Pensions
– a brief guide

One solution for all your financial needs

‘Having a pension’ is something that affects all of us when we reach pensionable age, which makes it surprising they are so notoriously complicated. It’s something we’re told to pay into ‘now’ for a payback that may be decades away, that seems cloaked in a veil of complexity with a language of its own and an army of self-appointed experts telling us what we should or shouldn’t be doing. It’s a subject where expert advice from a qualified financial adviser really does make a big difference.

This guide can only provide a very brief overview to what is a complex subject. Although there’s more information on our website at www.onefinancialsolutions.co.uk, we recommend you call us on 020 3714 9565 for a confidential discussion.

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Introduction

At some time in the future most of us are going to retire. When the day comes, we'll still have bills to pay and food to buy and, of course, we'll want to enjoy the free time we suddenly have. So, we'll need a steady, long-term income and, although there are some alternatives, most of us will probably rely on our pension, or pensions, to provide it.

Although the UK has a state pension scheme, it's generally accepted that it's not enough to live on comfortably – which makes it so surprising that many of us are making little, if any, additional provision for the 'financially secure and comfortable retirement' we all want.

Faced with a potential crisis in the not-to-distant future, the Government is overhauling the pension system. The State Pension has been simplified; much of the working population has been pushed into a workplace pension scheme through auto enrolment and, if you have been saving into a pension scheme, you've now greater freedom in the way you can use the money you've saved.

'Having a pension' is something that happens 'later in life' and that's when most of us do something about it – not just saving for it, but trying to understand what is universally agreed to be an incredibly complex subject. Although most of us think that 'saving for a pension' is a necessary evil and something we'll do 'tomorrow', the harsh reality is that we should have started 'yesterday'. As we near the end of our working lives, having a 'financially secure and comfortable retirement' is probably the most important thing we can work towards.

What is a pension?

A pension is a sum of money you receive on a regular basis. The money may come from the state or it could come from an investment fund or insurance product. Either way, the most important thing to realise is that the pension you receive is the result of having saved into a long-term saving scheme – a 'pension scheme' – and the more you've saved, and the longer you've saved for, the more you'll receive.

It's understandable why so many of us find excuses not to save: the constant drain on our finances in adult life make it a struggle just to 'get by' at times, let alone put money aside for the future. But, unless we do save, retirement could be even more of a struggle.

How pensions work

How much you'll receive will depend on the type of pension scheme you're a member of and how much you've saved into it.

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- State Pension

  Provided under the Welfare State, the State Pension provides a basic income once you reach State Pension age. Everyone is entitled to join the State Pension scheme, members saving into it through National Insurance contributions or National Insurance credits.

- Workplace pensions

  These are provided by your employer as an employee benefit. Workplace pension schemes were historically limited to salaried staff in large companies and the employees of government and public organisations. In 2012 auto enrolment legislation extended the provision of workplace pension schemes, making them a legal requirement for most workers. You, and usually your employer, make regular contributions to the scheme.

- Private pensions

  A pension scheme you start or join as an individual and set up in your own name. Private pension schemes are the preserve of the self-employed, those who don't qualify for a workplace pension and those wanting to ensure their retirement is as well funded as they can make it.

You can be a member of more than one pension scheme: most people are eligible for the State Pension; many have one or more workplace pensions and others will also have a private pension.

The contributions you make to a workplace or private pension scheme creates a 'pension pot', a descriptive term for the total amount of money you have invested in a particular scheme: if you're a member of more than one scheme, you'll have multiple pension pots.

Your pension pot is invested with the aim of growing its value during your membership of the scheme. There's a wide range of investment opportunities to choose from but the choice of fund will depend on the level of risk either the scheme's trustees, if it's a workplace pension, or you, if it's a private pension, are prepared to take to increase its value.

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Investment

Pension schemes are tax-efficient saving schemes using investment as a mechanism to grow. Although we could put money into a simple savings account, and some people do so, growth in its value would depend on interest rate movement. This is unlikely to provide a particularly good return which points towards using investment as an alternative strategy.

Workplace and private pensions rely on investment to grow, with different types of pension scheme using different types of investment. In some workplace pension schemes, the trustees of the scheme will decide the level of risk they want to take to meet given returns and then choose the investment type; in others you may able to do this yourself and, of course, if you have a private pension, particularly a SIPP, you can often make that choice yourself.

For more information about investment and pension schemes, please refer to our brochure, *Investment – a brief guide*, or visit the Investment section of our website at www.onefinancialsolutions.co.uk

The State Pension

The State Pension is a 'contribution-based benefit' provided by the state; the benefit you receive when you reach State Pension age being based on your personal National Insurance contribution record. A series of legislative changes first brought the State Pension age for women into line with that for men and is now gradually increasing it to 68 years.

