Pensions

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NW BROWN
WEALTH MANAGEMENT

Defined Benefit (Final Salary) Schemes

Defined Benefits, or 'Final Salary' schemes, once a common practice for many companies, are becoming increasingly phased out in favour of Defined Contribution or 'Money Purchase' schemes.

The former offers a portion of one's salary upon leaving the company at retirement, accumulated for every year of service, and increasing by a growth rate set by the scheme's rules. The latter is a plan directly invested in the market, which accumulates through contributions from the member or their employer, with the pot being used at retirement to either purchase an annuity, or enter into a 'drawdown' arrangement, where a portion of the income or capital is taken each year to meet your expenditure at retirement.

To give members the opportunity to transfer their Defined Benefits scheme into a Defined Contribution scheme, the scheme actuaries produce what is known as a 'Cash Equivalent Transfer Value' (CETV), in an attempt to compare the monetary value of the guaranteed income at retirement with a lump sum investment able to achieve a similar income. The actuary calculation is based upon a range of factors, including the accrued rights for the member, the demographics of the scheme's membership, its funding, guarantees under scheme rules, and gilt yields.

Gilt yields particularly affect the funding position of a Defined Benefit scheme, whereby the lower the expected return on gilts increases the funding required for a scheme to meet its income obligations, which in turn increases the CETV of a member's pension. Due in part to the recent historic low position of interest rates, Defined Benefit schemes have attracted a lot of media attention recently for the high CETVs quoted for members, sometimes being 50 or 60 times a member's annual income under the scheme.

These high CETVs have caused an influx of people seeking to 'cash in' their benefits, and take a large lump sum for a Defined Contribution scheme in favour of a steady income stream. However, due to the integral nature of pensions in retirement planning, it is mandatory for those seeking to transfer their Defined Benefits schemes into a Defined Contribution scheme to obtain financial advice. This advice is crucial to determine that the member is aware of the benefits they are giving up, and the risks and limitations of a lump sum investment.

When considering transferring a Defined Benefit scheme, the following are some of the factors that will prove useful in determining the suitability of this transaction:

- When are you likely to retire, and when would you need to take income from your pension?
- What are your, and any dependants', needs and expenditure requirements at retirement?
- What other assets are available to you, and what income are they able to provide?
- Similarly what liabilities or debts do you have, and how long are you likely to have these obligations?
- What are your prior experiences of investments, and market movements?

These factors will assist an adviser in ascertaining the role which your scheme plays in your retirement plans, and the effect which switching from a regular, guaranteed income to a lump sum which is more liable to investment risk will have on your financial position.

In fulfilling our responsibilities as planners, we will consider a broad range of factors, including, but not limited to:

- Is the current scheme able to meet your expenditure requirements?
- Are your requirements at retirement realistic given your situation?
- Would increased flexibility over when and how you take pension benefits be likely to place you in a better position?
- What is the current funding of the scheme, and are they likely to meet their obligations to you?
- What percentage of your overall wealth does this scheme represent?
- What is your understanding and appreciation of investment risk?
- What will be the likely effect of taxes and other costs if you were to transfer?
- What are the realistic expectations for investment returns over the longer term, and how would a period of volatility affect the likelihood of meeting your needs?

When planning your retirement arrangements, and determining whether you would be better off in your Defined Benefit scheme or transferring away, there is no crystal ball to determine the right decision. The key is to make the decision with your eyes open, and with as much information as available, rather than making a decision solely on a temptingly large lump sum.

With a careful assessment of your individual situation, we can help you understand the risks, weigh up both the known and potential consequences, and provide an informed recommendation which is most suited to your circumstances.

For more information please contact your financial planner or investment manager, or alternatively call us on 01223 720 208.