A question of balance

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Declan Keena cautions pension scheme members to think carefully before making a decision on their options at retirement.

It can be argued that more choice is always good. Freedom of choice is fundamental to our society and our economic system, however, society generally puts in place checks and limits to prevent people making wrong or harmful choices. This also applies in the financial world - there are limits on how much home buyers are allowed to borrow, certain countries attempt to outlaw gambling and there are strict rules governing what we are allowed to do with our pension funds on retirement.

For members of defined benefit (DB) schemes, these rules have changed quite significantly in the last year. From a position where an individual on retirement only had the choice of how much to take in a lump sum they can now decide whether they want to take the remainder as a pension or invest in an approved retirement fund (ARF).

Of course, this is to be welcomed. There is no such thing as a "one size fits all" solution in the pensions world. Everyone's needs and aspirations are different and these have to be taken into account when making decisions. However, the choices on offer must be approached with caution. The most recent change opens up the prospect of people making poorly informed and therefore bad decisions.

When compared to the returns which were available back in the 1980s, an income for life could be seen as representing very bad value today, but the 1980s was a decade of double digit inflation and economic stagnation in this country so no sensible comparison can be made.

ARFs have only been available for less than 20 years and have received largely positive press over the period. They allow for a wide range of investments across different asset classes in accordance with the risk appetite and need for return of the investor. They also give the investor a sense of control over their own destiny. This has led to an unfortunate situation where a view of "an income for life bad, ARF good" has developed among many pension scheme members. Such binary views are never wise when it comes to investments and could lead to people making very poor choices indeed.

Professional advice should always be taken before making such a decision. For example, it is not generally appreciated that a pension from a DB scheme offers a "guaranteed" income for life (to the extent that the DB scheme can continue to pay the pension) while an ARF may actually run out at a certain date. People may be willing to bet on their own mortality but they should understand the consequences of outliving their own expectations.

The table below sets out some of the features of each approach:

DB Pension (Annuity)	ARF
"Guaranteed" income for life	Flexibility to withdraw your savings as required.
If you live longer than expected, you will receive good value for money.	If you live longer than expected or investment returns are poor your fund may run out before your death.
If you die shortly after retirement your pension will die with you (some schemes provide spouse's pensions).	On death any remaining funds will form part of your estate.
You are not required to make any investment decisions.	You control the investment of your fund.

The security of the DB scheme and the adequacy of assets to meet pensioner liabilities now and as the scheme matures will also be a consideration.

The availability of an option to invest in an ARF at retirement for members of DB schemes is definitely to be welcomed and will almost certainly offer superior outcomes for many members. However, nothing is guaranteed and the most careful consideration of all the pros and cons must be undertaken before such a choice is made.