The system is infamous for its complexity so, to simplify it and make it 'fairer' to all, significant changes took place on 6 April 2016 with the introduction of a 'new' system which runs in parallel with the 'old'.

- 'Old' system

The 'old' system applies to those people who recached State Pension age before 6 April 2016 and consists of two principal components: the basic State Pension and, if you are eligible, the Additional State Pension. To receive the maximum, or 'full', basic State Pension you need to have paid National Insurance contributions, or received National Insurance credits, for a minimum of 30 'qualifying years'.

- 'New' system

  The 'new' system affects only those reaching State Pension age on or after 6 April 2016. It's a single-tier system that abolishes the Additional State Pension in favour a single, flat-rate payment. What you receive is still based on your individual National Insurance record but the number of qualifying years you need to receive the maximum amount has been increased from 30 to 35 years; if you've less than 35 years you'll receive a pro-rata amount. In addition, unlike the 'old' State Pension, you'll need a minimum of 10 qualifying years to receive anything at all.

The State Pension, in its current form, was introduced in 1946 and intended as a basic amount to prevent poverty in 'old age'. At the time, life expectancy (for men) was just 65 and this was the age at which they became eligible to receive the benefit. Today, average life expectancy has risen to 80 for men and 82 for women, with many retirees being healthy, active and aspirational – and wanting lifestyles the State Pension was neither designed, nor expected, to finance.

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Workplace pension schemes

Workplace pension schemes – sometimes called 'company' or 'occupational' pension schemes – provide a pension for an organisation's employees. When you join a workplace pension scheme, contributions are taken from your salary and paid directly into what is known as your 'pension pot'. What makes a workplace pension scheme so beneficial is that it's usual for your employer to make a similar contribution which, together with any tax relief, boosts the value of your pension pot.

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Automatic enrolment

Driven by a combination of increasing life expectancy and the number of people relying solely on the State Pension, the Pensions Act 2008 introduced automatic enrolment legislation which became effective on 1 October 2012. 'Auto enrolment' requires every employer, no matter what their size, to enrol every 'eligible jobholder' into a workplace pension scheme and make regular employer contributions to it.

For more information about auto enrolment, please refer to our brochure, *Auto enrolment – a brief guide*, or visit the Auto enrolment section of our website at www.onefinancialsolutions.co.uk/

Additional contributions

Additional Voluntary Contribution (AVC) and Free-Standing Additional Voluntary Contribution (FSAVC) schemes allow members of workplace pension schemes to increase their eventual retirement benefits by making additional contributions to either defined benefit or defined contribution schemes.

- AVC schemes
  A defined-benefit AVC scheme allows its members to buy additional months or years of membership; a defined-contribution AVC scheme allows its members to make additional contributions to the scheme.

- FSAVC schemes
  A FSAVC scheme works in much the same way as an AVC except that it is not connected to the employer's workplace pension scheme; it's a free-standing scheme similar to a personal pension policy.

Private Pensions

If we're going to live longer and want a 'financially secure and comfortable retirement' we're going to have to plan it and pay for it – and, ideally, we need to start doing that at the start of our working lives rather than at the end of it.

Although most of us will qualify for a State Pension, it's generally accepted that it's too little to live on. Many of us will supplement our State Pension with some form of workplace pension, but this may still not be sufficient to maintain the lifestyle we aspire to – and what happens if we're self-employed or don't qualify for auto enrolment?

Fortunately, several types of private, or personal, pension scheme are available. All are defined contribution schemes that can, quite often, be tailor-made to meet what you want in terms of contribution value, length of term, involvement and the level of investment risk you are prepared to take. The three most popular types of private pension scheme are personal pensions, stakeholder pensions and self-invested pension plans.

- Personal pension plan
  A personal pension plan is a defined contribution pension scheme opened in your name and is one of the simplest, most straightforward forms of private pension scheme available. You choose a provider and then select a plan that best meets your personal circumstances and future needs. You make arrangements for your contribution to be paid into the scheme and that's it: your pension pot builds up from the contributions you make, tax relief and any investment returns. It's there for you, when you want it.

- Stakeholder pension
  Stakeholder pensions were launched in April 2001; they're defined contribution personal pension schemes which have to meet a number of standards set by government legislation. Some employers offer stakeholder pensions as a workplace pension; its flexibility meaning that, if you change jobs, you can continue paying into a stakeholder pension, transfer it or leave the fund and let it grow.

"...ideally, we need to start [saving for our retirement] at the start of our working lives rather than at the end of it."

