

Transferring out of a defined benefit pension scheme

Pension Guide – Information for members

BAE SYSTEMS

If you are an active (or in service) member of a Defined Benefit BAE Systems pension scheme and are considering leaving the scheme this guide provides important information about leaving the scheme and taking a transfer value.

The Trustee, the Company and the Scheme administrator cannot provide you with advice about how to exercise the options available to you. We would ask you to take the time to read this note carefully before taking any further action.

Opting out

It is recognised that with the pension flexibilities introduced in the UK from April 2015 (please refer to the separate *Pension flexibilities Pension Guide* for more information), Defined Benefit members may be thinking about opting out of their scheme, so that they can then transfer the value of their benefits to another arrangement that would permit them to utilise the flexibilities.

It is important that as an active member you fully understand that by opting out and transferring your scheme pension you would be giving up valuable rights and that to do so would be a decision that cannot be reversed. It is not possible to re-join your current scheme (other than as a member of the BAE Systems Defined Contribution Retirement Plan), reactivate membership or reinstate benefits.

Members with Defined Benefits (DB)

The pension flexibilities do not apply to DB benefits. However, DB members who have left pensionable service and have deferred benefits in a DB scheme may, subject to certain legislative requirements, transfer the value of their DB benefits to a Defined Contribution (DC) pension arrangement. It is then possible to use the DC pension flexibilities. This is because, the DB benefits when transferred to an alternative arrangement are converted into a DC fund.

It is important that anyone who is thinking about leaving membership of a scheme understands the difference between DB and DC pension arrangements. A summary of these differences is drawn out below.

Key differences between DB and DC pensions

- A DB pension (also referred to as a final salary pension) is based on a prescribed calculation – broadly speaking, on a member's length of service (as an active member of a scheme), their earnings near retirement and the scheme's specific accrual rate. With a DB pension the level of pension is known but the cost of providing it is not because it depends on how long the recipient lives in retirement. The certainty of knowing what the retirement income is can give increased security when it comes to planning for retirement. The cost of providing the pension and the uncertainty of how

long it will be in payment for sits with the company sponsoring the pension scheme and not the member.

- With a DC pension the contribution made into it is known, but the benefit or income from it is not – there is *no guarantee*. The retirement fund built up in the member's individual pension pot to provide an income in retirement is not certain. Once the fund is converted into a pension this then provides a guaranteed level of income, but the DC pension pot will rise and fall in line with the performance of investments less any charges that might apply. The member bears the risk of this and not the company sponsoring the pension scheme.
- Once in payment, a pension from a DB scheme will increase annually in accordance with the Rules that govern the scheme. If a member becomes too ill to work, all BAE Systems DB schemes have the provision to provide an immediate ill health pension irrespective of age, but only if the member meets the scheme's specific definition of ill-health. Valuable death benefits are also provided under all BAE Systems DB schemes, with a pension usually being paid automatically for a spouse (or civil partner) and a dependant's pension and lump sum benefits may be paid at the discretion of the Trustee.
- If a DC member is planning to buy a pension, the member must think about what sort of pension to buy and how much it will cost. The member must also think about the potential impact of future price inflation on needs and affordability. For example a member can chose to buy a pension which increases annually, rather than staying at the same level (non-increasing). If this is the case the starting pension will be lower than if the member chose a non-increasing pension to take account of future unknown increases that will be applied. A DC member also has the choice about whether to provide a partner's pension in the event of their death or buy a guarantee if death occurs within a number of years of retirement, so that remaining instalments can be paid to a beneficiary.
- If a DC member choses to utilise the alternatives under pension flexibilities as opposed to buying a pension (e.g. income drawdown, taking the total benefit as a lump sum), the member will need to think about how long they might live for and whether the DC fund will last that long. The member will also need to continue to monitor the investment of their DC fund once in retirement (please refer to the separate *Pension flexibilities Pension Guide* for more information).

Transfer request

There is no statutory requirement to provide transfer quotations for active members of a DB scheme. However, past practice has been to provide an illustration of the transfer value based on a notional leave date. There will be a charge if an active member requests more than one illustrative quote within a 12 month period. Transfer illustrations provided to active members are not guaranteed and are for illustrative purposes only. The transfer value represents the value of a member's scheme benefits linked to the financial conditions at the time of calculation and these conditions can fluctuate up or down. The Trustee also reviews the assumptions underlying the calculation with the Scheme Actuary so this can also lead to changes. As a result there is no guarantee that the illustrative transfer and any actual transfer will be the same.

