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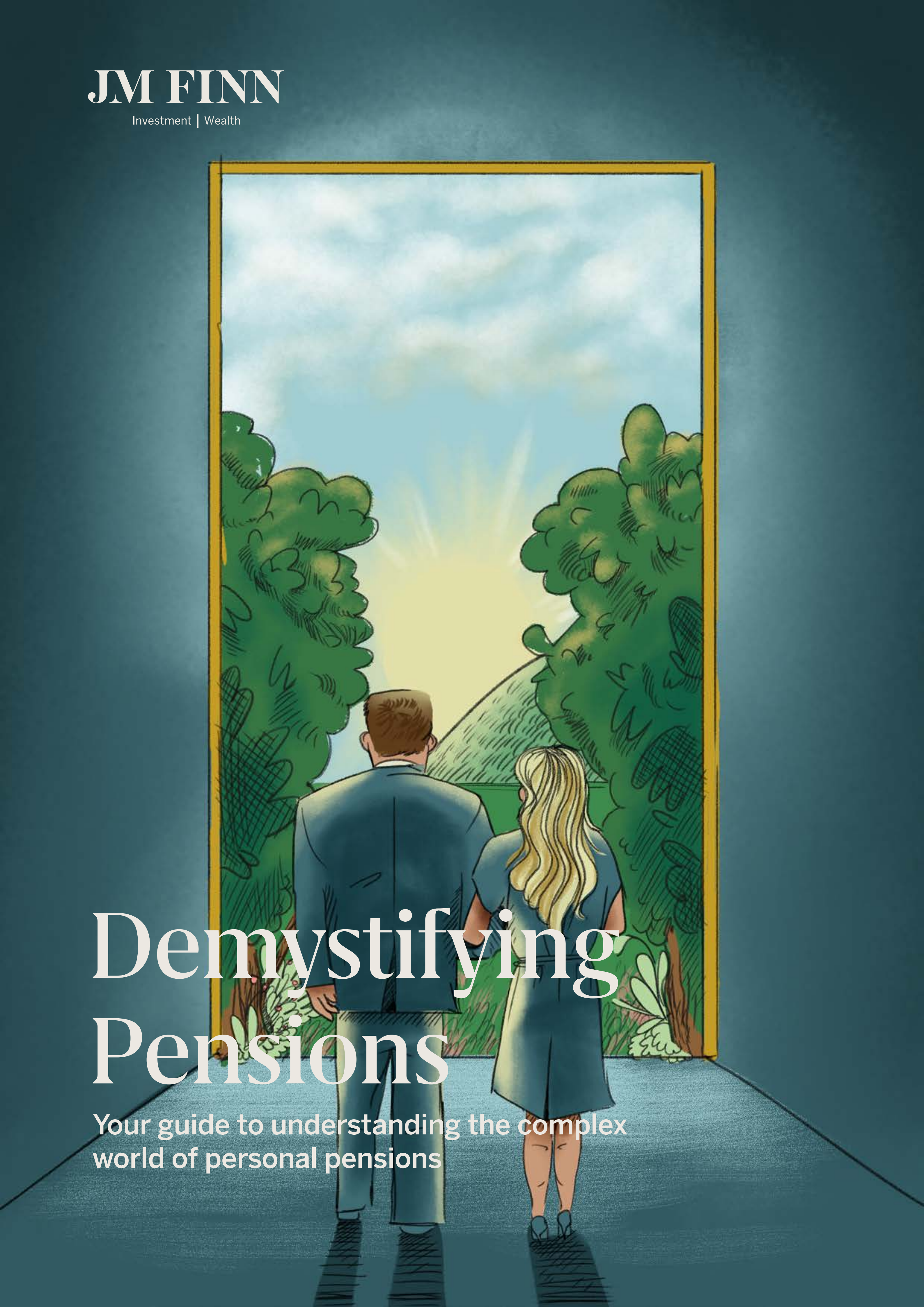


Demystifying Pensions

Your guide to understanding the complex world of personal pensions

Demystifying Pensions

Unless you are approaching retirement, thinking about your pension and retirement plans can seem unrelatable, possibly unnecessary and certainly boring. Many a financial services provider aims to educate their clients about the importance of pensions but few manage to make them interesting.

This guide does not claim to make them interesting, but it is designed to help private investors understand the importance of pension planning, make some sense out of the various rules that exist and generally enhance the knowledge of our readers. Why? Because the majority of people invest to save for their futures, and specifically one where they no longer earn a salary, and therefore are reliant upon their savings – and a pension can be the most important savings vehicle an investor might have.

Given the importance of a pension and the tax efficiencies than can exist, it is often surprising to us that knowledge around their use is limited. Much of this is down to the far-reaching changes that were instigated in 2016 which significantly enhanced the flexibility of pensions, which are discussed on page 6.

To gain a deeper understanding of attitudes to pensions, we commissioned an independent study of UK professionals aged between 45-65 years earning more than £50,000 [1] and learnt that:

36%

of those planning for their retirement, have never received investment advice

43%

are not aware of the difference between regulated financial advice versus financial guidance

42%

were not aware of the annual and lifetime limits on pension contributions

70%

of Baby Boomers and Generation X still feel confident they are making the best investment decisions in the current environment

[1] Independent research commissioned by JM Finn which surveyed 1,500 UK professionals aged between 45-65 years earning £50,000 + per year during August 2021.

Despite the majority of investors feeling confident of their investment decision making, many are not fully aware of the rules, a similar number didn't understand the difference between advice and guidance and a third have never received advice.

Why is this data so important? Because in the same study, two-thirds (67%) suggested their pension was to be their main source of income during their retirement.

We also noted that 20% of respondents were not aware of how they can use a pension to pass on their wealth to the next generation. Retirement plans are often considered alongside estate planning, so it is important to fully understand how best to use your different investment "pots" to maximise the amount you can pass on. This is discussed more fully on page 16.

Of course, many savers are extremely diligent and regularly save into their pension pot. This can have several consequences: you could over-pay, as the annual allowances are not always fully understood, as evidenced in our research, where 42% stated they were unaware of the limits. It could also lead to having multiple pensions.

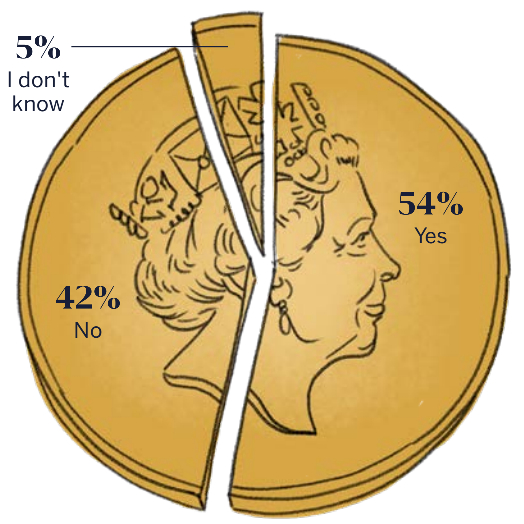
> **It is not uncommon for people to have six or seven different pensions**

It is not uncommon, according to Which? for people to have six or seven different pensions these days and therefore could well have a similar number of workplace pension schemes. Whilst this means employees have been taking advantage of their employers' contributions, it can lead to a much higher administrative burden, an over-exposure to certain investments and therefore greater total risk than you might otherwise have chosen and worst case, lost or neglected pensions. As referenced on page 12, nearly £20bn of pension pots remain unclaimed by close to 1.6 million people – so in a bid to not "lose" your hard earned savings, consider whether it is appropriate to consolidate your assets, which could result in paying less fees!

