DEFINED BENEFIT PENSION SCHEMES AN EXPLANATION

Defined Benefit (DB) pension schemes, also known as Final Salary schemes, are considered to be one of the best types of pension you can have because of the guarantees they provide.

You should think very carefully before transferring out of one of these arrangements and make sure you don't make any rash decisions. Consider your options carefully and make sure you understand what the implication and costs are.

THE FOLLOWING IS A GUIDE AS TO HOW THESE SCHEMES WORK:

When you were working for your old company, it was likely that you paid a fixed percentage of your income into the pension scheme, usually between 5% and 15%; your former employer also contributed into the pension although the amount they paid varied from year to year – in most cases it was significantly more than the amount you paid.

Being in the pension scheme meant you got the promise of a pension when you retired, which was dependant on how many years you worked for that employer and what your salary was.

The longer you worked for your old employer the bigger the percentage of your salary you would get as a pension in retirement.

When you stopped working for them and left the pension scheme, they would have known how many years you were in the scheme and how much your salary was – from this they would be able to calculate how much pension you would be entitled to at retirement.

However, your retirement age could be many years away from when you left your employment, so the amount of pension they calculated would be increased each year from the date you left your old employer up to the date of retirement – the idea being that it would keep up with inflation so in real terms it was worth as much in retirement as it was when you left work.

Whatever the cost is for your old employer to pay you that pension in retirement, they must find the money. If there is a stock market crash or some other event that means the value of the pension fund reduces, it's not your problem. They would have to find that extra money to ensure you receive the pension you're promised at retirement.

If you transfer your pension fund away from your old company scheme, you will then miss out on all the increases you might have otherwise got had you left this pension where it was in the first place and lose the benefit of your former employer taking on all the investment risk on your behalf. This is a very valuable benefit to lose and could mean you end up with a smaller pension in retirement.

If there is anything you're unsure of or at any time you want to clarify a point, please make sure you contact us here at Grove Pension Solutions Limited.

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A safeguarded benefit within a pension could broadly be defined as any form of guarantee or promise that could be beneficial to the member (or their survivors). The main types of safeguarded benefits are:

- Defined Benefit or Final Salary schemes
- Pension policies with Guaranteed Annuity Rates (GAR's)
- Pension policies with Guaranteed Minimum Pensions (GMP's)
- Pension policies offering a promised level of income in the future or guaranteed minimum level of income.

A policy with a GAR means that the accumulated fund at retirement will be converted to a guaranteed lifetime income (or 'annuity') at a certain rate which is often, although not always, higher than that available on the 'open market'. As the underlying fund can still go up and down in value, there is no guaranteed how much income you get. In addition, the GAR might be restrictive in only allowing certain pension options. Nevertheless, this type of guarantee can be very valuable – particularly during times where pension rates are very low as is currently the case.

A policy or scheme with a GMP means that you will receive a guaranteed amount of income at retirement age, irrespective of the value of the pension. If there is a shortfall e.g. the cost of providing the GMP is more than the value of the fund, then the pension scheme / company will have to make up the difference and it is this circumstance where a GMP can be particularly valuable. This can also sometimes restrict the ability to transfer this type of pension.

Equally, if there is more in the fund than the cost of providing the GMP, then additional benefits - in the form of a tax-free lump sum and / or income - would be available. However, the GMP benefit must be secured first.

Some older personal pension policies offer a promised level of income (or guaranteed minimum level of income) calculated by reference to the contributions or premiums paid. Much like a GAR, these policies may restrict the choice of income being paid.

The advantage of these types of guarantees is that like a GMP, you know what you will receive, and the pension company carries the risk of how much it will cost them to provide this pension. Also, if the value of the pension fund at retirement is enough to purchase a higher level of income you can still do so – so this is generally not restrictive.

Transferring a pension with any of the guarantee's detailed above carries additional risk, which must be weighed up carefully.

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