- Self-invested Personal Pension (SIPP)
  A SIPP (pronounced "sip") is a type of personal pension plan that is primarily designed for those who want some level of control over their pension scheme along with the opportunity to select and manage their own investments.

Receiving an income

When you retire, your pension plans will either replace or supplement your salary or pay and provide you with a regular income. Your pension income will now consist of a combination of payments from your State Pension (if you're eligible) along with any workplace pension schemes and private pension plans you may have. You'll receive plenty of notice as your pension scheme provider will contact you and, if you're being proactive and have a financial adviser, you'll know exactly what needs to happen and when.

State Pension

If you're eligible to receive a State Pension you'll receive what you're entitled to when you reach your State Pension age, the money being paid straight into your bank account every four weeks or on a calendar monthly date predetermined by your National Insurance number.

The single most important thing to do is to make sure you receive everything you're entitled to – it's surprising how many people simply accept what they receive. Calculating your entitlement can be a complicated so it's worth talking to a qualified financial adviser who can make sure you are receiving everything you should be.

Workplace pension schemes

What you receive and how you'll receive it will depend whether you have a defined benefit or defined contribution pension scheme.

- Defined benefit scheme
  The default position is that you'll receive a guaranteed monthly income direct from your pension scheme but, driven by the 'pension freedom' legislation, you may choose to cash in the scheme and take the money. If so, you'll have to apply to the scheme's trustees and will be offered the cash equivalent transfer value ('CETV').

- Defined contribution schemes

If your workplace pension scheme is a defined contribution scheme, you'll need to use your pension pot to buy either an annuity or an income drawdown product, a move that effectively 'crystallises' your pension pot.

The advice for anyone about to take their pension is as universal as it is consistent: get advice from a qualified financial adviser! Apart from the complexity of transferring the money out of one scheme into 'something else', you need to decide what the 'something else' is. There are also major tax implications and some of the alternative investment opportunities can be complex. Another thing to be aware of is that, although both schemes allow you to take up to 25% as a tax-free pension commencement lump sum ('PCLS'), it is only the first 25% that is tax free –cashing in your entire pension pot could lead to a sizeable tax bill.

Private pension schemes

If you've a private pension scheme you are free to do whatever you like with the pension pot providing you stay within the scheme's terms and conditions. If you want a regular income you will need to convert your pension pot into an annuity or put it into drawdown.

Converting your pension pot into an income

If your pension pot is in a DC scheme, or you're moving it from a DB scheme, and want to receive an income on a regular basis, there are few choices: the main ones being to reinvest the money into an annuity, a capped or flexi-access income drawdown scheme or make uncrystallised funds pension lump sum ('UFPLS') withdrawals. Again, this is something you should discuss with your financial adviser as they will discuss your needs, review your circumstances and then recommend the most appropriate scheme for you.

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Tax

Pension schemes are one of the most efficient forms of investment as contributions into the scheme benefit from tax relief – and that offers a huge advantage over any other form of saving plan. The 'good news' doesn't stop there as the money is not subject to tax while it's invested in your pension pot and, when the time comes to receive your pension, you can usually take a portion of your pension pot in the form of a tax-free lump sum.

Although you are free to pay a maximum of 100% of your wages or salary into your pension scheme(s), an 'annual allowance' limits the amount of tax relief you can claim each year. In addition, a 'lifetime allowance' sets a limit on the total value of your pension pots before which you start to pay additional tax.

Any income you receive from a pension scheme, including your State Pension, is treated as earned income and may be liable to tax; your pension provider(s) using your tax code to deduct tax before paying the balance to you. If you're still working when you become eligible to receive your pension, the combined effect of your salary and your pension may push you into a higher tax bracket – so you may find it beneficial to defer receiving your pension.

You should be able to take a proportion of your workplace or private pension pot as a tax-free lump sum. This may be the first 25% in the form of a pension commencement lump sum ('PCLS') or, if you choose an uncrystallised fund pension lump sum ('UFPLS') income drawdown arrangement, take smaller cash sums as and when you need them, the first 25% of each being tax free.

You need to think about any potential tax implications before you start receiving your pension as, ideally, you need to minimise your tax liability. It's one of those subjects you need to discuss with your adviser as your income strategy during your retirement will dictate what you do with your pension pot and how you receive your pension.

Freedom

New pension legislation announced in Budget 2014 introduced fundamental reforms to the way we can access our pension funds: it's become popularly known as 'pension freedom and choice'. Of a raft of changes, the one that hit the headlines was that abolishing the need for

members of a pension scheme to have to buy an annuity or income drawdown product; if you're aged 55 or over you can now take the contents of your pension pot in cash if you want to.