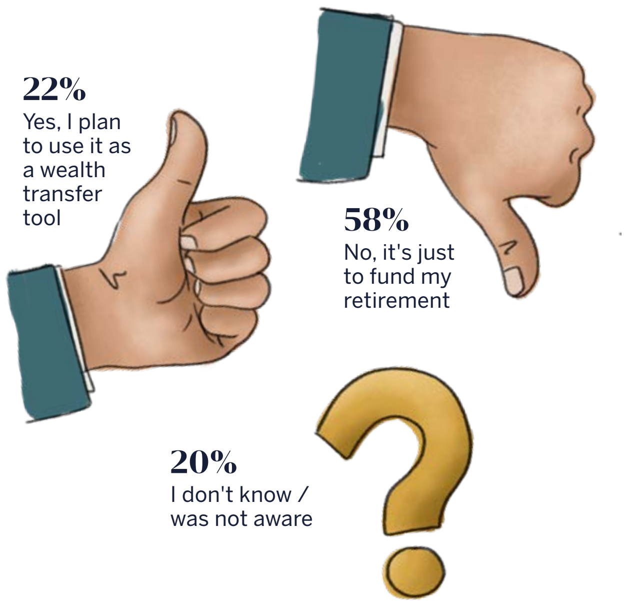
Other important areas discussed in this report include whether annuities are still an appropriate strategy for pension drawdown, and the case of transferring a Defined Benefit scheme. And finally, it is estimated pension thieves have stolen a staggering £10bn from 40,000 victims since 2015; we offer some tips to help avoid this financial disaster.

> There is a good chance that state-pension systems won't exist by the time millennials turn 65

Are you aware of the annual limits on pension contributions?



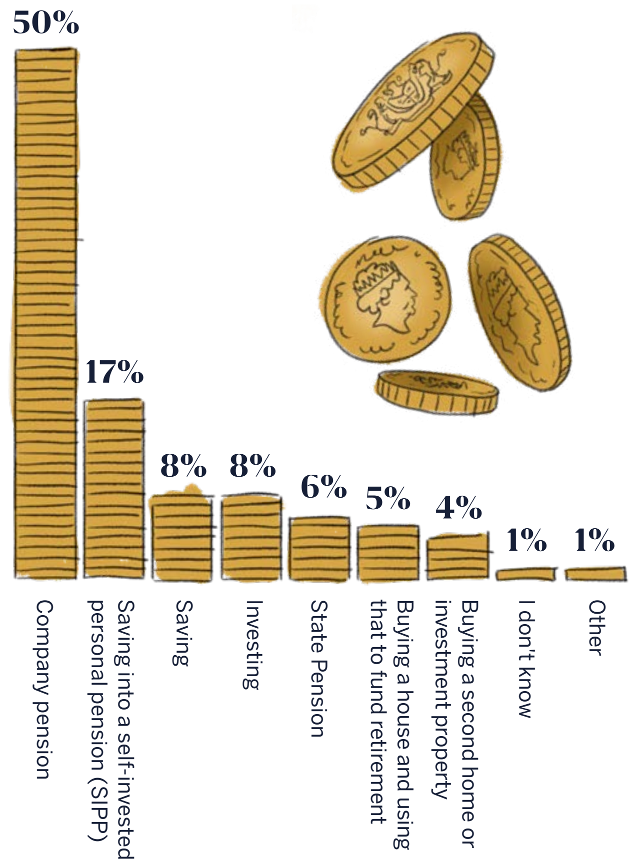
Have you thought about pensions as an estate planning tool?



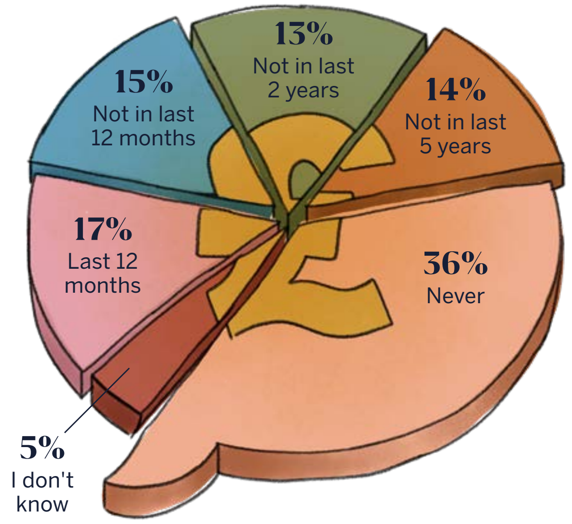
Demographic changes such as increasing longevity and a rising ratio of retirees-to-active employees have largely been responsible for the so-called pension crisis that has seen a huge amount of unfunded government pension liabilities. The result of this and government inaction means that state-pension systems will be under even more pressure by the time millennials turn 65. This means that the responsibility of receiving a future retirement income rests on each of us individually and how we manage our pension portfolios.

So if you're an early stage investor, it's probably a good idea to start thinking about setting up a private pension plan or start building an investment portfolio for the future and if you are already well on your way to accumulating a reasonable pension pot, it is worth seeking advice to ensure you are using it correctly. That is of course if you don't want to have to lower your quality of life when you retire.

What is your main means of retirement saving?



Have you ever received regulated pension advice or retirement planning?



> The majority of people invest to save for their futures

Did you know?

£260,000

The annual allowance tapers down for high earners

If you earn over £260,000 per year the maximum you can contribute can be restricted.

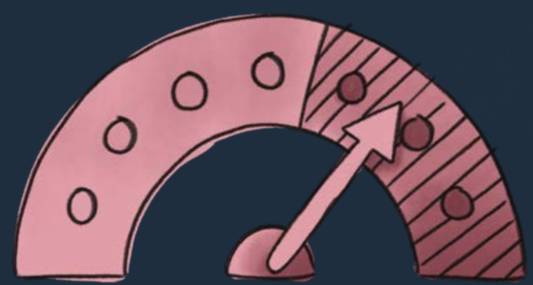
Passing on a pension fund could be entirely tax free

If you die before the age of 75 and your beneficiaries draw the fund within two years, it can be tax-free.

45%

You can still contribute to your pension after you retire

Up to 45% tax relief can still be claimed on payments into your pension up to the age of 75.



55%

Exceeding the lifetime allowance triggers a tax charge

If you exceed the lifetime allowance, you could face a 55% tax charge.

Pensions are flexible so you don't have to start to draw on them when you retire

It might by prudent or more tax efficient to use other pots, such as ISAs, to provide for you upon retirement. It's worth getting someone to review your situation before the decisions are made.

£203.85

The current basic state pension is £203.85 a week

You might get more or less, depending on whether you were "contracted out" at any time.

Five Years

You have got five years to get tax relief

Many pension savers forget to claim their extra tax relief, which you need to do via your tax return. This can be done within four years of making the pension contribution.

20%

You can set up and contribute to a pension for your children or grandchildren

Despite not paying tax, your offspring can still get 20% tax relief for pension contributions you make for the next generations.

You can make lump-sum pension contributions

Most savers contribute to a pension via regular monthly contributions, but you can also make lump sum payments at any time.

