WEALTH MANAGEMENT ALERT

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Could clients cash in on transfer window opportunities?

With the amount of cash people are being offered to transfer out of defined benefit pensions at all time highs, many are taking the cash now rather than waiting for a guaranteed income for life when they retire. Could any of your clients benefit?

Are any of your clients members of pension schemes provided by previous employers? Many of them probably are, including schemes commonly known as final salary or career average but more accurately called defined benefit schemes. Many such schemes are actively offering transfer values of up to 20 or even over 30 times the expected annual pension, tempting many people to transfer the cash into a defined contribution pension scheme.

While this gives them control over how their money is invested and, once they reach the age of 55, how they access their money, it means that they have given up the guaranteed (usually index-linked) income for life their defined benefits pension would give them. While transferring out could appeal to people who have built up substantial pension savings outside their defined benefit pension, it is not something to do without serious thought and independent financial advice.

Taking advantage of flexible access

The introduction of pension freedoms in 2015 has certainly given plenty of food for thought for people over the age of 55, with flexible access to pension funds allowing them to consider things that simply weren't available to them before.

For example, helping children or grandchildren onto the property ladder, paying down household debts, or funding a new business venture.

Although this new flexibility has been generally welcomed, it's only available to those who have a defined contribution pension fund. Those with defined benefit pension schemes cannot access these freedoms unless they take a transfer value and put the proceeds into a defined contribution scheme before retirement.

However, despite the pension freedoms, and despite many defined benefit schemes being in deficit, with a possible question mark over their long-term viability, the regulator's guidance is that unless it can be clearly shown to be in the client's best interest to switch to a defined contribution scheme, it should be assumed that they should stay in their final salary scheme.

Specialist financial advice mandatory

It's a complex area, and difficult for people to work out what to do. Indeed the regulators are sufficiently concerned about the potential risks involved that anyone who has a transfer value of more than £30,000 must take specialist financial advice (such as that offered by us) before they can activate a transfer.

Why consider transferring out?

It's not just the large transfer values on offer that make it tempting to switch to a defined contribution scheme. There are a number of other reasons:

- the ability to repeatedly take lump sums from the pension pot
- the ability for beneficiaries to inherit any unused funds, particularly important if the individual is in poor health and has a relatively low life expectancy and therefore is unlikely to really "get their money's worth" from a defined benefit scheme
- the income and other tax planning opportunities it affords, including, subject to certain conditions, inheritance tax.
- access to a greater amount of tax-free cash than would be available under the defined benefit scheme
- no need to worry about the ability of the company to continue to meet its liabilities in terms of pension pay-outs (the recent demise of BHS, with its huge pension deficit, being a high-profile example)
- flexibility and control.

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What about the reasons to stay in a defined benefit scheme?

The most obvious reason to stay, is the security of a guaranteed, index-linked income for life – however long that life might be. There may also be a variety of benefits, including substantial death benefits, in a good defined benefit scheme. Linked to this is the major concern that the individual may run out of money in old age, because they have walked away from that guaranteed income for life, and did not have sufficient other retirement income in place to meet their long-term needs.

Why are transfer values so high?

When defined benefit pension schemes calculate a transfer value, it's based on how much would have to be invested in order to yield returns to match the income guaranteed by the existing pension scheme. The yield is based on that offered by government bonds or gilts. Yields have fallen for some time now, making the guaranteed incomes of defined benefit pay-outs a heavy liability on the schemes. Many schemes are in deficit, so it is in their interest to cast off their long-term commitments, hence the very high transfer values currently being offered in the hope that many scheme members will transfer out and the liability removed from the scheme's books.

Have transfer values peaked?

However, as gilt yields have recently begun to increase, some analysts are suggesting that transfer values may have peaked in the second half of 2016, and are likely to continue to fall gradually in the foreseeable future. This could lead to some of your clients feeling they should transfer sooner rather than later, to maximise the transfer values they can secure.

Only fools rush in

But this is a complex scenario, and decisions should not be rushed. The regulator's insistence that advice must be sought before transferring out a large amount is intended to ensure that scheme members are not simply seduced by what may look like very large sums of money, without fully understanding what they are giving up, nor properly evaluating what their own future needs are likely to be.

To consider whether transferring is in the individual's best interest or not, it's important to:

- fully understand all the benefits of the defined benefit scheme – some of which the client may not be aware of
- take into account both the hard and the soft facts of the client's whole situation, their financial circumstances (particularly whatever other measures they have in place to provide income in retirement) and their future desires and needs
- consider the wider tax issues and implications
- ensure that any transfer is invested in a way that carefully matches the client's attitude to risk and capacity for loss
- ensure that if a need for capital is a motivation for cashing-in, suitable alternatives have been considered
- fully consider the likely returns on the assets into which the transfer value will be invested, in relation to critical yield, while not basing the decision to switch solely on this measure.

Defined benefit transfers are increasingly on the radar. Although the perceived wisdom is still that in the majority of cases the client should remain in their defined benefit scheme, there are a variety of situations in which a transfer would be the right decision, and indeed there are some situations in which not transferring would have a substantially detrimental impact on the client's finances.

Our independent financial advisers have the knowledge and expertise required to ensure that any such transfers are both suitable and in the client's best interests.

We would be delighted to work with your clients to help them navigate the minefield of the decision to transfer – or not to transfer.

To find out how we could work together with you and your clients email Mark Dallas, Managing Director, Lighthouse Carrwood.
mark.dallas@lighthousegroup.plc.uk

The value of your investments can go down as well as up, so you could get back less than you invested. A pension is a long-term investment. The fund value may fluctuate and can go down. Your eventual income may depend upon the size of the fund at retirement, future interest rates and tax legislation.

Workplace pensions and auto-enrolment: independent advice and set-up service

Many small businesses will have to set up their workplace pension and comply with auto-enrolment in 2017, but some are still unsure about exactly what this entails and how to ensure they meet their responsibilities. We are experienced in helping businesses of all sizes, including SMEs and micro-employers, find and set up suitable workplace pensions and comply with their auto-enrolment duties. We understand the challenges that businesses face and our aim is to ensure that a business adopts a suitable scheme that combines flexibility with value for money. Email Phil Mason, Business Development Director, LighthouseCarrwood Ltd, to discuss how we could work with you or your clients.

phil.mason@lighthousegroup.plc.uk.

Auto-enrolment advice is regulated by The Pensions Regulator, not the Financial Conduct Authority.

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