MODULE 8

Saving for retirement

Learning objectives

By the end of the session you will…

Know the options targeted for saving for retirement including:
- State pensions
- Occupational pensions
- Personal pensions
- Stakeholder pensions
- Extra pension (AVCs)

Know how to obtain a pension forecast.

Know how to obtain the State Pension.

Activity

8.1 Read the sections on Saving for Retirement. Try the quiz and check out the answers.

Saving for Retirement

Many people live for 20-30 years in retirement, i.e. without full time paid work. So funding retirement is expensive which means that saving for it takes a long time.

One of the ways of saving for retirement is through pensions. Other ways include:-
- *Individual Savings Accounts (ISAs)*
- *Buying property*
- *Investing directly in shares*
- *Unit Trusts*

Some of these are covered in Module 7. However, for most people a pension is a sensible part of planning for retirement. If additional money is available then more flexible savings like investments and property can be added.

Pensions

Pensions were invented to protect people from poverty in old age. The basic principle is simple – pensions are a way of putting money aside out of income so that a person will have enough money to live on when they retire.

Because it is in the interests of society that people save for their retirement, the Government gives tax concessions on pension savings. It is also a fact that the younger a person is when starting to save for a pension, the more time the money has to grow to create an adequate income in retirement.

The main kinds of pension arrangements are:
- *The State basic pension*
- *The State Earnings Related Pensions:*
  - *Graduated Pension*
  - *State Earnings Related Pension (SERPS)*
  - *State Second Pension (S2P)*
- *Occupational pension schemes*
- *Personal pension plans*
- *Stakeholder pensions*
- *Extra pension / Additional Voluntary Contributions*

It is unlikely that you will be in all these schemes at the same time. For example you may be in either a personal pension or an occupational pension. Occupational pensions normally have the advantage that the employer makes contributions to the pension.

State basic pension

Currently, to be eligible for this pension, National Insurance Contributions must be paid for at least 10 years and to get the full State pension you must have paid for 30 years.

If a married woman does not qualify for a basic state pension in her own right because she has not paid any National Insurance Contributions, or because she has paid the 'married womans' or 'small stamp', then she may be entitled to some pension based on her husband's National Insurance Contributions. State pensions are subject to tax depending on total income.

The State Earnings Related Pension Schemes
These provide an additional State pension for employees only. Self employed people are not covered by these arrangements.

Graduated Pension
This was the governments first earnings related scheme and commenced on 3 April 1961 and ended on 5 April 1975.

State Earnings Related Pension (SERPS)
This commenced on 5 April 1978 and ended on 5 April 2002.

State Second Pension (S2P)
This commenced on 6 April 2002 and replaced SERPS.

If you have no other pension, such as an occupational pension or a personal pension and you pay National Insurance Contributions then you will be automatically in SERPS/S2P.

You can also have an occupational pension or a personal pension instead of or as well as SERPS/S2P.

Occupational pension schemes
Many employers have occupational schemes for their employees. Either:

A salary related scheme (also called defined benefit), where your final pension depends on the number of years you have been in the pension scheme and your earnings when you retire, or
A money purchase scheme (also called defined contribution), where contributions are invested and then used to buy you a pension when you retire.

If an employer has an occupational pension scheme, both the employer and the employee will normally put money into the scheme. Employees will get income tax relief on their contributions. There may be other benefits in joining an occupational pension scheme, e.g. pensions for your dependents if you die, death in service benefits, ill-health early retirement pensions.

If you are given the option of joining an occupational pension scheme run by your employer then, because of the employer's contributions, this will often be preferable to a Personal Pension (see next page).

Getting a Pension Forecast
The Pension Service can provide you with a Pension Forecast when you complete and return Form BR19.

The information and amounts on your Pension Forecast will apply specifically to you. The amounts quoted are based on the pension rates at the time of your application. As increases in the state pension are approved by Parliament every year, it is impossible for the Forecast to tell you exactly how much the pension will be when you reach pension age.

The first page of the Pension Forecast tells what your total pension would be if you were using the rates current at the date on the letter. Remember, retirement pension is made up of a number of different components; your Pension Forecast will tell you how much of each component you are entitled to.

By getting a Pension Forecast you can take action, if needed, to safeguard your pension. It is especially important for married, or formerly married, women to have a Forecast if they have, at any time in their working career, paid the 'married womans' or 'small stamp' (reduced National Insurance Contribution rate) as this may mean that the pension entitlement is substantially reduced. In certain circumstances they may have no entitlement at all.