Pension Freedoms

Summary

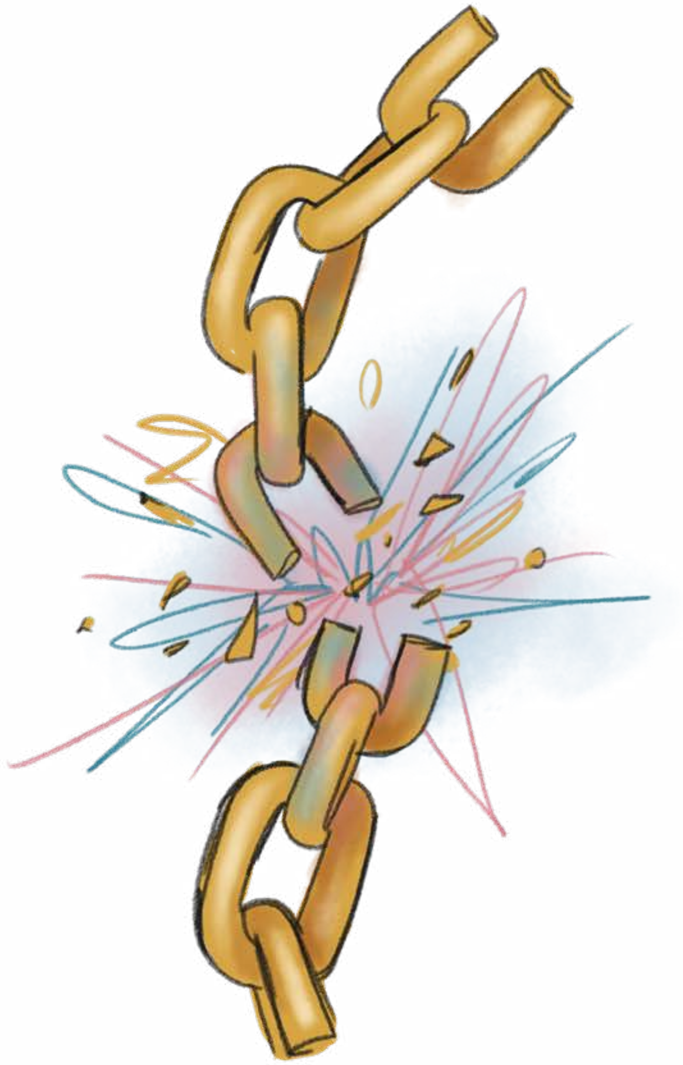
- Pensions freedom added two new options: flexi-access drawdown and uncrystallised pensions fund lump sum
- Anyone over 55 can spend 100% of their personal pension on anything
- You no longer have to buy an annuity
- Pension funds can be distributed to beneficiaries upon death
- Be aware of the caps imposed on pensions

With annuity rates reaching an all-time low in 2016, changes were needed to the pension rules. No one envisaged quite how much things would change. George Osborne, as one of his lasting legacies as Chancellor of the Exchequer, introduced what has become known as "pensions freedom." Historically, purchasing an annuity was compulsory for most pension savers but from 2015 fundamental changes were introduced giving increased flexibility when accessing pension funds.

These pension changes could drastically improve how efficient your tax planning is, and enable individuals' greater financial freedom with regards to retirement.

When it comes to pensions, many clients we meet confess that they do not fully understand how they work. Not being knowledgeable about personal finances can have serious implications, such as the age at which one can comfortably afford to retire. Understanding one's own finances is now, more than ever, critical with such drastic changes to UK pensions and increases in UK life expectancies.

The key change was to allow anyone over the age of 55 to spend up to 100% of their own personal pension pot for any purpose they wish, thus removing the requirement to purchase an annuity - an inconceivable freedom only 10 years ago. This was an attempt to combat the measly returns traditional annuities were offering, in a time of low growth and rock bottom interest rates.



> **When it comes to pensions, many clients we meet confess that they do not fully understand how they work.**

There are now three options to take benefits at retirement: flexi-access drawdown, uncrystallised pensions fund lump sum and a traditional pension annuity. These three options enable savers to pick the right form of pension income for their given needs. The changes have been very popular, with as of 2020 1.4 million people utilising the new pension freedoms for the first time. Of the 352,108 pension plans accessed for the first time between October 2021 and March 2022, only 31,806 were used to purchase an annuity – according to data published by the FCA[1].

Furthermore, there is now an opportunity to distribute your pension fund to your beneficiaries upon death. The fund is able to be passed down giving beneficiaries the choice of taking the pension fund as a lump sum or leaving the fund invested in a pension wrapper and withdrawing an income when required. If death occurs before the age of 75 then it will be tax-free, making pension provision a significantly more important tool for consideration when estate planning.

The Spring Budget 2023 made drastic changes to the caps imposed on pensions, most notably the lifetime allowance will essentially be eliminated from April 2023, removing the cap on lifetime pension savings. This means that when one accesses their pension funds, they will no longer face a lifetime allowance tax charge. Furthermore, the annual allowance, which is the amount that can be contributed to a pension fund tax-free, will rise from £40,000 to £60,000. This increase in the annual allowance provides greater flexibility for savers and an opportunity to save more without incurring taxes.

These measures have been introduced as part of the government's plan to stimulate employment and bring back early retirees like doctors who had left due to pension tax reasons. The aim is to encourage people not to opt for early retirement and to incentivise them to remain in the workforce. To this end, the government has also proposed increasing the money purchase annual allowance and the minimum tapered annual allowance from £4,000 to £10,000.

Although there will be a cap on tax free cash of £268,275 (25% of the lifetime allowance in the 22/23 tax year), those with tax free cash entitlement in excess of this, for instance due to lifetime allowance protection, will retain their higher entitlement.

Tax relief is still available on contributions at the marginal rate of income tax, subject to the capping. Pensions remain an efficient savings wrapper and, thanks to the increased flexibility of access, pension provision is a core component of any financial plan that might be constructed for an investor.

Generally, the new flexible pension freedoms are attractive but with the various, often confusing, options available it is essential to make sure the most appropriate route is selected and talking to a professional wealth planner or independent financial adviser is critical.

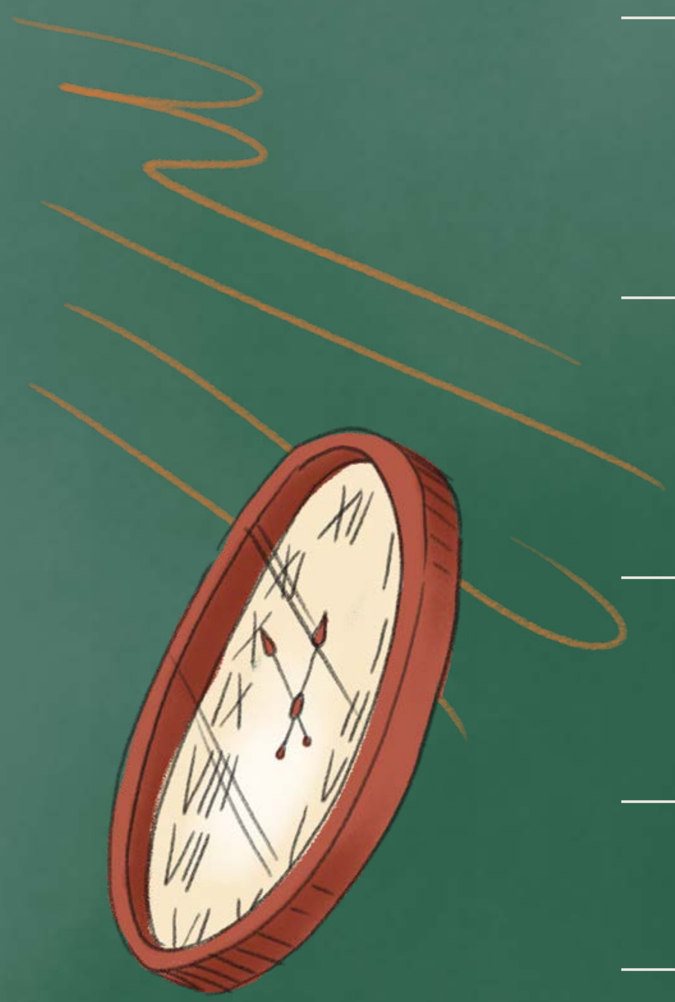
Finally, a word of warning: as with many opportunities come the latest wave of scams. In January 2019, a ban was enforced by the Information Commissioner's Office (ICO) on cold-calls in relation to pensions including emails and texts, but still scammers try to entice pension savers through other means, such as to transfer their savings into single member schemes promising either early access or incredibly high returns. As such, please continue to be vigilant and aware of scams.

Anna Murdock
Head of Wealth Planning, JM Finn

[1] https://www.fca.org.uk/data/retirement-income-market-data-2020-21

How do I take control of my pension?

