is based on a percentage of your final salary multiplied by the number of years you have been in the scheme (this 'accrual rate' is usually 1/60th, 1/80th or 1/100th of your final/average salary). This should not change even in light of recent events.

However, one consequence of the pandemic has been that the pensions watchdog recently allowed pension schemes to suspend transfers out of a Final Salary scheme for up to three months (until the end of June 2020). This date may be reviewed as matters progress.

This is to give trustees more time to calculate the cash value of a pension (called 'cash equivalent transfer value' or CETV).

It's important to note that, by mid-May 2020, a survey found that only around a quarter of pension schemes had suspended providing CETV quotations. The schemes that had suspended transfers did so as a result of falling markets caused by the coronavirus pandemic, as it was now more difficult for them to be sure of the underlying value of pension funds.

Without a CETV, it's not possible to consider a transfer. However, most schemes are still supplying the information needed for an individual to consider a Final Salary pension transfer.

Another factor to consider now is the ongoing viability of your employer. With a global recession all but inevitable, there are likely to be some high-profile business casualties. Countless small and medium-sized businesses are also likely to fold, despite government intervention through the 'furlough' scheme.

If your employer experiences financial trouble, your money will usually remain untouched, as a company's workplace pension scheme is usually kept separate to the rest of its assets. If your employer doesn't have the funds to pay your pension, you should have protection from the Pension Protection Fund (PPF), which was set up by the government for exactly this reason.

The PPF will compensate you for 100% of your pension if you've already reached the scheme's retirement age at the time your employer goes into liquidation.

Firms who suspended pension transfers in 2020 include:

- British Airways
- Jaguar Land Rover
- Tesco
- Stanley Black & Decker
- Wincanton

However, if you haven't yet reached the scheme's retirement age, you'll only be entitled to 90% compensation, to a set limit. So, if your employer fails because of Covid-19, it could result in a much lower pension than you expected (more on this later).

5 reasons you might want to transfer your Final Salary pension

Final Salary pensions are a hot topic and you may even have discussed the idea with colleagues. Some people may have even transferred their pensions already and be enthusiastically discussing the benefits of doing so.

In our experience, there are five main reasons why you might consider transferring your Final Salary pension.

1. You are interested in the ability to draw funds flexibly, as lump sums or income

Since Pension Freedoms were introduced in 2015, retirees have been able to manage their savings more flexibly.

Whilst a Final Salary pension will pay a set amount based on a calculation at the end of your working life, transferring your fund may allow you to access your savings as lump sums, income, or a combination of both.

2. You want to improve the size of the legacy you leave to your family

Under a Final Salary pension scheme, your pension will be paid until you die. Many schemes will then pay 50% of the value of your pension to your surviving spouse until they pass away. After this, payments typically end.

If you want to pass on a legacy to your children or grandchildren, your pension pot can be a tax-efficient way of doing so. Under the current rules, if you die before the age of 75, your funds can be inherited tax-free. If you die aged over 75, it can be passed on as a lump sum subject to income tax at your heirs' personal rate.

3. You want to take advantage of a high transfer value

As a member of a Final Salary pension scheme, you can ask the trustees to provide you 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.

CETVs are currently very generous. Indeed, the Financial Times reported in August 2019 that cash lump sums offered to individuals looking to give up Final Salary pensions had reached record highs. In addition, recent decreases in yields from gilts as a result of the Covid-19 pandemic have resulted in further increases to pension transfer values.

When you see the CETV offered by the trustees of your Final Salary pension, you may be surprised at the amount. The FCA reported in 2019 that the average pension transfer figure stood at £352,303.

4. You want to access your pension sooner – perhaps from age 55

Your Final Salary pension scheme will typically have a fixed retirement age. Often this is 65 or even later.

If you want to take early retirement and draw your pension early, you will often find that you receive a significantly lower monthly income even if a lump sum is available.

Transferring your pension gives you more flexibility as to when you can access your pension savings.

5. You are concerned about the viability of your employer and/or pension scheme

The coronavirus pandemic has left many businesses on the brink. Any extended lockdown or second wave of the virus could see thousands of businesses fail.

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 the worst-case scenario, when the sponsoring employer goes bust, the Pension Protection Fund (PPF) steps in.

While the PPF is designed as a safety net for employees, if you haven't yet reached your pension scheme's retirement age, you'll only be entitled to 90% compensation, to a set limit. For 2020/21 the limit is £41,461 for a 65-year-old.

If you were expecting to receive significantly more than this from your Final Salary scheme, the failure of your business could result in a significant reduction in your pension if it were to be paid through the PPF.