You can apply for a Pension Forecast if you are a man under age 64 years 8 months or a woman under age 59 years 8 months. The Form BR19 (along with all other leaflets) is available from your local Benefits Agency office. Look under 'Benefits Agency' in the telephone book to find your local office. Your Pension Forecast should be sent within 8 weeks. Form BR19 is also available by phoning the Future Pensions Centre on 0845 3000 168. If you wish, they will help you to fill in the form over the phone (if you have your National Insurance number to hand). Alternatively, there is an online version available by logging on to the website: **www.direct.gov.uk/en/Pensionsand retirementplanning/StatePension/index.htm** and clicking the link to "Getting a State Pension forecast".

Personal pension plans

These are often called 'private' pensions. They can either be used instead of S2P, when they are called an 'appropriate personal pension', or in addition to S2P. Personal pensions have more risk than salary related occupational pensions. Individuals pay into a pension plan, purchased from a provider such as an insurance company, bank or investment company, a regular amount or a lump sum. These build up into a pension pot, which is then used to buy a regular pension, called an annuity, at retirement. The annuity depends on the amount of the pension pot built up, and annuity rates at the time.

There is tax relief on contributions to a personal pension. The companies that sell personal pensions charge for their services. Some of the money paid to the pension provider is not invested in your pension but is used to pay these charges. You have a right to be informed about these charges. You should be aware that companies charge different amounts, so it is useful to make comparisons before choosing a pension provider.

Many people who join a personal pension plan drop out within three years. This means that much of the money paid in is lost in set-up charges. So it is important to find out in advance what would happen if you cannot continue making payments and how much it would cost to transfer your pension pot to another pension scheme.

Stakeholder pensions

The Government introduced Stakeholder Pensions with effect from April 2001. They were intended largely for individuals with less-than-average earnings who have no access to an employer's pension scheme. However they can be taken out by those who are not in work as well as by some people who already have a company pension or a personal pension.

Stakeholder pensions are very similar to personal pensions, but they must satisfy some additional conditions to ensure that the individual is protected. These include:-

Charges are limited to a maximum of 1% of the stakeholder's fund each year. All employers must provide access to a Stakeholder pension unless they have less than five employees or already offer a company pension to all employees. Terms are controlled – in particular there must be no financial penalty on early retirement, or on transfer of the funds to another provider.

An employer's stakeholder scheme is likely to offer you a limited choice of investment fund, but may provide you with the opportunity to have contributions deducted through payroll. Alternatively, you can take out a stakeholder pension directly with a provider (insurance company, bank or investment company) and have a wider choice of fund, but you will have to make your own contribution arrangements.

> As mentioned above, even if you are not able to take out a normal personal pension you may still be able to take out a stakeholder pension. This will be possible if either:-
>
> *You have no earnings but can pay contributions out of capital or (where appropriate) from pension, or you have relatives (e.g. a spouse, children, grandchildren) who are in this situation; payments for others may be subject to inheritance tax rules,*
> OR
> *You are earning less than £30,000 a year from employment – a stakeholder pension can then be additional to your company pension (if you have one).*

Extra pension / Additional Voluntary Contributions (AVCs)

Members of an occupational pension scheme can increase their pension pot by paying Additional Voluntary Contributions (AVCs). These may either be paid to the pension scheme, or to another pension provider when they are called Freestanding Additional Voluntary Contributions (FSAVCs).

If you have a personal pension, then the options are to increase the contributions or buy another pension.

Pension Credit

Pension Credit is a government benefit for people aged 60 and over which can be claimed from The Pension Service (part of the Department for Work and Pensions). The minimum age you can get Pension Credit is rising in stages from 60 to 65 between April 2010 and 2020. Introduced in October 2003, it tops up weekly income to a guaranteed minimum level. People aged 65 or over with modest savings may also claim the benefit.

State Pension Age

State pension age for the State pension (assuming contributions have been made) was 60 for women and 65 for men. However, women's retirement age will gradually increase from 60 to 65 between 2010 and 2020. The State pension cannot be taken before you reach state pension age.

Early retirement means giving up work before you have reached the official state pension age. Although you cannot receive your state pension until you reach the qualifying age, you may be able to access your occupational pension or personal pension after the age of 55. Normally, if you take early retirement and draw your pension early, you will receive less. Since you will no longer be paying contributions and your pension will be paid for longer, early retirement can dramatically reduce your pension.

Commutation

Commutation is an arrangement where part of your pension can be converted into a cash lump sum. This means that your pension will be lower and any pension increases will be applied to this lower amount. The lump sum is tax free whereas the pension is subject to income tax. Commutation of the State pension is not permitted.

To check your understanding of saving for retirement, answer the following questions.