Why consolidate your pension pots?



- Some schemes benefit from economies of scale and so larger balances may lead to lower overall charges
- Capitalise on a feature of an existing pension scheme that is not available in your other policies
- Older contracts may have less flexible methods to access your funds at retirement
- Your current pension may offer a limited array of investments
- Increased flexibility could help to meet your specific financial objectives

Research conducted by the Association of British Insurers (ABI) found that £19.4 billion of pension pots associated with 1.6 million people sit unclaimed. This works out at approximately £13,000 per pension pot and the primary reason identified for this was simply failure to update the pension provider when moving house. It may be optimistic to assume that a forgotten pension pot of considerable size is sitting somewhere in your name waiting to be claimed but this is the reality for a great many individuals in the UK.

This may also be associated with the phenomena of job hopping becoming more and more commonplace. With the dawn of auto enrolment this can mean numerous pensions with multiple providers, each with its own various features. With so many schemes and the associated paperwork that comes with them it can be a struggle to keep up to date with what you have and this ultimately leads to schemes being lost.

There are steps you can take to avoid this happening and you may be glad to hear that in 2017 more than 375,000 attempts were made to contact customers which led to £1 billion in assets being reunited with the account holder but this is still a small fraction of the total left unclaimed.

The simplest solution would be to contact your pension provider and let them know of a change in your address whenever this occurs. However, it is often not that simple and as individuals move from job to job and house to house it may become increasingly difficult to keep track of what you have.

Another option would be to consolidate your pensions. By combining the contracts it makes it easier to keep track of and manage these savings. Some schemes benefit from economies of scale and so larger balances may lead to lowered overall charges or you may wish to capitalise on a feature of an existing pension scheme that is not available in your other policies. Older contracts may have higher charges, less flexible methods to access your funds at retirement, limited online functionality or a limited array of investments and so a consolidation could help to meet certain financial objectives.

> **It can be a struggle to keep up to date with what you have and this ultimately leads to schemes being lost.**

There are potential downsides to consolidation as some schemes could have exit penalties that will eat into the pot, the policy may benefit from certain guarantees or safeguarded benefits that are valuable and cannot be replicated by another scheme and, there are certain tax advantages to keeping separate pots where these qualify under the 'small pots' rules. Additionally, it is seldom a good idea to transfer out of an existing workplace pension that benefits from employer contributions as these would usually be forfeited on transfer.

When consolidating individuals typically consider either an existing contract such as their active workplace pension as the receiver scheme or they may choose to establish an entirely new contract such as a Personal Pension or SIPP (Self Invested Personal Pension). The key difference between a workplace scheme and a SIPP is that the SIPP typically offers a wider range of investments and can offer greater flexibility at retirement, but will usually cost more than a workplace scheme. If looking to consolidate, the best option for a contract will require research and have to be compared to your existing situation and financial objectives.

In some cases, it is possible for an individual to complete a consolidation process and implementation of a new scheme themselves where desired. This involves filling in the relevant forms and/or speaking with your providers to arrange a transfer. However, as we have learned with the £19.4 billion in unclaimed pensions, paperwork and speaking to providers is not everyone's strong suit and this ignores the analysis required in order to move forward with an appropriate contract. If you are uncertain as to whether switching out is appropriate for you, then you should seek advice or guidance from a financial adviser.

Demystifying Pensions

Some schemes benefit from economies of scale and so larger balances may lead to lowered overall charges.

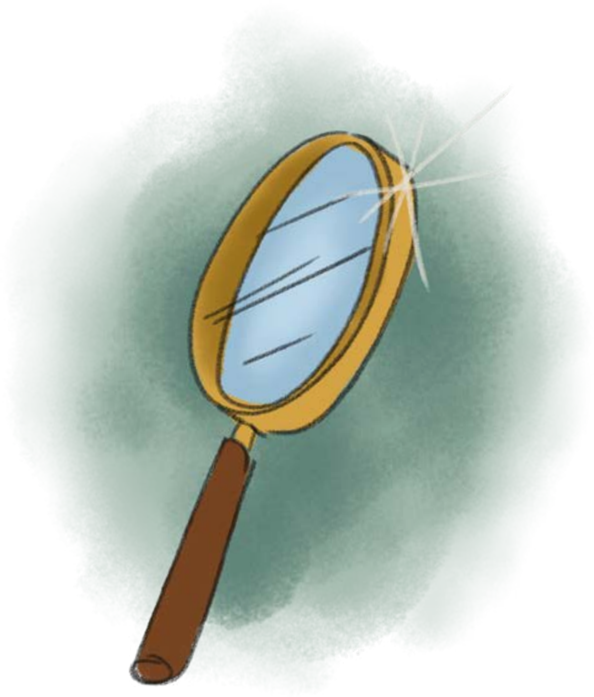
Ensuring you have your pensions in order could make a considerable difference to your pension in retirement. The FCA published a study of the non-workplace pension industry in 2019, they revealed various findings including; low levels of consumer engagement, consumers assuming they had selected a 'standard' investment, charges being highly complex across the market, older and smaller pots attracted higher charges, similar consumers paying materially different charges for broadly comparable products, little switching between products and weak price competition. All of these factors could be to the detriment of your retirement planning and so ensuring correct and thorough analysis is conducted on your existing pensions as well as any prospective new scheme is essential. Andrew Tully, technical director at Canada Life, estimated that £250 billion of pension pots could benefit from consolidation based on this study.

It is ultimately up to you to take control of your pensions. This could be by ensuring your existing schemes are registered with the right address or by considering consolidation whether that be purely for simplification purposes or to access a contract with lower fees, better investment options and/or greater flexibility at retirement or on death. Making sure your pensions are structured in a manner that suits you and your retirement objectives can help to make things considerably easier at retirement. If you are not comfortable tackling such big decisions alone it is possible to seek the help of a financial adviser who will be able to either provide guidance that will help you to come to your own decision or advice where the relevant analysis will be conducted on your behalf with your details in mind and a proper solution found and implemented.

