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Final salary pension
transfer guide

Final salary pension transfers

Recent years have seen a large increase in the number of transfers out of final salary pension schemes.

New Pension Freedoms introduced in 2015, combined with significantly higher transfer values as a result of falling gilt yields, have led to many more people coming to the conclusion that it is in their best interests to transfer away from their final salary schemes.

Indeed, the FCA have recently changed their default position from that of it not being in a person's interests to transfer away from a final salary pension, to that of a neutral stance, and they have suggested that any individual should carefully consider their options before making the decision to transfer their final salary pension or not.

Whilst there are several reasons why a transfer from a final salary pension may now be considerably more attractive than was previously the case, the fact remains that a final salary pension offers very valuable guaranteed benefits, and therefore any decision to transfer away from a final salary pension should be taken very carefully.

And it is imperative to seek advice on your final salary pension from a professionally qualified financial adviser.

Kingsley Financial Consulting is a specialist pension consultancy firm who can guarantee that you will only ever receive advice from a Chartered Financial Planner who possesses the specialist qualifications required to advise on final salary pensions.

What is a final salary pension

A final salary pension is a pension scheme which typically offers a guaranteed level of pension for every year of service. This is also known as an accrual rate.

For example, if a final salary scheme had an accrual rate of 1/60th, then a member will receive 1/60th of their final salary for every year of service. So, if a person has 30 years' service, they will receive a pension of 30/60th (i.e. one half) of their salary at their date of leaving employment.

This pension is guaranteed for life, and is also usually guaranteed to increase in line with inflation, either RPI or CPI.

If a member dies in a final salary pension scheme, then a spouse's pension is payable, typically 50% or 2/3rds of the members pension.

A dependant's pension can also be payable, although for the purposes of a final salary pension, children are classed as dependants only until the age of 23, if they are still in full time education.

A tax free lump sum can also be paid from a final salary pension, and this will reduce the amount of pension payable.

As with all other UK pension schemes, benefits can be taken from a final salary pension from age 55 onwards. However, if benefits are taken before Normal Retirement Age (NRA), an early retirement factor (i.e. penalty) will be applied, which will typically reduce the pension payable by between 4 and 5% for every year short of NRA

How is a transfer value calculated?

There are 4 steps in calculating a Cash Equivalent Transfer Value (CETV) from a final salary pension. Typically a final salary pension scheme will offer its members the opportunity to receive one free CETV every 12 months. Once a CETV has been provided, it is usually guaranteed for 3 months.

The four steps are as follows:

1. Establish a members' pension entitlement at Date of Leaving (DOL)

2. Increase the pension to Normal Retirement Age in line with inflation (for future years the rate of inflation is usually assumed to be 2.5%)

3. Calculate the lump sum required to purchase the pension by using annuity rated (for example if the pension at NRA is £6,000 and annuity rates are 3% then a fund of £200,000 will be required to purchase the pension)

4. Discount the fund back to present day by using 15 year government gilt yields. For example, if the fund required is £400,00 and gilt yields are 3%, and the member is 5 years off NRA, then the £400,000 would be reduced by 3% 5 times over to arrive at the CETV.

Consequently, the lower gilt yields are, the higher transfer values will be, firstly because the amount of fund needed to buy the pension will be higher, as annuity rates will be lower, and secondly because the rate at which the fund is discounted will be lower, leading to a higher final value.

15-year gilt yields - last 10 years

Based on figures for December 2017

The table below shows why transfer values are currently so high, as gilt yields are at historically low levels.

Advantages of a transfer

1. Greater flexibility: unlike with a final salary pension, you can choose how much pension and/or tax free lump sum you wish to take, and the level of pension can be changed at any time.

2. Higher tax free lump sum: with CETVs as high as they are currently, it is possible upon transfer to take 25% of the fund as a tax free lump sum. This is typically far higher than the lump sum available from a final salary pension, which is calculated in a different way.

3. No early retirement penalty: unlike with a final salary pension, there is no penalty applied if benefits are taken before Normal Retirement Age.

4. Superior death benefits: the entire fund can be passed on free of tax to your family upon death before age 75. It is also possible for an income to be taken by members of your family, which is not subject to income tax. On death after age 75, there is a 45% tax charge on the lump sum, or family members can take an income from the fund, which is taxable at their normal rate of income tax.

5. Tax efficient income: income levels, and also tax free cash payments, can be tailored so as to make them as tax efficient as possible. This is not possible under a final salary pension.

6. Transfer values are currently very high. Historically a 'fair value' CETV has been 20 x the level of pension. Currently it is not uncommon to see CETVs at 30-35 x the level of pension.

7. Upon transfer it is possible to benefit from future years of investment growth, which can be higher than the inflationary increases offered under a final salary pension.

