The PENSIONS Advisory Service

Spotlight

Defined benefit (DB) schemes and pension freedoms

This factsheet outlines how defined benefit (DB) schemes are affected by the pension flexibilities introduced in April 2015.

The Pensions Advisory Service is unable to give individual specific advice and you should seek alternative tax or regulated financial advice.

Have I got a defined benefit pension?

A defined benefit (DB) pension is a type of workplace pension which:

- Gives you an income that is normally based on your salary, length of service with your employer (or service in the scheme) and a calculation based on the rules of the scheme.
- May also be called final salary or career average schemes.
- You should receive statements which set out how much pension per year you are expected to receive when you reach your normal retirement age.

If you work in the public sector or have been a member of a workplace pension scheme for some years, you may have a DB pension entitlement.

Personal and stakeholder pensions are not defined benefit pensions.

What other pension types might I have?

Most pension schemes that people join now are “defined contribution” (DC):

- This is a personal, stakeholder or workplace pension where its value is based on how much money has been paid into your pot.
- When you take money from a DC pension scheme it comes from the money you (and sometimes your employer) saved into it over the years plus any investment returns your money may have earned.
- There is no guaranteed amount of pension. You could get back less than has been paid in.

Why are defined benefit pensions valuable?

With DC pensions, you can decide how you take your money out - with DB pensions, your employer guarantees a certain amount of pension each year when you retire, payable for life.

Because of the guaranteed nature of DB pensions they are often seen as more valuable than DC pensions as the risks (for instance of living longer than expected or of investments underperforming) are underwritten by the employer rather than the individual themselves. The Pensions Regulator (TPR) also believes that is likely to be in the best financial interests of the majority of members to remain in their DB scheme.

Can I take any cash from my defined benefit pension?

- You can normally take tax-free cash when you retire from a DB Pension (typically up to 25% of the value of your pension) but you will generally have to give up a part of your pension in exchange for the tax-free cash.
- The rate for giving up pension for cash will be set by the scheme trustees. This is not guaranteed and may change from time to time in line with changing financial conditions.
- The amount of tax-free cash you wish to take will depend on your preference for an initial tax-free lump sum cash payment or a higher taxable income for the rest of your life.

How do the 2015 pension flexibilities affect me?

The changes outlined by the Chancellor of the Exchequer in the March 2014 Budget brought about some significant changes to the way in which DC pensions can be accessed, with effect from 6 April 2015. The flexibilities ***do not apply to DB pensions.***

The Pension Wise service is available to anyone over the age of 50 who has a DC pension arrangement. Therefore, if you only have a DB pension arrangement you will not be eligible for the service.

Can people with DB pensions access the new flexibilities?

The only way that a person can take advantage of the flexibilities is to transfer out of their DB pension scheme into a new or existing DC arrangement which will offer you flexibility. However, if you are in a public sector scheme you will not be able to transfer your benefits out if the scheme is an unfunded one. If you do transfer, and you are at an age where you can take your benefits, you will be able to access the funds in the way you wish but check that the rules of the receiving arrangement allow you to do this.

In order to transfer out you must have stopped building up pension in the scheme. You should consider carefully as to whether it is in your interests to opt out of membership of the DB scheme as DB schemes have considerable security and you may be losing out on valuable benefits. You will also generally be required to take regulated financial advice before being allowed to transfer. If you are currently in receipt of a DB pension, you will usually be unable to transfer your benefits from that scheme.

Do I have to transfer out all of my benefits in a scheme?

You will generally need to transfer out all of your DB benefits in a scheme. However, some schemes may allow you to transfer only a portion of your DB benefits out of the scheme – you should check with your scheme's administrators what is permissible.

If you also hold DC benefits in the same scheme, you can normally either transfer these along with your DB benefits, or you can leave these benefits in the scheme while transferring out just your DB benefits. Similarly, if you are looking to transfer only your DC benefits from the scheme and you want to leave your DB benefits in the scheme, this is possible where you are no longer paying into the DC pot. If you have already started to draw your benefits, you no longer have the automatic right to transfer them – you should check with your scheme's administrators what is permissible.

A member's transfer right applies to each type of benefit you hold in a scheme (i.e. DB or DC) rather than to all the benefits in a scheme. You will have different options to access pension flexibilities depending on the type of benefits in the scheme, for instance if you have DC benefits such as Additional Voluntary Contributions (AVCs).

How do I transfer out if I wish to?

- Members who are more than one year away from their scheme's normal retirement age have the right to transfer their DB benefits out of the scheme (unless they are in a public sector scheme which does not permit transfers).
- Every 12 months you have a right to request a transfer value quotation from the scheme free of charge. Your scheme may allow you more frequent requests although you may be charged for these.
- When you request a transfer value, the trustees of the scheme need to provide you with a "statement of entitlement". The trustees normally have 3 months from the date of your request to provide you with this statement, although in certain circumstances, this can be extended to 6 months.
- The statement will provide you with a "Cash Equivalent Transfer Value" (CETV); the CETV is the current value of your benefits within the scheme.
- The transfer value is normally guaranteed for 3 months from the calculation date (known as the guarantee date) and the trustees should generally pay the transfer value to the receiving pension arrangement within 6 months of the guarantee date.
- There are requirements on trustees when members request a transfer out of a DB scheme where the transfer value is over £30,000. To protect people from making poor choices, there is a mandatory advice requirement for any member who wants to transfer out to take regulated financial advice from a suitably qualified person. Trustees will need to check that this has been taken before allowing any transfer to go ahead.
- You will be expected to meet the cost of this advice, although trustees will not be responsible for checking what advice was given. If you need help in finding a financial adviser, the Money Advice Service has a directory of authorised advisers on its website: https://directory.moneyadviceservice.org.uk/en.
- Schemes are required to notify members about what they have to do and the information the scheme will need to complete a transfer. If a member doesn't provide what the scheme needs the trustees aren't obliged to complete the transfer.