Atticus Kidd
Wealth Planner

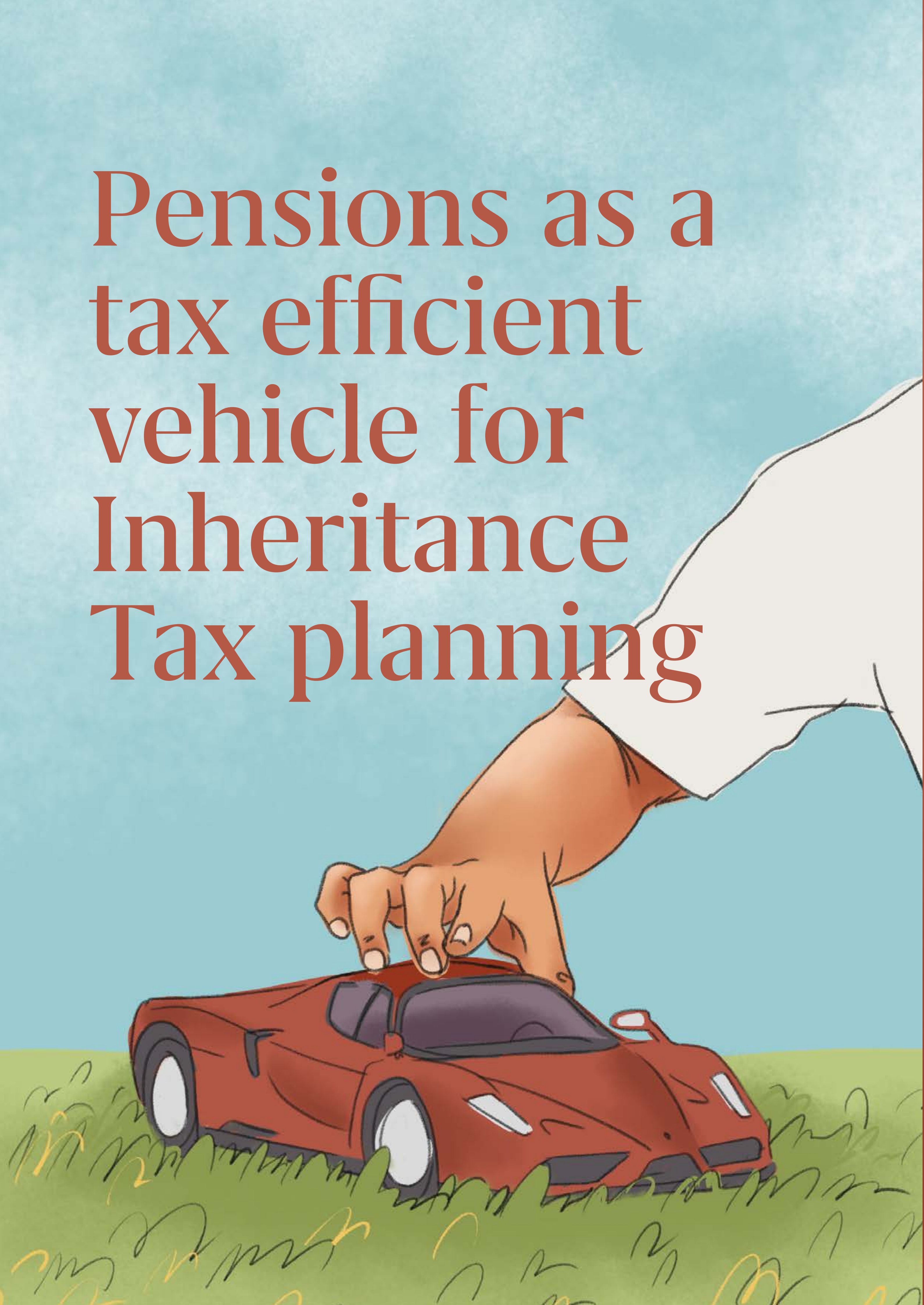
The above pertains to defined contribution (DC) policies. Where considering movement of defined benefit (DB) schemes these will be subject to separate considerations and procedures, as discussed in our article entitled, *Should I Stay or Should I go*.

As we have learned with the £19.4billion in unclaimed pensions, paperwork and speaking to providers is not everyone's strong suit.



At JM Finn we offer a service termed our pension policy summary which lays out the details of a client's existing policies and provides the basis of a discussion surrounding the features of their pensions and their potential role in retirement planning. Through this document we can highlight any valuable features that may be worth retaining or any number of factors that may be relevant to your situation. With all of the details available it is then possible to make an informed decision as to the most appropriate step forward. Unfortunately we are not yet able to work out whether you are one of the 1.6 million with an unclaimed pension but by familiarising yourself with your schemes and potentially taking some action early it may prevent an extra name being added to that list.

Pensions as a tax efficient vehicle for Inheritance Tax planning



Summary

- The fact that a pension does not usually form part of your taxable estate for IHT purposes makes it a tax-efficient way to pass on wealth to the next generation.
- It is often the last pot to draw from after using up other savings that form part of your estate.
- There is increased flexibility with regards to how you access (or don't access) your pension and how the associated death benefits are taxed.
- For Defined Contribution schemes, you are no longer forced into buying an annuity.
- If you die under the age of 75, the entire pension fund can usually be passed on tax-free.
- Pensions remain outside of the beneficiaries' estate upon death.
- The benefits are amplified for those who are high earners.

Inheritance Tax (IHT) has been referred to as a "voluntary tax" because there are many legitimate actions you can take during your lifetime such that on death, you can reduce the amount of IHT payable meaning you can pass on more of your estate to your loved ones.

The standard rate of IHT is 40%. This is charged on your taxable estate in excess of the Nil Rate Band (NRB) currently £325,000 per individual, taxed at 0%, when left to non-exempt beneficiaries, though various exemptions, allowances and reliefs can affect the amount subject to IHT.

Currently about 4% of estates in the UK pay IHT however recent trends suggest that more people are likely to face an IHT liability in the future according to the Office for Budget Responsibility, in part due to rising house prices and various thresholds being frozen until April 2026 (including the NRB which has remained frozen since April 2009). Even if you don't have a large enough estate now, you may well do in the future (for instance if you receive an inheritance) so it's important to plan ahead.

You may have already taken steps to mitigate future IHT such as: spending more, making gifts, investing in IHT schemes, setting up trusts or perhaps insuring against the liability. But don't forget about the humble pension when it comes to IHT planning.

> **The fact that a pension does not usually form part of your taxable estate for IHT purposes makes it a tax-efficient way to pass on wealth to the next generation.**

A popular option is to instead leave all your pension, or part of it, invested so that it can continue to grow free from income and capital gains tax.

The fact that a pension does not usually form part of your taxable estate for IHT purposes makes it a tax-efficient way to pass on wealth to the next generation hence why, perversely, it is often the last pot to draw from after using up other savings that do form part of your estate.

Since the introduction of pension freedoms in 2015, there is increased flexibility with regards to how you access (or don't access) your pension and how the associated death benefits are taxed. This can vary depending on your pension scheme, so it's worth checking that your scheme can facilitate the options you want. If not, then you may want to consider a transfer to one that does.

For Defined Contribution schemes, you are no longer forced into buying an annuity. A popular option is to instead leave all your pension, or part of it, invested so that it can continue to grow free from income tax and capital gains tax, with the ability to flex the amount of any income taken. If you die under the age of 75, the entire pension fund can usually be passed on tax-free whereas if you die over the age of 75, then your beneficiaries will only pay income tax at their marginal rate when accessing the funds. Importantly, the pension remains outside of the beneficiaries' estate and this process can be repeated indefinitely under current legislation until the funds are exhausted.

The benefits are amplified for those who are high earners with large estates making pension contributions because not only are they reducing the size of their estates, but also benefitting from higher rate / additional rate tax relief (40% / 45%) on the contributions going into the pension. In the past, one had to be mindful of how much was paid into pensions in the context of the pension Lifetime Allowance. However this is no longer an issue with the effective removal of the Lifetime Allowance from April 2023. Nevertheless, pension planning can still be a complex issue and it remains a fine balancing act in terms of the overall planning. Not to mention successive Governments may choose to reinstate the Lifetime Allowance.

