Staying in a defined benefit (DB) pension scheme

About the clients

Andrew, 65, and Emma, 63, are married. They have no children. Andrew works for an electrical installations company and Emma is employed as a manager for a local estate agent. Their total household income is around £65,000 a year.

The couple own their own home, worth £450,000 and have £15,000 outstanding on their mortgage. They have a total of £10,000 in other savings.

Where pensions are concerned, Andrew is saving into his workplace pension scheme, which is worth around £125,000. Emma is also saving into her workplace group personal pension, which is worth £15,000. Emma also accrued a DB pension when she previously worked for a high street bank, ABC Bank, for 30 years.

Clients' retirement objectives

- Both to stop working and retire in 12 months.
- Repay their mortgage.
- Minimum income of £2,500 per month (£30,000 per year), after tax in retirement.

Their problem

Emma is in the very fortunate position of having built up a DB pension with her former employer ABC Bank.

When she reaches age 65, this is projected to provide her with a pension of £22,000 a year. Should Emma die before Andrew, he would be entitled to receive two thirds of this amount (£14,000 a year), on Emma's death.

The ABC Bank pension scheme trustees have offered Emma a cash equivalent transfer value (CETV) of £710,000 instead of the DB pension of £22,000 per year.

Both Emma and Andrew are surprised by this value and want to know whether Emma should give up her annual £22,000 DB pension in return for the £710,000 CETV.

Their solution

The couple contacted us to speak with a financial adviser to help them to decide whether Emma should transfer out of her DB pension scheme.

At their Discovery meeting, their adviser gained a real understanding of what their goals were, any immediate concerns that needed addressing and what their existing savings, investments, pensions and liabilities were, which included looking in detail at how much income in retirement they would need.

After meeting the couple, their adviser ran a cash flow model that showed that they could meet all of their retirement objectives outlined above. However, their adviser recommended that they keep the ABC Bank DB pension of £22,000 per year and do not take the CETV on offer.

This is because combined with their State Pensions, the couple will have a guaranteed income for life of around £38,000 per year that will increase each year broadly in line with inflation. This is sufficient to cover their income need of £2,500 per month after taxes (£30,000 per year) in retirement.

If Emma had accepted the £710,000 CETV, they would have needed to use these funds to replicate the DB pension of £22,000 per year that Emma would have received from ABC Bank. They agreed with their adviser that this would have meant taking on risks that they were not comfortable with and could not afford to take. These risks would have included the £710,000 falling in value or spending all of the £710,000 pension fund before they both die.

Both Andrew and Emma are in good health and could live for at least another 25 years, so losing the security of a guaranteed income of £22,000 per year could be a decision they may live to regret later in life.

However, there may be years where Andrew and Emma may want a bit more money, and they would also like to pay off their mortgage. Andrew and Emma's existing workplace pensions will allow them to do this and provide a fund, including tax-free cash, that they can access on an ad-hoc basis via the pension freedoms rules.

Lastly, given they have no children, their pensions can be used for their benefit without having to worry about leaving a legacy to beneficiaries.

If you'd like to discuss your situation and learn more about how we can help you, please contact your Private Client Partner if you already have one. Or, if you are new to Foster Denovo call 0330 332 7866* or email advise-me@fosterdenovo.com.

*Calls are charged at your local landline rate.

This case study is for information only. The advice received in the case study was specific to the individual needs and circumstances of the client. Prior to taking any course of action, please seek financial advice.

Past performance is no guarantee of future returns and the value of investments and the income they produce can fall as well as rise. You may not get back your original investment and you may lose all of your investment. Accessing pension benefits early may affect levels of retirement income and is not suitable for everyone. You should seek advice to understand your options at retirement.

PrivateClients
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Transferring out of a defined benefit (DB) pension scheme

About the clients

John, 61, and Karen, 60, are married with two adult children. John works as the Head of Engineering for a large manufacturing company. Karen stopped working when her children were born.

Karen is in good health but John suffers from some health conditions and doesn't believe he will live much beyond his mid-70s.

The couple own their own home worth £750,000 and are now mortgage free. They have combined savings and investments totalling £250,000, which was mostly inherited from Karen's late mother.

Where pensions are concerned, John has £250,000 in his existing workplace group personal pension. He also previously worked for a company called XYZ Products for 15 years and accrued an estimated pension of £12,000 per year in the XYZ DB pension scheme, which is payable when John reaches age 63. Karen has £50,000 in a personal pension.

The clients' objectives

- John wants to stop work and retire at age 63.
- They want to make sure Karen is financially secure should John die before her.
- They would like a joint income of £2,500 per month after tax although they have a need for a flexible income approach. This is because they believe they will spend more when they are more active in the years immediately after retirement, going on holidays, etc.
- They want to make sure that they maximise the legacy left to their children in the event of their deaths and minimise any potential inheritance tax liability.

Their dilemma

The trustees of the XYZ DB pension scheme have offered John a cash equivalent transfer value (CETV) of £510,000 if he gives up the projected pension of £12,000 per year that he will be entitled to at age 63.

They feel the offer is generous and like the idea that their children could inherit the pension in the event of their deaths.

John wants to understand which option is most suitable for him and Karen.

Their solution

The couple contacted us to speak with a specialist retirement adviser.

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At their Discovery meeting, the adviser gained a real understanding of what their goals were, any immediate concerns that needed addressing and what their existing savings, investments, pensions and liabilities were, which included looking at how much income they might need throughout their retirement.

She advised John to accept the £510,000 CETV offered from his DB pension scheme and transfer this to a personal pension.

This is because the couple do not need to access their pension funds, including the £510,000 CETV, as they can use their £250,000 savings and investments to cover their income needs in the early years of their retirement. Also, once they are in receipt of their State Pensions, these will amount to £1,250 in total per month, which will cover half of their £2,500 monthly income need.

Using cash flow modelling, their adviser showed them that their remaining savings and investments and existing personal pensions would be more than sufficient to cover their income needs for their retirement and that they should not need to access the £510,000 CETV at all.

However, should their circumstances change or should Karen feel that she wants a more guaranteed income if John dies, they have the option to use this fund to purchase a guaranteed income in the form of an annuity.

Furthermore, should the couple need to access this money, they will be able to draw on it via the pension freedom rules. And lastly, when John eventually dies the fund could be passed potentially tax-free to either Karen or their children.

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