The PENSIONS Advisory Service

Spotlight

Defined Benefits: How secure is my Pension?

This factsheet outlines the funding issues surrounding defined benefits pensions, the safeguards in place and the guarantees attached to scheme benefits.

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

How secure is my defined benefit pension?

Defined Benefit pension schemes provide valuable benefits as they offer guaranteed pensions based on salary and length of service. In this way they provide members with some certainty regarding their retirement income. They are usually backed by a sponsoring employer but sometimes the benefits have been secured by transferring to an insurance company. To spread investment risk, schemes typically invest in a range of assets including stocks and shares, property and long-term Government bonds, called Gilts. When measuring the value of their outgoings (liabilities) pension schemes will base their calculations on the return, or yield, on Gilts. As this yield has reduced in recent years this is one of the main reasons why many pension schemes are underfunded against their future liabilities at the present time.

If you are in a public sector scheme you will not be directly affected by lower Gilt yields.

What happens if my scheme is in a deficit position?

Schemes trustees and sponsoring employers have developed funding and investment strategies to close the funding gap and will provide members with a funding statement, normally on an annual basis. Although they only have to carry out an actuarial valuation every three years, the trustees will be monitoring the scheme's financial state of health much more regularly, particularly at times of market turbulence and uncertainty.

What role does the Pensions Regulator have in monitoring DB schemes?

The Pension Regulator oversees the way in which defined benefit schemes are funded and sets out rules and guidelines regarding the way in which funding deficits should be eliminated. It also sets out advice for trustees as to how they should track the financial strength of the employer(s) who backs the scheme and what they should do if this changes. This also includes changes which occur as a result of a company sale or takeover.

In the worst case scenario, where an employer goes into administration and the scheme remains underfunded, the Pension Protection Fund (PPF) will step in and provide compensation to members. In some cases, with the prior agreement of the Pensions Regulator and the PPF, the latter may step in to take over a scheme whilst the employer continues trading in some form.

How does the PPF work?

What compensation will I receive from the Pension Protection Fund?

This will depend on whether you have already reached your Normal Retirement Age (NRA) or not:

- If you retired at NRA, or on the grounds of ill-health, the PPF will normally pay 100% of the pension income that was in payment when your employer became insolvent.
- Those in receipt of a pension in respect of a deceased employee will also receive 100% of the pension income that was in payment when the employer went bust.
- If you have not yet reached NRA, or you are an early retiree, the PPF will normally pay 90% of what your employer promised. This is capped at £36,018.00 (90% of £40,020 p.a., at age 65, as of 1 April 2019).
- From 6 April 2017, a Long Service Cap came into effect for members who have 21 or more years' service in their original scheme. For these members the cap is increased by three per cent for each full year of pensionable service above 20 years, up to a maximum of double the standard cap.
- In September 2018 the Court of Justice of the European Union ruled that individual PPF and FAS members should receive at least 50% of their old age pension. This ruling is only expected to impact a few PPF/FAS members and the relevant individuals will be contacted from 2019 onwards.
- If you paid Additional Voluntary Contributions, these will generally be kept separate and will not be picked up by the PPF unless the contributions were used to buy additional years' service in the scheme.
- If you transferred in benefits to your scheme these will be treated in the same way as your other scheme benefits (i.e. subject to same limits).

Can I still get tax free cash in the PPF?

Yes you can and it usually works out around 25% of your fund size (the PPF will then reduce your compensation to reflect the fact that you have given up some annual payments for a lump sum).

If my pension scheme is about to go into the PPF can I retire early and secure a higher pension?

Prior to going into the PPF, your scheme will go through an "assessment period". During the assessment period the scheme will usually pay out benefits on the same basis as the PPF. So even if the Trustees were to allow you to retire early on normal scheme rules, the PPF is likely to reduce your benefits to comply with their rules as soon as the assessment period is over.

Will I receive any increases on my compensation payments from the Pension Protection Fund?

There will be increases but these are often lower than those offered by your defined benefit pension scheme. It will depend on whether you have already reached your Normal Retirement Age (NRA) or not and the period you worked for your employer:

- For compensation already in payment, increases on pensions accumulated after 5 April 1997 will be in line with inflation, subject to a maximum of 2.5%.
- For compensation not yet in payment, increases on pensions accumulated before 6 April 2009 will be in line with inflation, subject to a maximum of 5%. Increases on pensions accumulated after 5 April 2009 will be in line with inflation, subject to a maximum of 2.5%.

Do my dependants get death benefits if my scheme goes into the PPF?

Yes, they will but they will be proportionately reduced in line with the overall reduction in PPF benefits (e.g. the 90% cap if you have not yet retired).

How is the Pension Protection Fund funded?

The PPF is funded by levies paid by eligible defined benefit pension schemes. It is not funded by the government or tax-payers.

Should I transfer my pension out?

This is an important decision, particularly if you are concerned about the security of your pension scheme. If you are considering transferring out of your defined benefit pension you will generally need to obtain regulated financial advice. A Regulated Financial Adviser regulated by the Financial Conduct Authority will be able to tell you if transferring out of a scheme with guaranteed benefits is the right course of action for you to take or not and give recommendations about your next steps. On the following website you can find a list of financial advisers which are local to you:

https://directory.moneyadviceservice.org.uk

How secure is my Defined Contribution pension?

Defined Contribution (DC) pensions work in a different way to Defined Benefit pensions and as a consequence do not have the same PPF-type guarantees. However they do have considerable levels of safeguards for times when things go wrong.

Generally if you are building up pension benefits in a DC scheme, or are in drawdown, the assets you are invested in (e.g. stocks, shares, bonds, property) are owned by you and not the pension providers or your employer. Therefore, even if your employer or a provider becomes insolvent then your underlying pension assets will be unaffected.

If you think you have received bad financial advice from a firm that goes under or one of your investments drops considerably, the Financial Services Compensation Scheme (FSCS) can step in and cover any loss up to £85,000. If you have an annuity in payment, then the Financial Services Compensation Scheme (FSCS) will step in and cover 100% of any annuities in payment if your provider becomes insolvent.

Any deposit accounts held in a pension are usually covered up to £85,000 per person per banking license.

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

Pensions Helpline (Monday-Friday 9am-5pm) — **0800 011 3797**

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

Web chat live (Monday-Friday 9am-6pm open late Tuesdays 7pm-9pm) — www.pensionsadvisoryservice.org.uk

Write to us

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