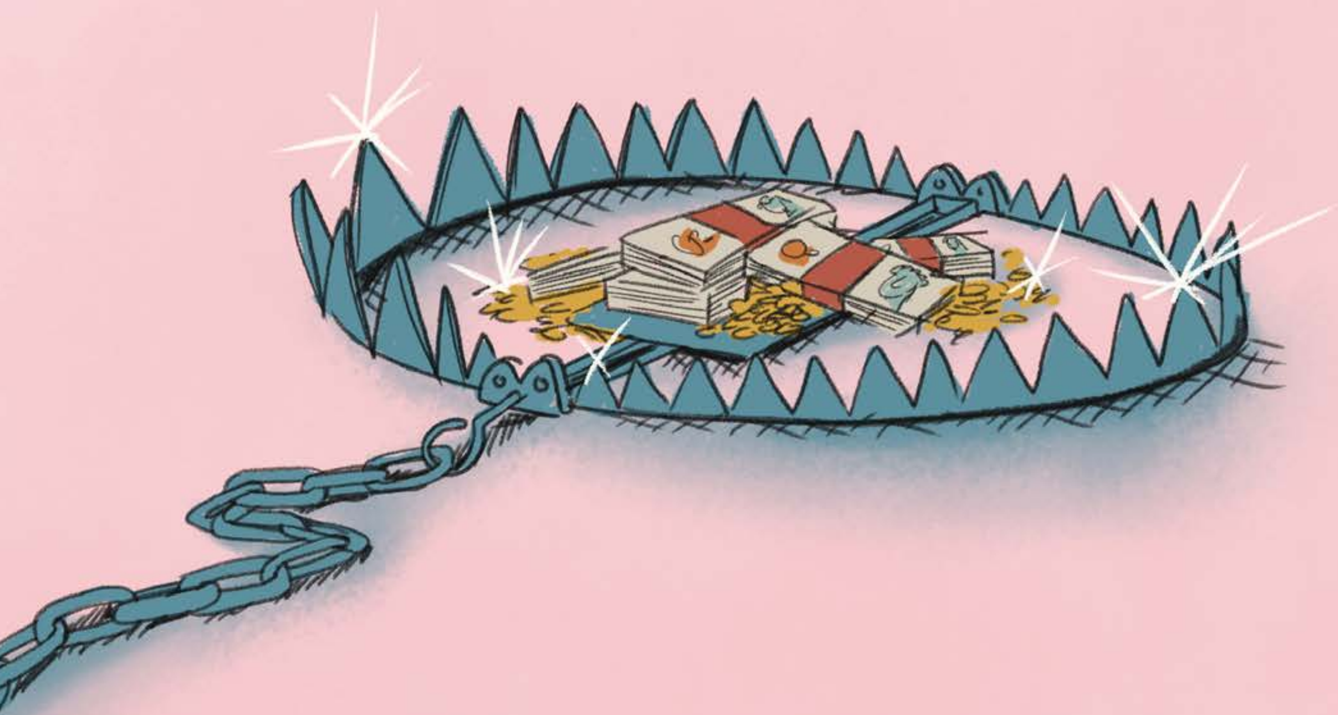
Beneficiaries can be whoever you want to inherit your DC pension – you are not limited to your spouse or dependants. Most pensions are held in a trust arrangement so the pension trustees are not bound by any instructions left in your Will hence why it's important you complete and keep up-to-date your provider's "Expression of Wish" form. This will help ensure your pension is passed on to who you wish to receive it and avoid delays when distributing the funds. This is not a legally binding document, however the trustees will do their best to accommodate your wishes.

Good wealth planning often comes down to structuring your estate so that your money is held in the appropriate tax wrappers, based on your own personal circumstances, allowing you to maintain access and control, whilst at the same time shielding your estate from future IHT. With this in mind, pensions are a valuable IHT planning tool that shouldn't be overlooked.

Uday Tuladhar
Paraplanner, JM Finn

Tapered Annual Allowance

Beware - the tax trap whose bite is worse than its bark



Summary

— The annual allowance is the most you and your employer can save into your pension within a tax year before you are required to pay tax on those contributions.

— There are limits to the tax-relievable contributions that can be paid.

— The annual allowance may be reduced if you have either flexibly accessed your pension pot previously or you have a high income.

— The annual allowance is reduced by £1 for every £2 of adjusted income over £260,000.

— Anyone with an adjusted income of £360,000 or above is now restricted to an annual allowance of only £10,000.

— The consequences of not being aware of these caps could be a tax charge known as the annual allowance charge.

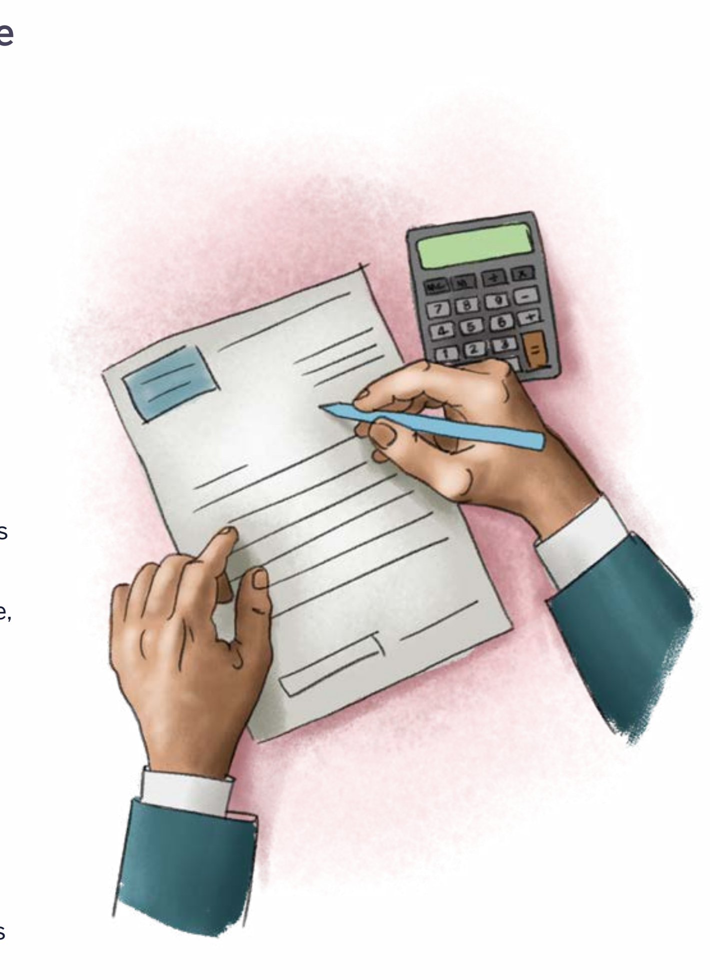
— It might be possible to carry forward any unused allowances from the previous three tax years.

When discussing pension contributions one of the primary considerations is the annual allowance. The annual allowance is the most you and your employer can save into your pension within a tax year before you are required to pay tax on those contributions. Depending on your taxable income the excess pension savings can be charged to tax in whole or in part at your marginal rate of income tax. In the 2023/24 tax year the annual allowance increases to £60,000.

However, there are limits to the tax-relievable contributions that can be paid. For personal contributions, you are permitted to make contributions of up to the greater of £3,600 or 100% of your annual earnings each tax year, capped at the annual allowance, in order to receive tax relief on them. However, your annual allowance may be reduced if you have either flexibly accessed your pension pot previously or you have a high income.

To focus on the latter point, as of the 6th of April 2016, a tapered annual allowance was introduced for higher earners, for which an individual's annual allowance was reduced by £1 for every £2 of adjusted income over £150,000 provided your threshold income did not also exceed £110,000. Adjusted income broadly being all taxable income plus employer pension contributions and threshold income broadly being all taxable income less personal pension contributions.

> **The annual allowance is a tax trap that is ensnaring individuals due to its complexity.**



However, as of the 2023/24 tax year, the rules changed in such that for every £2 of adjusted income over £260,000 (increased from £240,000), an individual's annual allowance is reduced by £1. This is good news for many who were previously restricted by this taper but will still serve as a bane to some. For higher earners still impacted by the taper, the minimum tapered annual allowance was increased from £4,000 to £10,000. This means that anyone with an adjusted income of £360,000 or above is now restricted to an annual allowance of only £10,000.

The calculation of annual allowance for higher earners can be the source of some confusion as there are numerous elements at play and as a minimum an individual would be required to know their income amounts chargeable to income tax and pension savings (including employer contributions) for the relevant tax year. This can be particularly troublesome for those with variable income arising from multiple sources. The consequences of not being aware of these amounts could be a tax charge known as the annual allowance charge. In order to calculate the charge applicable the total gross amount that has been contributed to pensions in excess of your annual allowance is added to your income for the year and then income tax is applied. For earners in excess of £260,000 threshold this would likely be 45%. This charge will be payable by the individual even in the case where the annual allowance has been exceeded through employer contributions. Subject to certain conditions it is possible to have the charge paid from your pension however, this is still not a situation many people would wish to find themselves in.

If you believe that you may be subject to the tapered annual allowance and as a consequence be subject to an annual allowance charge it is important to check with your accountant who will be able to work out your annual allowance and help you adjust your contributions accordingly. We have seen numerous high income individuals incur a large annual allowance tax charge as they were under the impression that they could pay in £40,000 (now £60,000) but were in fact restricted by this tapering. It is a tax trap that is ensnaring individuals due to its complexity, and often it is clients who do not employ the services of an accountant who fall foul of the rules.