8. Control: for those worried about the financial stability of their employer, and therefore whether the final salary scheme will remain solvent, transferring away can offer peace of mind. The British Steel pension scheme is a good example of a final salary pension scheme that has recently run into extreme difficulty.

Disadvantages of a transfer

Whilst some of the reasons for transferring from a final salary pension scheme can often seem compelling, it must always be borne in mind that a final salary pension has several attractive features. Not for nothing are they described as ‘gold plated’ pensions!

Potential disadvantages of transferring from a final salary pension scheme are as follows:

1. A final salary pension is guaranteed for the rest of your life.

2. A final salary pension will typically include escalation, meaning that your pension will increase in line with inflation, and therefore retain its’ real value.

3. A final salary pension will offer guaranteed spouse’s benefits upon the death of the member

4. By electing to take a final salary pension, rather than to transfer, you are removing any element of investment risk, which would always be present subsequent to a transfer.

5. Any requirement for future decision making is removed once you have taken a final salary pension, as there is no possibility to change the level of income once it has been taken

The importance of low charges

If you do take the decision to transfer, then it is imperative that your pension fund is professionally invested. It is your life savings after all!

Quite simply, there are only ever two things that will affect the value of your pension fund: investment performance and charges. And so you should always look for good investment performance that comes with a reasonable charge.

Recently, the FCA, in the Asset Management Consultation Paper, made the point that over the years the vast majority of investment management firms that have charged excessively for access to their funds have not produced investment returns that have justified their high charges. If you paid £10,000 more for a car, you would expect to get a better car. Unfortunately the opposite is often the case with fund managers: the more charges you pay, the worse the product you get, simply because the higher charges make your returns worse.

Therefore at Kingsley Financial Consulting our approach is quite simple: we look for long standing companies who have produced consistently strong long term performance, and who have made the decision to significantly reduce their charges over recent years. Some companies have reduced their charges, some haven't. Quite simply, we don't recommend the companies that haven't, because there is no research which suggests that this would be in our clients' best interests.

Our guarantee to our clients is that the total charge of any pension portfolio, to include pension company charge and adviser charge, **will never exceed 1% per annum**. The industry average is 1.7%. It is your life savings, and it is better that as much as possible of it remains in your fund!

Cash flow modeling

The major requirement of a pension fund is that it provides you with sufficient income for the lifestyle you require for the rest of your life.

Therefore an important part of considering any transfer from a final salary pension is to consider whether the transfer value provided will be sufficient for this purpose.

At Kingsley Financial Consulting we take a more scientific approach to this, rather than leave it to guesswork.

We do this via cash flow modelling, whereby we input all your financial circumstances, and model this to ascertain whether your final salary pension transfer value will be sufficient to provide you with the income you require, for the remainder of your life.

As a final salary pension transfer will also involve an element of investment risk, and nobody can ever guarantee that your fund will not fall in value, we also provide modelling based upon a worst case scenario, which in our opinion is a 20% fall in the value of your pension, so as to establish how things would look if the worst were to happen.

This way, you can be confident that if the advice is to transfer your final salary pension, then it is based upon a robust process, rather than just on guesswork.

Is a transfer right for you?

The simple answer to this is that there is no right or wrong answer.

The right decision for any person when considering whether they should transfer their final salary pension is to consider all their options carefully, and after having taken professional advice, and then to make the decision that is right for them.

These days, there is a lot of rhetoric and speculation in the press, a lot of which is badly misguided and sensationalised. Therefore, it can often be misleading to base opinions on things that have been read in the press (which are typically written by people who are not professionally qualified to give pension advice)

Also it can be misleading to rely on advice from friends, as their opinions may sometimes be based upon information which is not factually correct, and also because they may well have financial and familial circumstances which are entirely different to your own.

So the correct approach to making a decision with regard to transferring your final salary pension should be to have your options fully explained, without influence, by a professionally qualified adviser, and to then take your time and give some very careful consideration to your decision. And ultimately to make a choice which you feel is the best one for you and your circumstances.

Don’t get scammed!

Unfortunately, the advent of pension freedoms in 2015 has attracted scammers to pension n funds, as it is now possible to withdraw the whole of your pension fund at once (although this is very rarely, if ever, advisable!)

It is important to be aware of the following points, to ensure that you don’t fall victim to a pension scam:

1. Only ever take advice from an adviser who is authorised by the FCA, and who appears on the FCA register

2. Don’t accept any cold calls offering pension advice

3. Don’t believe anything offering unrealistically high returns e.g. guaranteed 10% per annum. There is no such thing! If something appears too good to be true, it will be!

4. Don’t ever invest your pension fund offshore. There is no need to do this, as UK pension funds are tax exempt. If somebody is recommending you invest offshore, they are likely to be a scammer!

5. Ask to see an adviser’s qualifications: if they are professionally qualified, they will be happy to provide you with evidence of this

6. Don’t invest your pension fund with a company you have never heard of