FINAL SALARY PENSIONS (FSP)

There's Nothing Better

Summary

This month we look at the merits of a final salary pension scheme and the beliefs/mindsets that many people have established from the day they joined the scheme.

There is clearly a mindset that has been established over the years, that there is nothing better than a Final Salary Pension. This has come from history, where, people joining a company pension would benefit from their own contributions, but more importantly the company contributions. These can be very significant, and people have no idea what those numbers are. Being a member whilst you are working with the company is a very valuable benefit. However, when the scheme closes or you leave employment, then other options exist then simply taking the money form the company.

A final salary pension is simply a deferred annuity. A guaranteed income that will be paid to you when you get to retirement age or earlier if the rules allow. Whilst the membership part is very valuable, once you leave the scheme, because of scheme closure or you leave the employer, then there are other options that can be taken. Sometimes these options can give significant gains. Examples such as

- increased tax free cash by an extra £100,00,
- increased pension income by an extra 30% or 60%, and
- extra benefits to spouse/family, such as a full pension or an unspent pot equivalent to say 20 years income upfront and tax free.

Now let's look at the main features of the company pension schemes.

Cost versus Future Planning

When you join a company pension scheme, one of the first thoughts are 'how much will it cost'.

The mindset includes things like *When I joined the company, retirement seemed a long way off. I was working for an established company, and was being told that the benefits were good, so why would I disbelieve that?*

However, for those who have joined the FSP, when they get to enjoy the full benefits from a well run/well funded pension, that cost becomes an investment.

The last thing I was thinking about in my 30's, 40's, 50's was my pension. I knew it was there and I was contributing every month and the company was too.

We all thought that drawing our pension was such a long way off. We were more concerned over the cost of being in the scheme and it reducing our monthly salary.

A cost is something where there is no reward/gain. An investment is where there is a pay off/return on the effort. So, instead, the mind focuses on the benefits.

Knowing I was part of a plan that would allow me to have visibility of my future pension was hugely reassuring. I had little knowledge of pensions, so I felt I was in good hands.

I realise how lucky I was that this scheme was available to me and my only regret is that I did not join sooner!

My employer told all joiners how the figures were calculated and how the payments would be taken from the monthly salary.

A Pension Linked to my Final Salary

A career minded individual will really benefit from a Final Salary Pension as long as they retire at the peak of their career! Most pension schemes definition of Final Salary is linked to the last 3 years earnings. For those who time it right and peak at retirement age, it works out well. If you reduce your hours or reduce your responsibilities, then you could lose out.

Those with career minds think that The Final Salary pension was seen as an attractive thing for hospital doctors because when one retires, one assumes you are at the top of your salary range and therefore your pension is based on that top salary/maximum salary.

Those who like the guarantee of an income in retirement, believe that *the NHS/Civil Service would provide a good pension which was index linked and would provide for us all until the day we died, if we paid our contributions.*

A Gold Standard Pension

Employment packages come with pension benefits. If it is linked to your salary, then the liability is on the employer to pay the promise. The promise is a combination of your salary and years' service. The longer you work the higher the number. You pay say 5% of your salary, and the employer has to pay the balance. i.e. whatever it takes to cover the cost of the pension liability. Typically, this is 25% - 30% of your salary/payroll.

My pension was part of my employment package. I was told it was one of the benefits of working for ABC. There was no reason to look for an alternative pension, so I stuck with it whilst employed with ABC.

Whilst you are employed and a member of the pension, then the amount of money being added is a very valuable benefit. Even for those who leave early, for family reasons, it can still provide a cash refund to give you a support when you need it.

I was only part of a final salary pension scheme for 2 years back in the 80's. I left the company to have my first baby (33 years ago) and cashed it in it was so small.

Joining a company pension scheme is a valuable thing to do and can be the best thing that you do.

We assumed we had to be in the pension membership and it was the best pension offer. We didn't ask any questions.

I believed the final salary pension must be a good deal.

The NHS pension is the best and most secured pension – so take it and don't opt out.

I joined my pension at senior level. I knew it was better than the basis company pension, it was called 'executive pension'.

When I first started work, we were all signed up to the company pension scheme. There was no alternative. We were told it was the best thing since sliced bread. I believed this to be true.

We were told the ABC pension was gold plated and that it was linked the DEF pension. The government would always see it right no matter what. Why would I leave this for something else?

It seemed to me that this was gold standard in pension terms, compared to others I had read about or friends were part of.

However, at the point of retiring, there can be very valuable alternative options that are not offered by the scheme administrators because they are unable to give advice.

The Employer's Commitments

The employer has to ensure that the pension scheme is well funded and that the members receive statements showing what they have built up so far and what they are likely to get in the future. From time to time, usually annually, the scheme will provide a statement showing what you have built up to date and then illustrate what you may get in the future assuming your salary grows and you don't leave. Over the years, the cost of these schemes has become more and more costly to companies, so they have modified the scheme membership in order to reduce the ever increasing costs.

I wondered how the business could afford the pension given how generous it seemed. It did become an issue later when the scheme closed to new employees and switched to a career average scheme rather than a final salary scheme.

People mostly get their information from their peers. This can be because the administrators are inaccessible, the employee can't find the time to make the necessary telephone calls to the pension administration team, or they don't want to ask the stupid questions and be made to feel like a fool. In my experience, the scheme administrators, secretaries to the actuaries and the like can be very critical and judgemental. Here are some real quotes from the secretary to the trustee.

The scheme went to some expense to get the actuary to split out the relevant assumptions……you appear unable to make use of them……we have reached the end of our correspondence. The CETV basis is not open for debate… if this is how they treat a professional, what chance has the general public?

We were given regular updates and informed of any changes. We discussed it amongst us as employees to clarify our understanding.

Index Linked Pension in Payment and Family Benefits

Index linked pensions are useful when inflation takes off. Inflation used to be linked to interest rates; interest rates were always higher than inflation. So, if you put your money in the bank, then the interest received was higher than inflation. Happy days.

Since 2008, the reverse is true. i.e. interest rates from the bank are lower than inflation. Putting your money in the bank for retirement/growth planning, doesn't work anymore.

Widows benefits are between half and 2/3rds of the members pension.

It would provide a good widow or widowers pension and provide for our children until they were age 18.

I have looked at the numbers several times and considered taking the money out instead (CETV). I find it hard to see how else I can be guaranteed that pension income any other way than by staying in the scheme.

Conclusion

A well funded final salary pension scheme gives peace of mind, security of income in retirement and security of income to a widow/widower, with no responsibility or hassle for the member. However, there are other options. Our philosophy is to educate and empower people to make good choices based on the options in front of them. We like to ensure the data is accurate, understood correctly, and clear, before making any choices.