It might be possible to carry forward any unused allowances from the previous three tax years. Ultimately this is a complex issue and one that could be detrimental to your long term financial planning were you to incur a large unanticipated tax charge however, this can be easily amended by proper and regular surveillance and seeking help from appropriately qualified individuals.

Anna Murdock
Head of Wealth Planning

In the 2022/23 tax year the annual allowance stands at £60,000

Is an annuity still the right option?

What is an annuity?

- An annuity is a retirement product that allows you to swap some, or all, of your pension savings for a regular income that's guaranteed to be paid for life.
- Annuities are provided by a handful of insurance companies, and how much you get will depend on the annuity rate offered by the provider at the time, as well as other factors.
- Unlike some other retirement options, you don't need to worry about how much to withdraw or what the stock markets are doing with the key benefit being that your income will be secure no matter what happens.
- Annuities can be bought any time from age 55 (rising to 57 from 2028). You can usually choose to have up to a quarter (25%) of the amount paid to you as a tax-free cash lump sum, and use the rest to buy the annuity. The annuity income you receive is taxed as earned income.

Demystifying Pensions

When retirement looms, we all wish for the reassurance and security that we will have enough money saved to sustain us for the rest of our lives. Nevertheless, time is uncertain and, if you'll forgive us for acknowledging mortality, no one knows when their time is up.

An annuity - that being a guaranteed income for life - was previously the 'go to' mechanism upon retirement to ensure your pension savings lasted for the remainder of your life. This was until 2015, when the shackles were loosened and a suite of pension freedoms were granted to allow, from age 55, choice as to how, when and if you can access your pension savings or pension pots (note this applies to 'defined contribution' pensions only).

Where in the past, the majority of people solely purchased an annuity with their pension pot, as of 2015 you were granted the choice to draw some, or all of your pension pot in one go, or at different times, or simply leave it.

There are now numerous ways to draw an income from your pension, including:

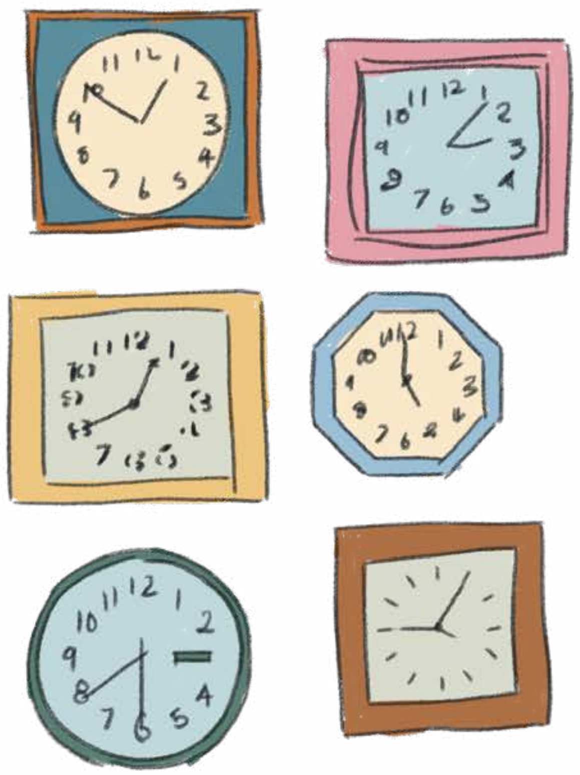
- To purchase a guaranteed annuity income for life or for a set period;
- To elect for flexible retirement income – this is called drawdown;
- To take the whole pot at once – known as 'Uncrystallised Funds Pension Lump Sum' (UFPLS);
- To take a mixture of all of the above or partial drawdown/UFPLS.
- To leave your pension invested;

It is important to stress that different options and solutions apply to different people, hence why a variety of options exists!

With regards to the traditional and, in effect, most restrictive option available, The Business School (previously Cass Business School) has commented that 'annuity rates are currently at an historic low and this is forecast to continue. If you die young the annuity dies with you and so you risk wasting your money by annuitizing too early.' People save for their lives to enjoy their retirement, and given the rates are at historic lows it's not surprising that they may wish to gain more value from their investment.

At present, should a 55 year old man in good health, purchase an annuity for £100,000 in which he receives a 25% tax-free lump sum (i.e. £25,000), at current rates he would receive the miserly sum of £2,575.32 per annum. Note that this example is inclusive of an annual 3% increase, which is an important feature to protect the value of the annuity payments against inflation. Source: Assureweb

> **“In the case of an annuity, unless specified when the annuity is purchased that it is done so under joint life, the payments will cease on your death regardless of age.**



In contrast, the retirement option of drawdown is more flexible than an annuity. You can draw as much money as you wish to at any time and leave the remainder invested achieving growth against inflation.

Nevertheless, it is important to note that without a guaranteed lifetime income providing longevity 'insurance,' the nature of a great number of people's habits of overconsumption alongside the 2015 pension freedom reforms, provides a case for many of not 'if' your pension pot will run out in later retirement - but 'when'.

People cannot manage longevity risk apart from extreme cases (such as terminal illness), but what they can manage is whom they may wish to receive their pension pot on death. From a legacy perspective, drawdown pensions offer greater sums to whomever has been nominated to receive your pension on death. In the case of an annuity, unless specified when the annuity is purchased that it is done so under joint life, the payments will cease on your death regardless of age.

What it boils down to is that we now have greater autonomy over our pensions and how we wish to use them, but this puts at risk the longevity of pension savings if poorly managed. At current rates, annuities are secure but offer a reduced return on investment. From a purchasing power and legacy perspective, if managed smartly and correctly, then for some individuals it can be attractive to utilise the freedoms afforded to us in 2015.

Simon Wong
Senior Wealth Planner, JM Finn

Pensions scams

Don't lose your hard-earned savings

Far from being a victimless crime, financial fraud, especially when stealing someone's pension, can be devastating and potentially leave the victim facing poverty.

Official figures from Action Fraud, the UK's national reporting centre for fraud and cybercrime, suggest occurrences of pension scams, while troubling, are falling year-on-year to £30m between 2017 and August 2020. However, the Pension Scams Industry Group, a voluntary organisation, says the figure is considerably higher, partly due to many people not realising they have been swindled until many years later. In fact, it estimates pension thieves have stolen a staggering £10bn from 40,000 victims since 2015.

The problem escalated in 2015 when we gained more choice in how to use our pension pots for different investments. While this allowed many people to improve their financial circumstances, it also allowed scammers to trick others into handing over their life savings. Support for victims of this type of crime is low, and very few ever recover their live-savings or receive compensation.

It's not only the naïve or confused who scammers successfully con. They regularly trick highly educated people, even those with experience in the financial sector. Their tactics are constantly evolving and are increasingly sophisticated, with polished websites and convincing testimonials that they have added to secondary websites to bolster their credibility.

> If they don't try and steal the money outright by gaining access to the pension directly, they can lure victims in with attractive, but unusual, investments.

If they don't try and steal the money outright by gaining access to the pension directly, they can lure victims in with attractive, but unusual, investments. Sounding 'too good to be true', these often guarantee better returns than on pension savings by exaggerating the potential earnings and downplaying the risks. Types of investment can include overseas property and hotels, airport parking, storage units, bonds for renewable energy, and forestry.

Often these 'opportunities' are unregulated and have no consumer protections. The investment structures are usually overly complicated, preventing careful analysis, and are long-term, which often mean people don't realise anything is wrong until much later. Common danger words and phrases used include: 'free pension review', 'loan', 'savings advance', 'one-off investment', 'government endorsement', and 'cashback' or 'cash bonus'.

