Avoiding pitfalls

Jonathan Watts-Lay suggests how to help scheme members avoid the pension pitfalls of freedom and choice

Figures published by HM Revenue and Customs have revealed that individuals have withdrawn more than £28 billion from their pensions since the freedoms were introduced in 2015.

Whilst freedom and choice in pensions is popular with individuals, the downside is that due to an array of risks, it can be easy for pension scheme members to make poor decisions that can create a permanent dent in their retirement income. Some of these risks are outlined below, as well as what employers and trustees can do to help.

1. Paying unnecessary tax

Pensioners are paying £4 billion a year more in income tax on their pension than what the government had previously estimated, indicating that individuals are often paying tax when it could be avoided with careful planning. Ultimately, tax planning should be at the heart of any pension transaction and many will need support around how to do this effectively.

2. Underestimating how long retirement savings may need to last

Scheme members need to think about if they will have enough money to last the duration of their retirement. Research has found that most people live longer than expected, so this needs to be considered when doing the sums. However, it's no easy task working out how long it needs to last and how to best achieve this, so support around this is crucial.

3. The risks around DB pension transfers

Since the pension changes, we have seen a rise in individuals wanting to transfer their defined benefit (DB) pension schemes into more accessible pensions. Regulated financial advice must be sought to transfer a DB pension if its value is £30,000 or above. However, the FCA has warned that DB pension transfer advice is often substandard. Caroline Rookes also carried out a review for The Pensions Regulator on the communications and support given to British Steel Pension Scheme members, and found that members who acted on an uninformed or ill-informed basis, were exposed to unscrupulous advisers and were swayed by the size of the transfer figures rather than the value of the benefit.

Rather than leaving employees and members to go it alone when sourcing an adviser for DB transfers, many forward-thinking employers and trustees are now putting robust processes in place to ensure that individuals have access to reputable advisory firms.

4. The pension scam epidemic

Individuals getting scammed out of their retirement savings is a real issue. Our research found that a vast majority of trustees (88 per cent) fear their members nearing retirement will face predatory attention from scammers.

The amounts lost to pension scams can be significant, with the FCA revealing that victims of pension fraud had lost £91,000 on average each, with some even losing more than £1 million to fraudsters. More needs to be done to highlight how this can be avoided.

5. The value of regulated financial advice

Many don't realise that when they buy retirement products such as annuities, through for example online brokers, there are charges deducted that can cost just as much, if not more, than getting regulated financial advice. Studies have shown that those who take regulated financial advice are more likely to increase their wealth than those who do not.

To help their employees and members avoid these pension pitfalls, many employers and trustees are now seeing the benefits of putting robust processes in place. This includes offering support such as financial education seminars and one-to-one financial guidance over the telephone, in the months or even years before retirement, as well as facilitating an introduction to a regulated financial advice firm that has been through a thorough due-diligence process. This approach should ensure an improved retirement process, leading to better outcomes.

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