The Financial Conduct Authority has published some useful information and guidance for those considering a DB pension transfer: https://www.fca.org.uk/consumers/pension-transfer-defined-benefit

How does my scheme calculate the value of my benefits?

- The cash equivalent transfer value of your benefits is calculated by the scheme actuary. It represents what the actuary and the trustees consider a fair value of the benefits you would be giving up in the scheme.
- The calculation will take into account many factors, including how long you might be expected to live, future inflation and investment returns. The trustees will review the assumptions underlying these calculations on a regular basis.
- It is important to note that the transfer value you receive may not enable you to purchase from an insurance company the same level of benefits you have given up. This is because insurers and other providers of retirement products will take a more cautious view of the future, so the cost of buying an income with these companies will tend to be higher.
- You should also be aware that if the scheme is currently underfunded, the trustees may decide to pay transfer values at a reduced level until full funding is restored. The trustees need to tell you if they are applying any reduction to your transfer value because of underfunding.

What is the role of the trustees of a defined benefit pension schemes?

DB pension schemes are looked after by a board of trustees.

- Trustees have a legal duty to act in the interests of all members.
- When approaching requests to transfer out of the scheme, they must balance the interests of both the members wishing to exercise their right to transfer with those that wish to remain in the scheme. Therefore they may, from time to time, reduce the amounts paid out if there are insufficient funds in the scheme at a particular point in time.

- Most importantly, there is a legal requirement on the trustees, set by the Pensions Regulator, to check that a member has obtained appropriate regulated financial advice before a transfer is allowed to proceed. This is because, for many people, transferring out of a DB scheme will not be in their best financial interests.
- You will need to provide the trustees with confirmation that you have obtained such advice, which sets out the relevant details of your adviser, who needs to be authorised by the Financial Conduct Authority (FCA) for this type of advice.
- The trustees do not need to review this advice but they do need to be satisfied that you have been properly advised. If you have a small amount of benefits in a DB pension scheme (valued by the trustees as £30,000 or less) then the trustees do not need to check whether you have received this advice. However, you still need to be sure that giving up this guaranteed level of income is in your best interests.

What will a regulated financial adviser do?

The adviser will consider all your personal and financial circumstances when considering whether a transfer out of a DB scheme is in your best interests. For some individuals there may be advantages of moving out of a DB scheme into one in where you can access the new pension flexibilities. A regulated financial adviser will provide more information on the advantages and disadvantages of such a transfer.

Can the trustees stop me transferring out?

Apart from ensuring that you have received proper advice, the trustees are expected to conduct proper due diligence on the scheme which you intend to transfer your benefits to. In some cases the trustees may have reason to believe that the receiving scheme is not a legitimate one and in these cases they will need to carefully consider whether to allow the transfer to proceed. This may happen if the proposed new scheme presents the warning signs of a pension scam.

If the trustees do this, they may be stopping you transferring to a plan where you might lose a significant proportion, or possibly all, of your pension savings and be faced with a large tax bill. If the trustees are conducting further investigations they should contact you to explain why there is a delay and why, in some cases, they are not permitting the transfer to proceed. Where a request is made to transfer benefits overseas, the trustees will also need to check whether the receiving scheme is one qualified to receive UK pension benefits.

What if I am offered an “enhanced” transfer value?

In some cases, those running DB pension schemes may wish to reduce their exposure to DB pensions, by offering members beneficial terms to transfer out from the scheme. They will calculate the transfer value on the usual basis but will then apply an enhancement to this. Typically, they will write to members explaining their options and advising them how long this offer lasts for. You will still need to take regulated financial advice if you wish to take advantage of this offer and transfer out, but in many cases the employer will offer to pay for this financial advice.

Additional Voluntary Contributions (AVCs)

As a member of a DB scheme you may have decided to make contributions in excess of those required by the scheme in order to enhance your pension income. These are known as Additional Voluntary Contributions (AVCs) and are often DC in nature. If you have made DC AVCs to a DB scheme then you may be able to take advantage of the new flexibilities with respect to these benefits.

You should check if your scheme allows you to take advantage of these flexibilities. If not, they may allow you to transfer some or all of your AVCs out to another arrangement which does allow the flexibilities.

About Us

The Pensions Advisory Service (TPAS) works to make pensions accessible and understandable for everyone. We provide independent and impartial information and guidance about pensions, free of charge, to members of the public.

We help with all pension matters covering workplace, personal and stakeholder schemes and also the State Pension. We answer general questions, help with specific queries and offer guidance for people with complaints about their private pension scheme.

The Pensions Advisory Service is provided by Money & Pensions Service

Contacting us

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Online enquiry form www.pensionsadvisoryservice.org.uk/online-enquiry

Web chat live www.pensionsadvisoryservice.org.uk
8am-6.20pm Monday/Wednesday/Friday
9am-6.20pm Tuesday/Thursday
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