Another common term to look out for is 'pension liberation'. This type of scheme involves persuading the victim there is a loophole for an early release of funds from their pension pot. This can be particularly dangerous as there are no such loopholes and doing so will leave the victim with large fees and/or tax bills of 55% from HM Revenue and Customs (HMRC).

Given enough time to consider these deals, especially if discussed with family, friends or an expert, most people will choose to err on the side of caution, but scammers work around that. Cold-calling, either on the phone or at home, used to be their preferred tactic but since 2019 it is illegal for anyone to do that about pensions.

While that still happens, scammers are now making contact through social media and via recommendations from duped friends and family to make them seem safe and legitimate. Once they have made contact, they use high-pressure sales tactics, such as suggesting the schemes are time-limited offers. They use couriers to send official documents to the victim's home, who wait until they've signed them, without giving an opportunity to properly read them or to consult with experts.

> **It's estimated pension thieves have stolen a staggering £10bn from 40,000 victims since 2015.**
>
> Pension Scams Industry Group

The advice for avoiding this financial disaster is clear

- It is illegal for anyone to cold call you about your pension. If anyone does, report them to the Information Commissioner's Office using their online reporting tool, or by calling 0303 123 1113.
- If you decide to go ahead with changes to your pension, always research who you're dealing with by checking they are authorised to do so on the FCA Register, or by calling 0800 111 6768.
- Visit The Pensions Advisory Service website MoneyHelper for impartial guidance, or get financial advice from an FCA-authorised financial adviser.
- If you have already transferred your pension and have suspicions, contact your original pensions provider immediately. They may be able to stop the transfer.

Should I stay or should I go?

There are around 11.8 million people who have built up benefits in private sector defined benefit pensions and its seems that higher transfer values are increasingly tempting people to leave these so called "gold-plated" schemes.

There has been a huge increase in interest in defined benefit (aka Final Salary) pension scheme transfer values since new pension freedoms legislation was introduced by Chancellor George Osbourne in 2015. According to the FCA, 34,053 people were provided with a recommendation to transfer or convert their defined benefit pension between April 2020 and September 2021 alone[1].

The Financial Times previously reported "cash lump sums offered to individuals looking to give up generous final salary pensions have jumped to records highs." According to the insurance company Royal London, six million people with defined benefit pensions have seen their transfer values increase significantly. The insurer suggests some members are being offered "eye-watering" sums, often tens of thousands of pounds more than several years ago. For an individual with a pension income worth £20,000, it is not uncommon to be offered 30 times that amount, in other words, £600,000 in cash.

A Royal London survey of more than 800 financial advisers found growth of more than 50% in the volume of transfers out of defined benefit pensions taking place in 2017, with the most common transfer value lying in the £250,000 - £500,000 range[2]. The vast majority of clients transferring were in their 50s, and the typical cash sum offered is between 25 and 30 times the value of the annual pension given up.

So why are so many people transferring out of these schemes that offer a guaranteed payment for life? The answer is twofold: Transfer values for defined benefit schemes have been at inflated levels recently and secondly, the recently introduced pension freedoms that provide for vastly improved flexibility in how a pension can be taken applies to Defined Contribution (DC schemes) only.

[1] The figures are according to https://www.fca.org.uk/freedom-information/data-defined-benefits-pension-transfer-activities-february-2022

[2] https://www.actuarialpost.co.uk/article/people-choosing-cash-lump-sum-over-regular-pension-income-12233.htm

Inflated transfer values

Transfer values are the sums paid from a pension scheme when a member chooses to withdraw their entitlement. In the past, lack of knowledge and lethargy meant many people kept pensions in previous employers' schemes until they came to retirement.

The level of a transfer value from a defined benefit scheme is not specified in the scheme's rules, unlike other benefits. The terms used are set by the trustees, on the advice of the scheme actuary, at the time of the transaction. Transfer values paid from defined benefit schemes are the only ones that require assumptions about the future. Also, due to the pooling of risk between members, the level of transfer payment can also affect other people's entitlements. The scheme actuary's aim is to calculate the "best estimate" of the amount needed to buy the equivalent to the scheme entitlement. The actuary has to tread a careful line to be fair to both sides, ensuring any transferring member and those remaining in the scheme are not left worse off. The actuary also has to be mindful that schemes have to guarantee their transfer value quotations for a period of at least three months to give members time to make arrangements with an insurer.

So let's briefly look at the reasons for the increased transfer values in the last couple of years which has sparked increased interest from members.

Transfer value calculations require assumptions about discount rates, inflation rates and demographic assumptions, all of which apply many years into the future and so there is considerable uncertainty over how these factors will play out. Discount rates are often based on long-dated bonds adjusted for the scheme's actual asset mix. Currently gilt yields are at low levels, which results in lower discount rates and higher transfer values. At the same time, the long-term inflation rate outlook has risen, which also tends to increase transfer values in many defined benefit schemes.

Experience suggests that those who have requested and received inflated transfer values may also have told their friends and families about the relative size of their transfer values, encouraging more people to consider transferring.

> **Cash lump sums offered to individuals looking to give up generous final salary pensions have jumped to records highs.**
>
> The Financial Times

Pension freedom

Members transfer for different reasons. They might feel more secure with a policy in their own name, in case anything happened to the scheme; the BHS pension debacle in 2018 is an example of this. Or perhaps they want to have all their pensions in one place. It also allows defined benefit members to tailor their pension to suit their own needs, where these differ from those in the scheme's rules, for example by:

- Taking their pension earlier or later than the scheme rules offer
- Allowing for different levels of inflation protection
- Altering the level of dependants' pensions to provide more or less for a spouse, or to remove them completely if they have no dependants

Pension freedoms introduced in 2015 changed this in a big way, encouraging more members to transfer. Since 2015 holders of defined contribution plans:

- Do not have to buy an annuity
- Can draw their pension flexibly
- Can even take the whole pot as cash, although this would be subject to tax

The important point is that these freedoms only apply to members of defined contribution schemes, so if defined benefit scheme members wish to take advantage of the flexibilities, they must transfer. Publicity over the new legislation also seems to have spurred people into considering their own pension and taking action.

It must be noted however, that if a scheme is underfunded, paying out a full transfer value could mean remaining members are left worse off. Underfunded schemes, those with a poor outlook for returning to full funding, may reduce transfer values (an "actuarial reduction") so as not to disadvantage those left behind even further.

For an individual with a pension income worth £20,000, it is not uncommon to be offered 30 times that amount, in other words, £600,000 in cash.

Transfer incentives

Over the past few years, more defined benefit schemes have closed and sought to reduce the risk in their scheme. BP confirmed in early 2021 that it will close its defined benefit pension scheme to future accrual and retail giant British Airways told its active defined benefit members that they will no longer be able to accrue additional benefits.

One way to further reduce risk for the scheme trustees is to reduce the number of members and the size of the scheme's liabilities, which means the members who transfer out are helping the de-risking process. This has led some schemes to offer incentives, by increasing transfer values, as an inducement to transfer away.

> The typical cash sum offered is between 25 and 30 times the value of the annual pension given up.
>
> Royal London

Should you stay?

While obtaining the cash value of a defined benefit pension may be beneficial for some people, there can be significant disadvantages. Keeping a defined benefit pension is sensible for many people, as they offer:

- Certainty: such pensions pay an income for life
- Inflation protection
- Risk-free income, which does not depend on the ups and downs of the stock market

It is a regulatory requirement that anyone seeking a transfer over £30,000 must seek advice from a suitably qualified financial planner and the trustees of the ceding defined benefit scheme must ascertain that this has been done. Otherwise, the transfer is not permitted.

We would encourage members of defined benefit schemes to seek advice to review their situation and their entitlement from the scheme, including the benefits at retirement and the relative transfer value offered. The advice process can often be complex and a member should consider carefully their options with their adviser. Giving up a guaranteed payment for life is a big decision so any action should not be taken without due consideration.

Simon Wong FPFS
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