Note: Transferring out of a Final Salary scheme is unlikely to be in the best interests of most people.

Factors to bear in mind if you're considering a Final Salary pension transfer

While there are plenty of reasons to consider a Final Salary pension transfer, there are also many risk factors. Indeed, the law stipulates that you cannot transfer a Final Salary pension with a value of more than £30,000 without taking advice from a qualified financial adviser.

Transferring out of a Final Salary scheme is unlikely to be in the best interests of most people.

So, before you act based on the word of a colleague, or an article you read in the press, here are some things to bear in mind.

1. 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.

Even though the capital value of your money in a savings account can never fall, there is still a risk of you losing out in real terms if your returns are lower than the rate of inflation. You also only benefit from limited protection against your savings provider failing.

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

2. Uncertainty

A Final Salary pension will provide you with a guaranteed, fixed income for life. You'll know exactly what you will receive, and you don't need to worry about the amount reducing or running out of money before the end of your retirement.

If you transfer your pension, you'll benefit from greater flexibility but reduced certainty. Your income may fluctuate depending on investment performance. There is also a possibility that you will run out of money before the end of your retirement if you don't manage withdrawals carefully.

3. Management

With a Final Salary pension, you can relax knowing your payment is coming at the same time every month.

When you transfer your pension, you will need to be more involved with your finances. Taking advantage of the flexibility on offer means becoming more comfortable with your pension pot and what you can do with it. Even if you work closely with a financial adviser, they will need input from you.

4. Need

Quite simply, there may be no need for you to transfer your Final Salary scheme. If you do transfer your Final Salary pension, you will give up a guaranteed and often inflation-proofed annual income and you may well be worse off by doing so.

Remember also that transferring a Final Salary pension is not a decision which can be reversed. Once the transfer has been completed you cannot change your mind. For these reasons, careful consideration must be given to all options before you make a final decision.

The right course of action will be different for everyone, which is why taking independent financial advice is so important. We strongly recommend that no one transfers out of their Final Salary scheme without first taking advice, and later we'll consider what 'good advice' looks like.

A quick note about allowances

Pension legislation in the UK is complicated, and pensions are subject to a range of allowances, many of which have tax implications.

If you've built up a sizeable pension fund over the years, the Lifetime Allowance could well come into play. 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 in the 2020/21 tax year, it covers all pensions, including Money Purchase Schemes (Personal Pensions, Stakeholder Pensions, Self-Invested Personal Pensions etc.) as well as Final Salary pensions.

If you have pensions worth more than the Lifetime Allowance you could face tax charges of between 25% and 55%, depending on whether money is withdrawn as an income or lump sum. And, when it comes to Final Salary schemes, calculating the value of the pension is 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.

Other allowances you could be impacted by include:

Annual Allowance (AA)

For the 2020/21 tax year, you can contribute up to £40,000 a year (or 100% of your annual income) into a pension and benefit from tax relief.

This amount is across all schemes you hold and includes contributions made by your employer and any third parties.

Tapered Annual Allowance (TAA)

If you earn over £200,000 you may trigger the TAA.

This reduces the standard Annual Allowance by £1 for every £2 of income you receive if your 'threshold income' is over £200,000 for the 2020/21 tax year.

The reduction is applied to 'adjusted income' over £240,000 and could reduce your Annual Allowance to £4,000.

Money Purchase Annual Allowance (MPAA)

The MPAA is triggered if you 'flexibly' access any taxable pension funds you hold – for example, if you do transfer your Final Salary pension.

Utilising one of the new pension options available from 2015 could trigger the MPAA and reduce your Annual Allowance to £4,000.