But is that as good an idea as it sounds? To force people to think about the implications the FCA advised all pension scheme providers that they must make scheme members aware of the risks associated with cashing in their pension. If you do choose to do so it's probable that you'll have to complete a risk questionnaire and sign a declaration confirming that you've taken financial advice and understand the risks you face before the provider allows you to have the money.

In addition, some pension schemes will have a contractually binding retirement age (usually 65) and, if you're below that, they may decline your request. If you still want to take the money you may have to transfer the money into another scheme incurring administration costs and redemption fees throughout the process. The best thing you can do is talk to a suitably qualified, independent financial adviser.

Although the reforms opened up opportunities to have more choice in what you do with your pension savings, it also gave the fraudsters more of an opportunity to get rich at your expense. Scams proliferated and, unfortunately, many people lost their retirement savings – so please remember the old adage: 'If it seems too good to be true, it probably is'.

The advice for anyone about to take their pension is as universal as it is consistent: get advice from a qualified financial adviser! Apart from the complexity of transferring the money out of one scheme into 'something else', you'll need to decide what the 'something else' is. There are also major tax implications and some of the alternative investment opportunities can be complex. Another thing to be aware of is that, although both schemes allow you to take up to 25% as a tax-free 'pension commencement lump sum' (PCLS), it is only the first 25% that is tax free – cashing in your entire pension pot could lead to a sizeable tax bill.

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Death benefits

Many people are financially dependent on a spouse, partner or parent; the income they rely on being the person's salary or their pension. In simple terms a pension is a savings scheme and, if the person dies, then the value, or part of it, can often be passed on. How this happens depends on the type of pension scheme, or schemes, the person has – it could be just their State Pension or it could be a combination of this along with any workplace or private pensions they may have.

If your spouse or partner has a State Pension then you may be eligible to receive a payment – although what you receive will depend on whether they were receiving a State Pension under the 'old' or the 'new' scheme along with a number of other criteria. It can be a complicated issue to sort out and you'll need to apply for any payment you may be eligible for.

The situation with workplace or private pensions is usually more straightforward because the pension scheme often asks you to nominate any beneficiaries or dependents who you want to benefit if you die. What is paid will depend on the type of pension scheme you belong to, whether you're an active member and whether you've started to draw your pension.

Losing a spouse, partner, parent or someone close to you will be traumatic, more so if you're also financially dependent on them. If you are a dependant, then you'll need to act quickly to avoid any financial hardship, and you may not be in the right frame of mind to get involved in complex financial issues. It's another example of why having a trusted financial adviser, someone who understands your financial situation and has made sure you're covered, can leap into action and act on your behalf.

Questions and myths

Questions, myths and misconceptions are common in the world of pensions. Pensions are complicated so it's best to work from a position of 'there's no such thing as a silly question'. Myths and misconceptions often start from an assumption or misunderstanding; some come from self-appointed experts who think they know what they're talking about and others are the result of those who haven't taken good advice and have tripped-up on reality.

Although there are examples of some of the more usual questions, common myths and misconceptions on our website, your financial adviser will be more than happy to answer any you have and ensure you know what's true and what's false.

How can One Financial Solutions help?

At some time in the future most of us are going to retire and, when we do, we'll have to rely on our pension to provide a steady, long-term income. Despite its importance, many of us are doing too little, too late – quite often, 'retirement' suddenly appears on the horizon and we're forced to do something, not from choice, but from necessity.

One Financial Solutions is here to help you. We'll work with you, assess your current circumstances, review your retirement goals and help you put in place a pension strategy to meet them, ensuring that having a 'financially secure and comfortable retirement' isn't something that's left to chance.

We'll assess the value of your State Pension and make sure you receive everything you're entitled to. We'll review any workplace and private pensions you may have and recommend any changes we feel are beneficial. If you need a pension scheme, we'll find one for you and, as a truly independent firm of financial advisers, we'll select one from the entire market and make sure it's the best one for you.

So, if you're looking for specific help about any aspect of your pension or just want advice on the subject, please call us on 020 3714 9565 or ask us to call you by sending an email to admin@onefinancialsolutions.co.uk

Regulatory message

For further information and specific financial data relating to the current tax year, please visit our website at – www.onefinancialsolutions.co.uk

One Financial Solutions is here to help you.

We advise on a wide range of financial services including protection for both you and your business, general and business insurance, savings and investments, commercial finance, pensions and auto enrolment, employee benefits, profit extraction and mortgages: our aim being to provide you with 'one solution' for all your financial needs.

We provide truly independent financial advice, sourced from the whole of the financial marketplace, for individuals and commercial businesses throughout the United Kingdom.

Please call us on 020 3714 9565 for a confidential conversation about how we can help you, or visit our website at www.onefinancialsolutions.co.uk for more information.

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