

Pensions 101



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Agenda

- What is a pension?
- DB v DC
- At retirement
- Contribution example
- Pension providers
- Auto-enrolment
- Pensions freedoms
- Consolidation



What is a pension?

- A pension (/ˈpɛnʃən/, from Latin pensiō, "payment") is a fund into which a sum of money is added during an employee's employment years, and from which payments are drawn to support the person's retirement from work in the form of periodic payments – *wikipedia*
- In simple terms, a pension scheme is just a type of savings plan to help you save money for later life. It also has favourable tax treatment compared to other forms of savings. – *The Pensions Advisory service*
- The challenge of retirement is how to spend time without spending money. - Author Unknown
- There are three main types of pension, State, workplace and personal with two main categories; Defined Benefit and Defined Contribution

Defined benefit (DB) V Defined Contribution (DC)

	Defined Benefit	Defined Contribution
What does it cost?	Rates set by trustee (advised by the scheme actuary)	Rates set by employer with minimum prescribed levels
What does this produce?	Known income, calculated to a known formula	Unknown. Dependent on contribution rates, investment returns and charges
Death benefits	Typically life cover, plus survivors & dependents pensions	Varies. Maybe life cover, plus fund value
Can deficits arise?	Yes – deficit payments required by employers	No – but value of investments can go down
Investment Decisions	Trustee takes professional advice, sets strategy and appoints investment managers	Member choice from a defined number of funds – default
Who pays the pension?	The pension scheme	Annuity provider, SIPP, drawdown product, all taken as cash
Can a member transfer?	Yes	Yes

Pension at retirement - DB

The pension for each year is calculated using a set formula, typically:

Pensionable pay / accrual rate/pensionable service

E.g. $\text{£}30,000 \times 1/60 \times 30 \text{ years} = \text{£}15,000 \text{ per year (NRA)*}$

The annual pension amount increases each year with an inflation link (often capped)

Members can typically exchange part of the pension for a tax-free lump sum at retirement

Dependants' benefits for death after retirement (50%?)

*normal retirement age



Pension at retirement - DC

The member has a 'pot' of money at retirement

E.g. £300,000

- As a pension (annuity) at 65 (male) this would equate to £10k per year single life or £8,300 per year with a 50% dependant's pension (fully inflation proofed) *AJ Bell 'ask Tom' Mar 2019*
- Or take it as cash, with a resulting tax bill of £99,500 (emergency tax)
- Drawdown product, withdraw as required, tax to consider, will you outlive your 'pot'?



Contribution example

Member rate	5%	5%	5%
Annual Salary	£20,000	£25,000	£30,000
Monthly Payslip cost	£80	£100	£125
Tax relief	£16	£20	£25
Difference in take home pay	£64	£80	£100
Employer contributes (5%)	£80	£100	£125
Total contribution to pension	£160	£200	£250

Pension Providers

- Workplace – Linked to an employer:
 - *Mastertrust*
 - *Insurance company*
 - *Own scheme*
 - *Multi-employer*
- Personal pension:
 - *Personal pension scheme*
 - *Self invested personal pension plan (SIPP)*
 - *Stakeholder pension*



Auto-enrolment



Auto-enrolment

- Introduced by the government in 2010
- Employers are required by law to enrol all 'eligible jobholders' into a qualifying pension scheme
- Eligible jobholders are employees aged between age 21 and State Pension Age earning above £10,000 per year
- Contribution rate of 8% including at least 3% from the employer
- Members can opt-out within 30 days of being enrolled and re-enrolled every three years
- Non members can opt-in at any point

Pension freedoms



Pension freedoms

- First announced in March 2014 Budget
- Fully in place from April 2015
- DC members can take part or all of their fund as cash
- Tax-free element remains at 25% of fund
- Remaining 75% taxed at marginal rate
- A DB member with a transfer value in excess of £30,000 must take financial advice before transferring
- Over £25bn has been withdrawn since April 2015 – *HMRC April 2019*

Consolidation

- Consolidation
 - DC
 - *Master Trust authorisation*
 - *Market contraction*
 - DB
 - *Consolidators*
 - *New to the market*

