Pension decision time is looming

Changes to retirement schemes will leave many out of pocket

Terry Shields, from Reydon, Suffolk, has been offered an increase in payments on his ITV final-salary pension now if he gives up future inflation-linked rises

Jennifer Hill

ONE MILLION workers will be stripped of their final-salary pension benefits over the next three years — and employers are already scaling back perks.

Three-quarters have closed their final-salary schemes to new members, and almost half expect to shut up shop for existing members by 2012, according to research by Watson Wyatt, the consultancy. Companies are also increasingly looking at other ways to reduce their pension liabilities. Here, we look at how they may change your benefits, and offer some advice.

What might companies do?

A total of 41% of businesses are thinking about making members contribute more to their schemes, according to a separate survey by Hewitt Associates, the consultancy.

About 34% are considering lowering the rate at which members accrue benefits and 31% may move from payouts based on final salary to those based on workers' average earnings over their careers.

Meanwhile, members of ITV's final-salary scheme have been asked to accept an increase in payouts now in return for giving up future inflationary increases. Companies are also offering lump sums for transferring out but it can be difficult to work out if you are getting a fair deal.

Should I give up index linking?

ITV has asked the 10,000 pensioner members of its final-salary scheme to accept a boost to their funds in return for giving up future rises in line with inflation. The other 12,500 members of the scheme, which had a £538m deficit at the end of June, will be asked to do the same when they retire.

Terry Shields, 58, from Reydon, Suffolk, is in the former camp. He started receiving a pension from ITV at the age of 50 and is getting £13,899 at present. If he accepts the higher payout, he will receive £15,595 a year — but will forgo inflationary increases of up to 5% a year.

Steve Hunt, at Rockingham Retirement, an independent annuity broker, said: "We are in a deflationary environment just now but anyone who thinks we're not going to have a period of high inflation in the next 20 years is living in cloud-cuckoo-land."

The broker's research shows that a pension of £14,000 will in effect be worth just £8,594 in 10 years — a fall of 38.6% — if inflation runs at 5%, as this erodes your spending power.

Shields' decision largely depends on how long he expects to live and what he thinks inflation will run at in the meantime.

Laith Khalaf at Hargreaves Lansdown, an adviser, said: "If inflation runs at 3.25% a year, he'll be better off keeping his index-linking if he lives for another 15 years and 10 months — so to age 74."

Someone of his age can expect to live until 85 — another 27 years — according to the Government Actuary's Department, so on this basis he'd be much better off turning down a boost to payouts now.

Inflation would need to run at 1.8% or less for fixed higher payouts from today to beat index-linking if Shields lived until 85, Khalaf estimates.

Inflation, as measured by the retail prices index, has averaged 2.7% a year over the past decade — making a figure of 1.8% or below unlikely.

However, Khalaf said: "If he smokes or has any medical complaints that mean he doesn't expect to live that long, then the increased flat pension becomes more attractive."

Think, too, about your other pension income and whether that benefits from index-linking.

Should I transfer out?

Workers who want to move out of a final-salary scheme are offered a lump sum by employers, roughly the amount you need to invest in a personal pension to produce the same benefits — based on an assumption about future investment returns.

The lump sums on offer have gone up recently because returns, as measured by gilt yields, have gone down — meaning employers need to give workers more to produce the same benefits. At the same time, some firms are offering enhanced transfer values to cut their liabilities.

Another reader, who did not wish to be identified, has built up a sizeable pension after almost 30 years' service at a big British company — and has been given transfer values varying from £350,000 to more than £450,000 in the past year. "There's no consistency at all and it's very difficult to understand how it can vary so much over such a short period of time," he said.

John Richardson at Towry Law, the adviser, said: "Final-salary schemes offer valuable promises that would be extremely difficult to replicate elsewhere. For that reason, the default position for most employees will be to stay where they are."

Make sure you seek independent advice. "The adviser may only get paid if they recommend the employee leaves the final-salary scheme so there's a danger this can lead to inappropriate advice," said Richardson.