



## Clients with funds in final salary schemes?

**F**ollowing the collapse of a number of high profile companies offering defined benefit pension schemes, concern is growing among final salary scheme members about the security of their pension.

Two recent surveys spell out the difficulties such schemes are facing. Two thirds of schemes open to new members are considering changes in the next five years, according to the National Association of Pension Funds (NAPF). It is unlikely that these 'changes' will be positive news for scheme members, and many schemes will consider closing to new members and/or restricting benefits to existing members. This is likely to affect a huge number of individuals. In a separate report, the CBI states that pension scheme funding has fallen from a surplus of £53bn in June 2008 to a deficit of £218bn in March 2009.

People concerned about the solvency of their current or former employers may consider transferring their fund into a personal pension plan (PPP). This option is now more appealing than it used to be. Although scheme deficits have increased, changes which came into effect last October have increased transfer values, in some cases by a considerable amount. Transfer values are now calculated on a scheme specific basis, often with higher mortality assumptions which increases the transfer value. On top of this, the yield from gilts, used to determine the

returns on final salary schemes, has fallen, resulting in lower rates of return and therefore higher transfer values. In addition, some employers are even offering cash incentives on top of the transfer value, to encourage employees to leave.

Whether an individual should transfer out of the scheme is a complex issue and specialist advice should be taken. The decision will depend on both personal and commercial factors that require careful consideration.

At Lighthouse Group we have a specialist department that can review an individual's final salary pension and provide a formal report and recommendation.

The report will provide the member with a 'critical yield'. This is an estimate of the annual return required for the transfer value to match the pension that the member will give up on leaving the scheme. We also include a second critical yield. This shows the annual return required to match the pension provided should their employer (or former employer) fail and their scheme enter the Pension Protection Fund, (PPF) the compensation scheme for members of final salary schemes where the sponsoring employer has become insolvent – the PPF rarely provides the 90% level of benefit that it is perceived to offer.

Some members are particularly vulnerable to having

their benefits scaled back if their scheme was to enter the PPF, such as high earners and members who built up benefits prior to 1997. Once a scheme has entered the Pension Protection Fund, the transfer option is lost.

### The decision depends on many factors, as these scenarios show:

	Mr Poorman	Mr Middleman	Mr Richman
Date of birth	05/03/1970	01/11/1960	05/03/1950
Joined scheme on	01/01/1990	01/01/1995	01/01/1980
Left scheme on	31/12/1996	31/12/2004	31/12/2004
Salary	£15,000	£40,000	£150,000
CETV (transfer value)	£32,000	£60,000	£1,000,000
Scheme pension	£2,490	£6,859	£74,088
PPF pension	£2,241	£6,173	£66,679
Revalued at 65 (scheme)	£9,327	£11,459	£93,974
Revalued at 65 (PPF)	£4,596	£10,053	£35,583
Capitalised value of (scheme)	£198,245	£241,149	£1,927,944
Capitalised value (PPF)	£72,254	£197,309	£611,084
Critical yield at 65 (scheme)	7.7%	8.6%	9.0%
Critical yield at 65 (PPF)	4.0%	7.5%	-3.8%

**We would be pleased to offer your clients in final salary pension schemes a report on their current position, free of charge. To take advantage of this and for further information please contact Mark Dallas, Managing Director, on 07899 981607 [Mark.Dallas@lighthousegroup.plc.uk](mailto:Mark.Dallas@lighthousegroup.plc.uk).**