1. What influences the amount of the Basic State Pension? Tick the appropriate boxes.
   - ☐ Age
   - ☐ Number of years of contribution
   - ☐ Income at State Retirement Age

2. Is the State Pension a taxable benefit?
   - ☐ Yes
   - ☐ No
   - ☐ It depends on total income

3. How can you get a State Pension Forecast?

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   ____
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4. What is the current age for eligibility for the State Pension (assuming contributions have been made)?

   for men ______________________________
   ____

   for women ______________________________
   ____

5. What is an occupational pension?

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6. What is a Stakeholder pension?

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7. What is a personal pension?

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8. What other ways are there to save for retirement?

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   ____

9. Do you have any of the following?
   - ☐ An NI record for State Pension
   - ☐ Occupational pension with employer
   - ☐ Stakeholder pension
   - ☐ Personal pension
   - ☐ Other forms of saving for your retirement

10. What tax benefits are there if you have a pension plan?

11. When do you need to start saving for retirement?

12. How can you add to your pension?

13. What is a 'pension pot'?

14. What is an annuity?

15. Can a married woman have a State pension based on her husband's contributions?

16. What are the pension implications of early retirement?

17. What do you need to do to maximise income in retirement?

18. Who is mainly responsible for creating a pension for your retirement?

19. What does commutation mean in a pensions context?

Answers to the Pension Quiz

1) Age influences it – can only be obtained at age 60 (increasing to 65) for women and 65 for men. The number of years of making contributions through National Insurance also influences it – a minimum pension requires 10 years of contributions

2) Yes, the State pension is a taxable benefit and is taxed as part of your total income.

3) You can obtain a State pension forecast from The Pensions Service in Newcastle when you complete and return Form BR19.

4) 65 for men, was 60 for women. Between 2010 and 2020, women's State retirement age will increase to 65.

5) An occupational pension is a pension provided by an employer. There are two kinds.

   final salary (also called defined benefit) which provides a pension based on earnings close to retirement and years of membership, and

   money purchase (also called defined contribution) which invests the employer and employee contributions until retirement. The funds so accumulated are then used to buy a pension (this is called an annuity).

6) A Stakeholder pension is a low cost second pension (i.e. in addition to the state basic retirement pension) intended for those who do not have an occupational pension.

7) A personal pension is usually taken out by someone who is not able to join an occupational pension scheme. It is bought from a provider such as an insurance company, bank or investment company.
   Personal plans do not normally have employer contributions and are all money purchase schemes, so are not linked to final salaries.
   The contributions are invested and the value of the annuity you buy when you retire will depend on how much has gone into it, how well the fund has performed and how much the provider has charged.

8) There are many other ways to save for retirement in addition to pension. These include:
   shares
   unit trusts
   ISAs
   property

9) If you are unsure, check this out with the appropriate body or bodies.

10) Your contributions are free of tax.
    The investments are largely (but not completely) free of tax.
    The lump sum at retirement is free of tax.
    However, you do pay tax when you receive your pension.

11) Saving for retirement is a major task and so should be started as soon as possible. This makes it easier to obtain a good income in retirement.

12) If you belong to an occupational scheme, you can add to your pension by paying Additional Voluntary Contributions. These can be bought via your occupational scheme, or from other sources. If you have a personal pension, then you have to pay more contributions.

13) A pension pot is the total sum of money available to purchase a pension. This consists of your contributions, your employer's contributions (if appropriate) and any interest, bonuses or dividends added by the fund manager. Funds can of course decrease as well as increase.

14) An annuity is an insured, guaranteed annual income paid by a life assurance company in return for your pension pot. It can be for an agreed term or for life. When you die, the insurance company doesn't have to pay out any more money and keeps the fund. It's a kind of bet between you and the insurance company, if you live a long time, you win. Insurers use 'mortality tables' to work out the rate of pension and it normally depends on your sex and your state of health.

15) Yes, a dependent wife can receive an element of the husband's State pension, although there is an 'earnings limit' for this. In other words if the wife has an income greater than a certain figure, the dependent wife element of the husband's pension will not be paid.

16) The implications of early retirement are:

The state retirement pension is not paid until you reach state pension age.

If you are aged over 55 and have an occupational or personal pension, you can normally ask the provider to pay your pension early. However, the pension you receive is likely to be substantially less than you were expecting at age 60 or 65.

17) Income in retirement can be maximised by:
Starting pension planning early
Paying AVCs
Saving in other ways
Doing some paid work after retirement
Delaying your retirement by working longer.

18) It is your responsibility to create a pension for your retirement and the sooner you start the better. You may have a choice about whether to join the company pension scheme (which will normally be your best option), or have a personal pension. This decision needs to be made on accurate information.

19) Commutation is an arrangement whereby part of your pension can be converted into a cash lump sum at the time you retire. This means that your remaining pension will be lower. The lump sum is tax free but, if it is invested, tax may be payable on the income from it.