



KEY ISSUES

Pensions are a tax-efficient way of saving for your retirement. They may have the added benefit of contributions from an employer.

The two main pension types are defined contribution (your pot depends on what you pay in) and defined benefit (your pot depends on your salary and length of service).

Most pensions will provide a tax-free lump sum. From April 2015 most of us will have the flexibility to choose how we access the rest of our funds and when.

What is a pension?

A pension is a way of saving for your retirement. You put money into your pension each month, and in return, you get a regular income once you've retired. You don't have to pay tax on pension contributions, which is one of the reasons saving into a pension can be more effective than saving for your retirement in other ways. There are three types of pension – state pension, workplace pensions and personal pensions. All three types are available to everyone, as long as you are in employment.

State pension

When people reach their state pension age (SPA), they will receive an income from the state, called the state pension. SPA is currently between 65 and 66 for women and men. To claim the state pension you have to have made National Insurance (NI) contributions throughout your working life. The full state pension amount for people reaching SPA on or after 6 April 2020 is £175.20 per week. For more information on your state pension age and entitlement visit gov.uk. The state pension will not be able to provide all your retirement income so many people will use workplace pensions or personal pensions to top it up.

Workplace pensions

Workplace pensions take contributions from you, your employer and the government, and use them to provide you with a pension when you retire. To encourage more people into retirement saving the Government has required employers to automatically enrol eligible workers into a workplace pension scheme and make contributions on their behalf.

When this applies to you, your employer must provide information on the scheme and the contributions you are expected to make on your behalf. Your contributions will take the form of a percentage taken from your salary each month, and your employer's will also be added as a percentage of your pay.

The fact that your employer pays into your workplace pension is one good reason for having one – it's like extra pay. These contributions will be invested, with the aim of increasing the amount you have to retire on. You can usually opt out of a workplace pension scheme, however, if you do, you'll usually miss out on your employer's contribution.

Personal pensions

These work by you paying money into a pension scheme from a provider (such as high street banks, Scottish Widows, and Standard Life). Unlike a workplace pension it is up to you (with or without the help of a financial adviser) to select the provider. At your chosen retirement age, you will have built up a sum of money with which to buy an annuity or arrange income drawdown, although people over 55 have had more flexibility since April 2015.

Like workplace pensions, personal pensions invest your money with a view to increasing it. Personal pensions may be particularly suitable if you're self-employed or not in work, or if you don't yet have access to a workplace pension. But anyone can save into a personal pension.

Why save in a pension?

There are many reasons to save into a pension:

- If you contribute the Government will top up your payment with tax-relief.
- State pension is unlikely to provide enough income to secure a comfortable retirement.
- Your employer will often add a contribution on your behalf.
- You can usually take up to 25% of your pension pot tax-free when you retire.
- Pension freedom regulations from April 2015 now mean the way in which you can access your pension pot from age 55 is more flexible than ever.



There are two main types of pension:

Defined Contribution (DC) - a pension pot based on how much is paid in.

Defined Benefit (DB) - a pension pot based on your salary and how long you've worked for your employer.



Defined contribution (DC) pensions

These are usually either personal or stakeholder pensions. They're sometimes called 'money purchase' pension schemes. Money paid in by you or your employer is put into investments (e.g. shares) by the pension provider. The value of your pension pot can go up or down depending on how the investments perform.

Where is your money invested?

There will usually be a range of investment funds to choose from, but particularly for workplace pensions you may be put into what's called a default fund unless you give other instructions. Some schemes move your money into lower-risk investments as you get close to retirement age (this is sometimes called 'lifestyling'). You may be able to ask your pension provider for this if it doesn't happen automatically.

You should take time to read any documentation from your pension provider so that you're aware of where your contributions are being invested. You may wish to consult a financial adviser for help with where to invest your pension contributions.

What you'll get

The amount you'll get when you take your pension pot depends on three main points:

- How much was paid in
- How well the investments have done
- How you decide to take the money (e.g. as regular payments, a lump sum or smaller sums)

What are the costs?

The pension provider usually takes a small percentage as a management fee. This should be clearly communicated from the outset. If you receive advice from a professional adviser (like Aspira) there will usually be a charge. This may be in the form of a one-off fee and/or a small percentage of your fund. For workplace pensions, your employer will sometimes pay for some of your advice.

A pension is a long term investment. The fund value may fluctuate and can go down. Your eventual income may depend on the size of the fund at retirement, future interest rates and tax legislation.

Useful links

For more information on pensions you might want to visit some of the following:

Money Advice Service

<https://www.moneyadvice.org.uk/en/categories/pensions-and-retirement>

Gov.uk

<https://www.gov.uk/plan-retirement-income>

Citizens Advice Bureau*

<https://www.citizensadvice.org.uk/debt-and-money/pensions/>

* This is the England site, readers in Northern Ireland, Scotland and Wales should select the relevant region.

You'll also find lots of information on our website in the Resources and Inform sections.

Defined benefit (DB) pensions

These are sometimes called 'final salary' or 'career average' pension schemes. They're always workplace pensions arranged by your employer.

Where is your money invested?

You may or may not make a personal contribution to your pension. If you do, it will be added to your employer's contributions with those of all the other scheme members. The whole fund is managed by the scheme's trustees who are a mixture of professionals and lay-people whose job it is to ensure that there's enough money in the fund to pay all the benefits out to scheme members. They decide where the employee and employer contributions are invested.

DB schemes have to report to members on a regular basis about their funding positions (i.e. whether they're in surplus or deficit).

What you'll get

The amount you'll get back does not depend on investment performance. It will depend on a number of variables:

- How much your salary is when you retire, or,
- How much your average salary is when you retire
- How long you've worked for your employer

The pension provider will promise to give you a certain amount each year when you retire. You'll usually get 25% tax free and the rest as regular payments.

A DB pension can have valuable secured benefits, however if you have a DB pension with a previous employer, in some circumstances a transfer could be considered. You should seek advice from an expert to help you establish whether this is the right course of action for you. There is usually a charge for this kind of advice.

EXAMPLE:

Pension entitlement:
1/80th Final Salary for
every year of service.

Final salary = £80,000
20 years service

$£80,000 \div 80 = £1,000$

$£1,000 \times 20 = £20,000$
Annual pension