In order to effect a transfer out of a scheme, active members must first opt out of the scheme by giving two months' notice and, after having opted out, request a transfer quotation. Scheme leaver data including details of the last contributions that have been made is then gathered. This is needed to calculate scheme benefits and a final transfer value. This will mean that there could be several months between the initial illustration being provided and the amount that is actually available for transfer being calculated (meaning the amount actually available is different from the illustration initially provided). It is important to note that you will only know your actual transfer value after you opt out of a scheme.

Deferred members (members who are no longer in-service) of a DB scheme are entitled to a transfer value free of charge once in a 12 month period up until one year before their Normal Retirement Age. This is a statutory entitlement. This statutory transfer value will have a guarantee period of three months. If deferred members require more than one transfer value in any 12 month period this can be requested but there will be a charge for any additional quotations.

The advice requirement for DB transfers

If you are considering opting out of active membership of a scheme, we would urge you to consider this option carefully and take independent financial advice on whether this is in the best interests of you and your family, both in the short and longer term.

It is a statutory requirement that members take advice from an appropriately authorised independent financial adviser before the Trustee can pay the transfer value (unless the value of the transfer is less than £30,000). This requirement was put in place to protect members against the risks associated with making a DB to DC transfer. To comply with this requirement the Trustee is required to check that members have obtained advice from an independent financial adviser ("IFA") authorised by the Financial Conduct Authority with permission to advise on pension transfers.

Information required by an IFA will include details of the member's entitlements under the scheme (which is provided to members in a benefit statement after they have left pensionable service - whether by opting out or otherwise), the amount of the transfer value available (in the transfer quotation) and detailed personal information about the member's circumstances, requirements and attitude to risk.

Please refer to the separate *Independent Financial Advice Pension Guide* for more information about getting independent financial advice.

The Pensions Regulator and the Financial Conduct Authority

The Pensions Regulator is the regulator of UK work based pension schemes. The Pensions Regulator's view (as set out in their guidance) is that it is likely to be in the best interests of the majority of DB members to remain in their DB scheme. However, the guidance does recognise that, for some DB members, taking a transfer to a DC arrangement might be better suited to their particular circumstances.

The Financial Conduct Authority has also expressed concern that individuals are entering into drawdown products without taking advice or without fully understanding the impact of the investment choices that they are making and/or the charges that will apply.

Pension flexibilities have attracted pension scams, where cold calling and cash inducements to leave an existing scheme have led to fraudulent activity and a large loss of benefits to members. The Trustee is acutely aware of this and closely monitors any transfer request. Members are urged to look at the Pensions Regulator's advice on their website: thepensionsregulator.gov.uk/pension-scams

Other considerations

Money Purchase Annual Allowance (MPAA)

The MPAA applies to anyone who is deemed to have flexibly accessed any personal or workplace DC pension arrangement after April 2015. Flexibly accessing includes taking a cash lump sum greater than 25% of the DC fund, taking income from a flexible retirement income product or from a lifetime annuity which could decrease (such as an investment linked annuity). (It does not apply to members who have only used some or all of their pension fund to buy a lifetime annuity, with or without having taken a tax free cash sum of up to 25% of the DC fund).

Where flexible access has occurred, from that point onwards, the individual is only permitted to contribute (including any employer pension contribution) £4,000 per annum (as opposed to the standard £40,000 Annual Allowance) to one or more DC pension arrangements. Members who exceed the MPAA will be subject to a tax charge which claws back any tax relief which was given at source.

Taxation

Income (and, in some cases, all or part of a cash lump sum) received from a pension arrangement is taxable. It will therefore count as part of total taxable income (including any pay). Depending on the amounts involved, it could result in the individual moving into a higher rate tax band.

Automatic Enrolment

It is important to understand that where a member has opted out, their employer is required to automatically re-enrol them into a suitable pension arrangement if they meet certain age and salary criteria. It is therefore possible that even though an active member may have opted out, they may subsequently need to be enrolled into the BAE Systems DC Retirement Plan (DCRP) at the appropriate time. However, once auto-enrolled into the DCRP, the member may, if they wish, choose to opt out. Please visit the Non Member section of the BAE Systems pension website for more information: baesystems.com/en-pensions/non-members