DB Schemes and Enhanced Transfer Values

Defined Benefit (DB) schemes regularly review how to manage their future liabilities and one exercise that many will undertake is to offer deferred members an ETV (Enhanced Transfer Value). This amounts to their Standard Transfer Value based on their future pension entitlement under the scheme plus an additional incentive. This is normally offered for a limited period and many schemes will require members to obtain financial advice from an advisor appointed by the scheme before allowing them to accept.

ETV Example

Comparing the value of an ETV requires a comparison with the standard TV and the potential benefits that are being given up.

If the members defined benefit pension had been valued by the scheme at €350,000 based on the standard transfer value calculation for a Defined Benefit Scheme and the scheme was offering an enhancement of 20%, then the total Enhanced Value Transfer would be €350,000 + €70,000 = €420,000

The ETV offer places members under no obligation to accept the Transfer Value and many will choose to retain their deferred benefits under the scheme. However, it will be of interest to some members who may favour the flexibility that the transfer value can provide or whose circumstances may favour an alternative approach to retirement.

Although the transfer value offered may look attractive, it is important that clients understand exactly what they are giving up in exchange for this transfer value and the risks involved. Before deciding whether to accept an Enhanced Transfer Value, clients should always seek advice from a Financial Advisor. They will take their personal circumstances into account and help them weigh up all the pros and cons involved in transferring to a Defined Contribution Arrangement such as a Personal Retirement Bond or similar arrangement. Clients can then make an informed decision on the transfer value being offered.

Some (but not all) of the issues which would need to be considered are outlined below:

	Defined Benefit Scheme	Taking a Transfer Value
Certainty	A Defined Benefit arrangement offers a degree of certainty as the member is promised a pension on retirement. This pension may or may not also include annual increases and a spouse's pension which is a percentage of the original pension but payable to the members spouse after their death.	Taking a Transfer Value transfers the Defined Benefit pension into a monetary lump sum. This is invested in line with the members risk appetite. The members retirement benefit depends on the future performance of their investment and the charges.
Flexibility	Defined Benefit schemes offer limited flexibility to members. Members may be able to: • Exchange some of their pension for a lump sum on retirement. • Although not common in some instances they may also take retirement benefits early but at a reduced level of pension (subject to any scheme specific conditions).	A Transfer Value offers more flexibility relative to a Defined Benefit plan. Members can: • Decide on the investment strategy and change it at any stage. • Choose the form in which they take benefits on retirement, subject to Revenue rules. • Access benefits early under Revenue early retirement rules (Age 50 under a PRB (Personal Retirement Bond) where they have left service).
Income in Retirement	The scheme will provide a pension which will be known in advance of retirement. The pension is subject to Income Tax and the Universal Social Charge.	Clients have a choice between an Annuity or an Approved Retirement Fund (ARF) or a mixture of both. An annuity will provide a fixed income for life whereas an Approved Retirement Fund keeps the members money invested throughout retirement with a retirement income provided via regular withdrawals from the ARF. Payments under an Annuity are subject to Income Tax and the Universal Social Charge. Payments under an ARF are subject to Income Tax, Universal Social Charge plus PRSI up to State Pension Age.
Pension Lump Sum	Some Defined Benefit schemes allow the pension to be commuted or reduced in return for a lump sum. Clients may also have Additional Voluntary Contributions (AVCs) outside of the Scheme which can be used to provide a pension lump sum. The taxation of the Retirement Lump Sum will be subject to the usual limits.	Clients will have the choice to either take a lump sum based on: 25% of the fund, or Under the salary and service method. The taxation of the Retirement Lump Sum will be subject to the usual limits.
Health Issues or Reduced Life Expectancy	The benefits payable on death tend to differ both before and after retirement and between schemes. These benefits are detailed in the scheme rules which should be consulted.	Where members are in poor health, and have a lower-than-average life expectancy, they may prefer to take a transfer value. On death under a PRB, the full value of the fund could be paid to the members estate. It would be assessable to Capital Acquisitions Tax (CAT) depending on the recipient. There is no CAT between spouses so a spouse could inherit the full value of the fund Tax Free. Children would have a lifetime threshold of €335,000 for an inheritance from parents. Where funds are held in an Approved Retirement Fund, the ARF can pass on to the spouse who can take ownership of the existing contract with future withdrawals subject to Income Tax, USC & PRSI (prior to State Pension Age). The ARF Fund can also be passed to children with a flat 30% tax rate applicable for Children over 21 and CAT rules applicable for Children under 21 (Children would have a lifetime threshold of €335,000 for an inheritance from parents)
Risk – Financial Strength	A Defined Benefit scheme relies on the strength of the scheme and on the employer covenant to pay benefits for all members. Longer term, poor investment returns could lead to the inability to pay member's benefits in full.	Taking a Transfer Value means the clients retirement benefits will depend on the investment returns the transfer achieves. Investing in an Approved Retirement Fund means that they are exposed to that investment risk throughout retirement.

Try our Defined Benefit Transfer Tool

Available from the "Advisor Tools" on our secure Broker site. Our Defined Benefit Transfer tool pulls together a comprehensive report for your clients. This has been designed to assist members of Defined Benefit pension schemes, if they are offered a Transfer Value or Enhanced Transfer Value to transfer from their scheme into a Personal Retirement Bond or similar pension vehicle.

The purpose of the report is to help clients understand some of the advantages and disadvantages associated with remaining in the scheme and those associated with accepting the Transfer Value. It is important to understand that the report does not account for all the risks associated with remaining in the scheme, nor does it account for all the risks inherent in taking the Transfer Value.

This is a big decision for members and will impact their future retirement so before deciding what to do, members should always ensure that they speak with a Financial Advisor.

If you have further questions on any aspect of this briefing, please contact your Broker Consultant or the TechTalk Team on 01 209 2020 or techsupport@zurich.com

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