PENSION
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Pensions – the lowdown

Do you pay into a pension? It's one of the most effective ways to build a secure future and that retirement lifestyle you crave. With a pension you can save monthly and reap the benefits of tax relief and, with a workplace pension, employer contributions act as the cherry on top.

What is a pension?

A pension is a pot of money for your retirement. You build it up throughout your working life with contributions. And so, when you eventually stop working, your pension acts as an income from which to live.

So that's it?

Well, not quite. There are different types of pensions:

A **workplace pension** is something that both you and your employer pay into. As long as you qualify, you're automatically enrolled into a workplace pension when you start working for that company, and your contributions are topped up by your employer to help boost your savings.

Workplace pensions usually come in two forms. Defined contribution (DC) and defined benefit (DB). Most people's workplace pension will be in the shape of a 'defined contribution' pension.

This means the amount of money you have in your pot depends on how much has been paid in by you, and your employer, and how your investments have performed over time.

With a defined benefit pension, often called 'final salary' or 'career average', your employer pays you a guaranteed income for life in retirement, and its value is determined by how long you've been a member of the employer's scheme and the salary you've earned when you leave or retire.

DB pensions are most often provided by the public sector (health, education, etc) but are becoming much rarer these days due to the high cost to run.

A **personal pension** is something you may have set up yourself through a provider. There are different types of personal pensions, such as self-invested personal pensions (SIPPs), stakeholder pensions and individual personal pensions. These work the same way as a workplace pension, except you don't benefit from employer contributions.

The **State Pension** is a little bit different. If you've made enough National Insurance contributions over the course of your life or have been credited with National Insurance contributions, you'll receive payments from the government once you reach State Pension age. The State Pension is probably not enough to live on on its own, but it's a good supplement to your other savings.

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What's so special about a workplace pension?

If you're working at the moment – or have been employed any time in the last few years – you've probably got a workplace pension. Your employer is obligated, by law, (as long as your eligible) to automatically provide a pension scheme to employees. This is called 'automatic enrolment'.

Workplace pensions are brilliant because it's all done for you – no set up, no sign up, nothing. You're automatically enrolled, and whenever you pay money in, your employer pays in too. And to top it all off, the tax you would have paid on your contribution goes into your pension instead – this is called tax relief. So effectively a workplace pension gives you free money.

Are there rules I have to play by?

Kind of. In a defined contribution pension, the minimum amount that you must pay in monthly is 8% of your total salary. This is made up of a 5% contribution from you, and a 3% contribution from your employer. So, whilst you benefit from 8% of your salary invested each month, only 5% of it actually comes out of your pocket.

Defined benefit pensions work a bit differently. Your employer pays you a guaranteed income for life in retirement, and its value is determined by how long you've been a member of the employer's scheme and the salary you've earned when you leave or retire.

Can I contribute less if I want to?

In a defined contribution pension, the minimum you can contribute each month is 8% - but that's a minimum.

It's possible – even encouraged – to pay more than that. Some people like to work to the rule 'saving roughly half of your age as a percentage of your salary'. So, for example, a 30-year-old would divide 30 by 2. That's 15. Or we'll call it 15%. That's how much of your pre-tax income you would aim to pay into your pension each month. Remember though, with your employer's contribution, you would actually only need to pay in 12%.

Many employers will pay in more than the minimum requirement, so it's worth maximising their contributions. Some may even match your contribution, up to a certain amount – ask your employer how much they're prepared to give you and get as much as you can into your pot!

What's all this about investments?

Your pension doesn't just sit there idly twiddling its thumbs while you get on with life. No. It works in the background.

Your pension can be invested into the stock market, companies, property, government bonds and cash. The aim is for these investments to help your pension grow over time – and with the added power of compound interest (where your investment returns are then re-invested), your money has a greater potential to grow. It's important to remember though, when it comes to investing, the value of your pension can go down as well as up.

With a defined contribution pension, the income that you'll receive in retirement depends on how much has been paid into your pension and how your investments have performed over time.

With a defined benefit pension, your employer bears the risk of the investments and is responsible for ensuring there's enough money at the time you retire to pay your pension income. Your income is guaranteed, and it also rises with inflation.

Can I withdraw my pension?

Yes. That's what it's for! But only once you've reached 55 (or 57 from 2028) for defined contribution pensions.

There are different methods for taking your money, and your personal circumstances might demand using one method over another. Some, for instance, allow you to withdraw your pension as a lump sum. Others pay out a guaranteed income for life or for a set number of years. Regardless, 25% of the money you take will usually be tax-free.

With a defined benefit pension, you may be able to take some of its value as a tax-free lump sum, but this will depend on the rules of your scheme. The rest of the money will be paid to you as a guaranteed income for the rest of your life. You can usually begin taking your DB pension from the age of 60 or 65, but this could be different depending on your pension scheme's rules.

And what about the State Pension?

The State Pension is designed to supplement your workplace pension and other savings. It's not designed to support you on its own. To check whether you're entitled to the State Pension, and how much you'll receive, check your forecast. To get a State Pension you need to have made enough qualifying National Insurance contributions or have been credited with National Insurance contributions over the course of your life. These are called 'qualifying years'. If you haven't made enough qualifying National Insurance contributions, you can always make up for them if you want to.

It's important to factor the State Pension into your future plans. The full new State Pension amount could be worth up to £203.85 a week!

So, when do I start saving?

As soon as you can! The earlier the better. If you're employed, you'll likely already have a pension – unless you've opted out. Make sure to work out how much you can afford to save each month and reap the rewards of employer contributions!

The earlier you begin to think about your retirement – and what you want out of it – the easier it will be to save sensibly.

So, what do you want out of your retirement?