Helping you to understand your defined benefit pension

If you are a member of a **defined benefit (DB) pension scheme**, sometimes known as **'final salary'** or **'career average'** schemes, you can generally consider yourself to be very fortunate. It can however, be difficult to know what exactly it is that you will get from them.

The aim of this guidance is to cut through all the jargon and help you understand and appreciate what you are entitled to, particularly if you are thinking of transferring your benefits to another pension plan.

How they work

Defined benefit (DB) schemes are corporate, or company, pensions that you and your employer pay into regularly, building a communal pension fund that is kept separate from the business.

The scheme uses this fund to pay you a **guaranteed pension income** when you retire, calculated using your salary and how long you worked for the sponsoring employer. Once it starts, this income is paid for life and isn't affected by investment performance.

Although you are a member of the scheme, you do not 'own' any of the fund. Your entitlement to a future income may however, be valued and expressed as a cash amount which is based on the *estimated* cost to the scheme of providing it.

This amount is called the Cash Equivalent Value (CEV), but it only matters if you decide to transfer your benefits. (see below). *If you take your pension from the scheme, you will receive the promised amount regardless of these variables.*

What you'll get when you retire

DB pension schemes provide extremely valuable benefits to their members, which are difficult to replicate if you transfer to an individual pension plan.

- A **guaranteed income for life** – a DB pension is guaranteed to be paid to you from the '**normal retirement age**' **(NRA)** of the scheme, usually 60 or 65, for as long as you are alive to receive it.

  Even if the original employer goes bust, and there isn't enough in the pension scheme to cover future payments, there's a lifeboat called the **Pension Protection Fund** which will provide a similar amount.

- A **tax-free lump sum** – you are also entitled to a Pension Commencement Lump Sum (PCLS) when you retire, commonly known as 'tax-free cash'. Some schemes will automatically provide this; others give you the choice between taking the maximum pension amount, or a reduced pension with tax-free cash up front.

- **Protection against investment risk** - The amount of your pension is set at outset and is unaffected by investment conditions. This means **your income will not go down** when markets perform badly, even in the event of a significant crash such as 'Black Monday'.

- **Inflation-proofing** – most DB schemes increase the amount of your pension each year, meaning that your income should keep up with increases in the cost of living.

- **Death benefits** -DB pensions usually provide a reduced income to your spouse or civil partner if they outlive you, and sometimes to any dependent children as well. A lump sum may also be payable if you die while still in service with the employer.
- **Early/late retirement** – Most schemes let you take your pension before the NRA, but the income will be reduced because it is likely to be paid for longer. If you continue working beyond the NRA, your pension is usually increased to reflect the shorter expected payment period.

In summary, a DB pension will provide you with a known amount of income in retirement, which will be paid to you for as long as you live.

Transferring your benefits

You will not lose your entitlement to a future pension if you leave service and move to another firm, however your future pension will only be based on the years that you worked for the original employer, and it will not be paid until you retire[1]. This is known as a '**deferred pension'** (sometimes also referred to as '**safeguarded rights'**).

- You can transfer your entitlement to a 'flexible' pension arrangement which may be used to provide a pension which is a better fit for your personal circumstances.
- The scheme will advise you of the current cash value of the deferred pension, known as the **Cash Equivalent Transfer Value (CETV)**.

  The CEV depends on several factors, such as interest rates, changes to longevity assumptions and the state of investment markets, and it will therefore vary depending on when the calculation is carried out. It is usually guaranteed for **three months**, after which a new valuation is required, which may be higher or lower than the previous value.
- **If you transfer your benefits from a DB pension scheme to a personal pension, or Self-Invested Personal Pension (SIPP), you will be giving up the guarantees described above.** Consequently, for many people, the best option would be to keep their DB pension and not to transfer it.
- In order to protect you, if your CETV is above £30,000 there is a **legal requirement** to take professional financial advice before transferring out of a DB scheme. This must be delivered by a qualified **Pension Transfer Specialist** (PTS) who has permission to advise in this area.

Things to consider

There are many things to consider before deciding to transfer your benefits, including:

- **Are you used to receiving a guaranteed income?**
- **Are you happy to take investment risk, even if this means you could lose out?**
- **Do you have other pensions or investments to fall back on if necessary?**
- **Are you prepared to pay for professional advice before you transfer?**

Take a look at our separate guide '**What to think about before transferring your DB pension benefits**' for more on this.

[1] You do not actually have to stop work, but you must be over the minimum pension age before you can take benefits.