How to find the right advice

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

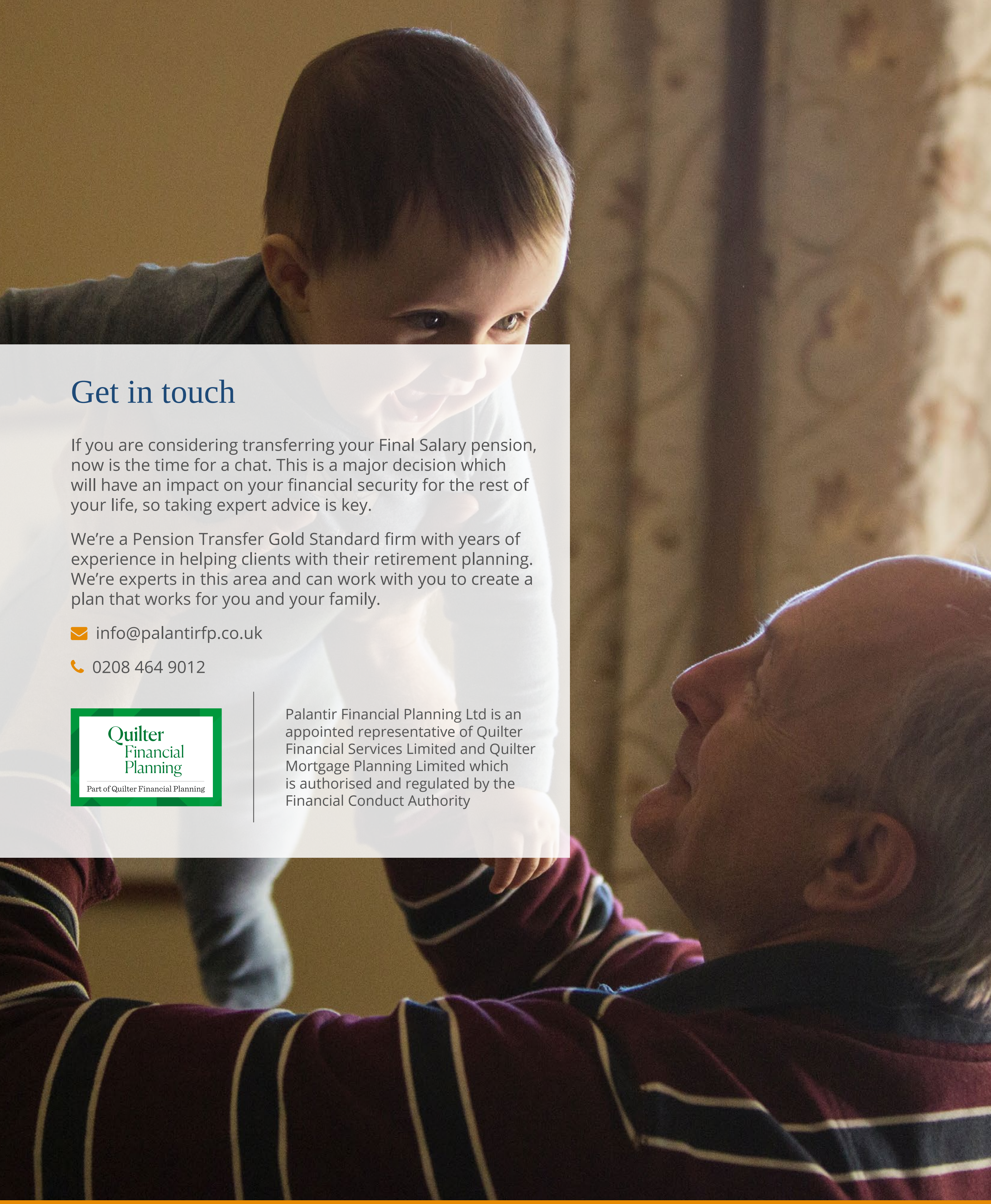
The rule was designed to stop people with valuable Final Salary schemes from making knee-jerk decisions, which they may regret or leave them financially worse off in years to come.

However, not all financial advisers were created equal – and certainly not where Final Salary pensions are concerned. So, what should you look for when seeking advice?

- 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'
- Your financial adviser should commit to a high level of service. Transferring your pension is a big decision, and once the transfer is complete you are likely to have to become more involved (as we saw earlier). So, choose a financial adviser who is committed to regular meetings and reviews.
- Your adviser should charge fair fees. For example, we will only charge you once we have carried out work for you. We don't charge for initial meetings, so you have the peace of mind that you will only pay us when our advice is put into practice.
- Your planner should have the backing of a solid, established business. Palantir are a member of the Quilter Financial Services Network who are part of Quilter PLC, which is listed on the FTSE 250 and oversees £95.3 billion in customer investments (as at 31 March 2020).

Pension
TRANSFER
Gold Standard

In 2019, the Pension Transfer Gold Standard kitemark was introduced. This is a voluntary code of good practice for safeguarded and Final Salary pension transfer advice, based around a set of nine principles. Dealing with a Gold Standard firm gives you the confidence that you are dealing with a firm with a high ethical standard, that is going beyond minimum requirements when giving financial advice.



Get in touch

If you are considering transferring your Final Salary pension, now is the time for a chat. This is a major decision which will have an impact on your financial security for the rest of your life, so taking expert advice is key.

We're a Pension Transfer Gold Standard firm with years of experience in helping clients with their retirement planning. We're experts in this area and can work with you to create a plan that works for you and your family.

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