PENSIONS

Be careful when you quit your final-salary pension

Taking out your money at 55 could cost you 50 per cent of its transfer value

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George Osborne introduced pension reforms when he was chancellor, allowing people to withdraw some or all of their pension pots ANTHONY DEVLIN/PA

If you are one of the savers with a defined-benefit pension, you may be hoping to take advantage of new rules that allow you to access your money from the age of 55.

About 200,000 people have been lured by sums averaging over £250,000 to move from a guaranteed pension into a riskier, but more flexible scheme. However, the age at which you transfer your savings can dramatically affect the amount you are given.

Pension savers in their fifties leaving their gold-plated pension schemes are being given lump sums equivalent to just half of what they would have received if they stayed in their scheme. Leave it until the year before you retire to make the move, and you will be offered far more.

The difference between how much you're offered to leave the security of a defined benefit scheme could be crucial in ensuring that your money lasts throughout retirement. The Financial Conduct Authority (FCA), the city regulator, is investigating whether thousands of members of the British Steel pension scheme were given poor advice and encouraged into leaving the scheme. This week the FCA revealed that a single company advised more than 800 steelworkers into walking away from their guaranteed pension before the regulator halted its activities over mis-selling concerns.

LCP, an actuary, says that most defined-benefit pension schemes are offering 55-year-olds transfer values (or lump sums in lieu of their future pension) of between 45 per cent and 55 per cent of the value of their savings. The average figure was 57 per cent.

Its research found that transfer values rise substantially as the saver nears retirement age. Scheme members who are a year from retirement could expect to be offered an average of 73 per cent of the value of their pension. Most DB schemes offered between 70 per cent and 80 per cent.

Jonathan Camfield, partner at LCP says: "Our research shows that ten years ahead of retirement, people who are considering transferring out of a company pension will typically be told that they are giving up around half of the full value of their pension.

"This does not necessarily mean that transferring is a bad idea, but it does show very clearly that those who transfer out are forgoing a great deal of certainty about their future retirement income and that this certainty is of considerable value".

LCP's research looked at 200 pension schemes from different industries ranging from £100 million in size to over £10 billion. It calculated the transfer values savers were being offered as a percentage of the replacement cost of the benefits they were giving up. Defined benefit (DB), or final-salary pensions are considered the most secure and generous of pension schemes because they commit to paying members guaranteed sums for life in retirement. Typically they offer lucrative perks such as inflation protection and spousal benefits which are expensive to replace outside of the scheme.

These cash lump sums are offered in lieu of future pension entitlement and the money is typically moved into a defined-contribution pension. Since the pension freedoms came into effect in 2015, savings in a defined-contribution pension can be dipped into from the age of 55 and either reinvested, used to provide an income, withdrawn entirely or used to by an annuity.

LCP’s research also highlighted the wide difference between the size of lump sum that different pension schemes offer. For members aged 55 some quoted as little as 40 per cent of the full value of their entitlement, while others offered over 80 per cent. “There are good reasons for this, but it may come as a surprise to some scheme members,” says Mr Camfield.

Last year, more than £20 billion was transferred from DB schemes. Experts have warned that people may be impoverishing themselves as the amount of money they receive fails to last throughout a long retirement. Steve Webb, the director of policy at Royal London, an insurer, says: “It is vital that people have a clear understanding both of the advantages of transferring and of the valuable benefits they are giving up.”

There are calls in the industry for the introduction of partial transfers, where people take some of their benefits early as a lump sum and agree to receive a lower pension in retirement.

Pension trustees work out transfer values based on advice from their actuaries and estimated investment returns. Schemes with more adventurous investments tend to offer savers lower transfer values than schemes which take a more cautious investment approach. This is because a higher-risk investment style is expected to create higher returns, and so the schemes perceive they can afford to let members leave with lump sums.

Mr Camfield believes that transfer values are likely to increase over the coming years. “This is because most occupational pension schemes are gradually changing their investment mix towards lower risk and lower return assets. This makes it more expensive to provide pension benefits and therefore increases the amount schemes are willing to pay someone who is prepared to transfer out,” he says.