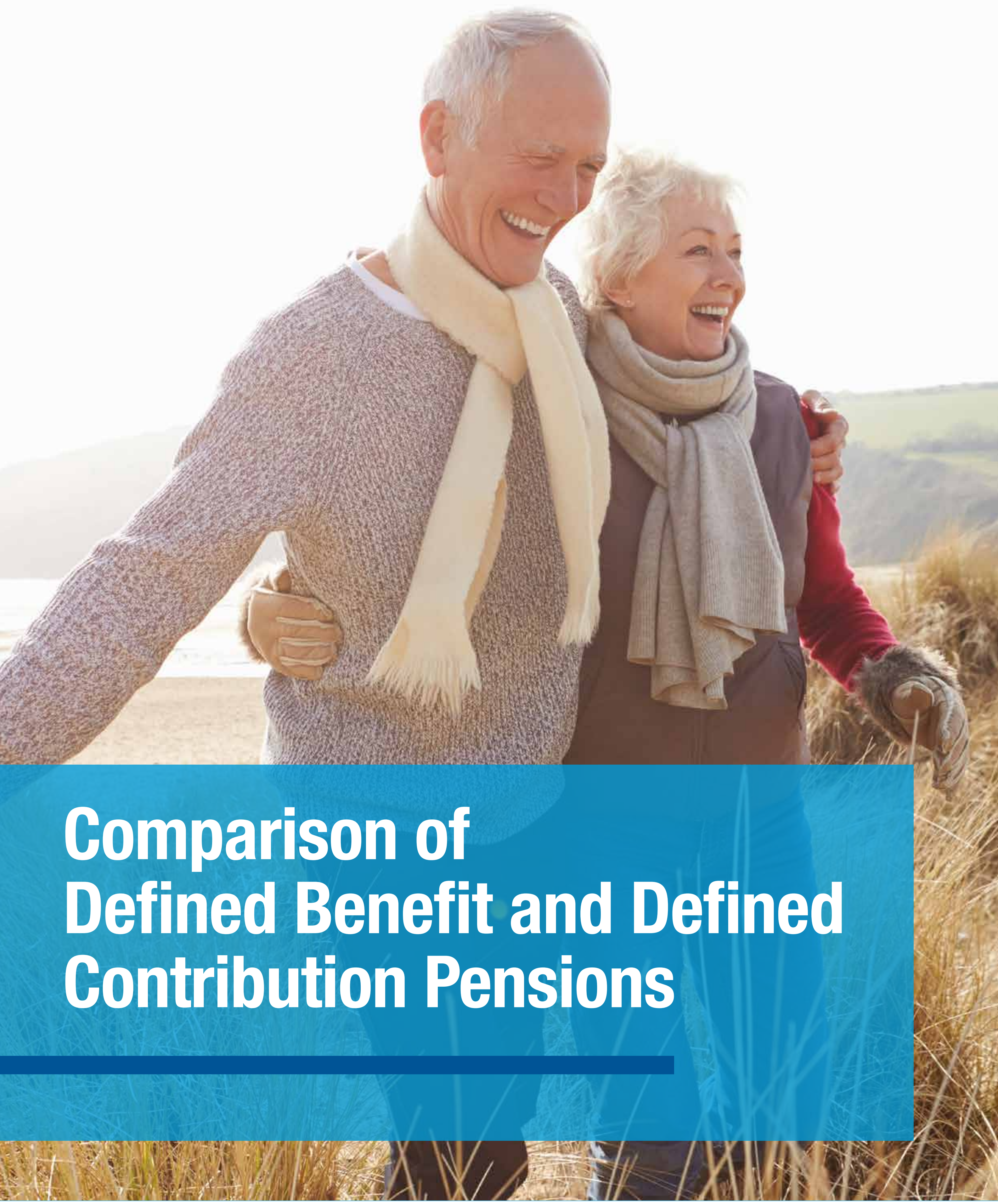

Comparison of Defined Benefit and Defined Contribution Pensions

bdhSterling*

We are here to help you make the right decisions now, for your future retirement

This Guide to the Comparison of Defined Benefit and Defined Contribution Pension schemes is intended for anyone who has a UK pension scheme and is wondering exactly what pensions they have and whether they are in the right schemes for them.

Introduction to UK Pensions

If you work or have worked for a UK employer, the chances are that you would have joined a pension scheme, set up by that employer.

There are many different names for these pensions with a variety of different pension providers, that could be looking after your pension funds, however, when you break it down, there are only two main types of UK pension scheme.

The two main types are Defined Benefit (sometimes known as a final salary) schemes and Defined Contribution (sometimes known as money purchase) schemes.

During your working life, across many jobs, you could become a member of one or the other – or quite possibly both.

Why do I need to understand the pensions that I have?

UK pensions can have very different features meaning that there are a range of benefits that can be provided across UK pension schemes.

It is vital that you have an understanding of what type of pension scheme you have and what it provides you to ensure that you have adequate provision for retirement or benefits for any potential beneficiaries, upon your death.

Your pension scheme may provide you with guarantees or it may be subject to investment risk. It is therefore important to understand what you have to make sure that your existing pensions are right for you now and at retirement.

How can we help?

bdhSterling are UK based financial planners with many years of expertise in advising on UK pensions.

The assistance of a professional financial planner can help you understand what pensions that you have and help you plan for retirement.

We will take the time to understand what is important to you, both now and in the future.

By taking advice you will have all the information you need to make informed decisions regarding retaining or adding to your current arrangements.

Financial planning in these areas is highly specialised – especially if you are a member of a defined benefit scheme - and requires the financial adviser to hold the appropriate qualifications.

For further advice please call **01372 724 249** or email **infouk@bdhsterling.com**

We realise that sometimes you may be gathering information before seeking advice, so over the next few pages we have provided information you need to consider when comparing Defined Benefit (DB) and Defined contributions (DC) schemes.

Defined Benefit Pensions

A defined benefit (DB) pension scheme is one type of workplace pension scheme, in which an employer promises a specific pension payment, lump sum (or a combination of both) on retirement. The scheme trustees make all the investment decisions, so there is no investment risk to the individual members.

This type of pension scheme is also commonly known as a 'final salary' scheme.

The benefits payable are predetermined using a number of factors, typically including; your earnings, the length of time that you have been a member of the scheme, your age and a rate of accrual determined by the scheme. The pension scheme will define what is meant by 'earnings', this could be basic pay and may not include overtime, commission or other benefits.

Defined benefit schemes may be based on your final salary or an average over your career whilst you have been a member (career average).

Defined benefit schemes pay out a secure income for life which typically increases each year. You might have a defined benefit pension if you've worked for a large employer or in the public sector.

Your employer contributes to the scheme and is responsible for ensuring there is sufficient money within the scheme at the time you retire to pay your pension income. You may also be asked to contribute to the scheme. Any contributions you make are normally deducted from your salary before your income tax is calculated.

At retirement you will receive a pension income and potentially the option of a tax free lump sum. Many schemes will offer a reduced income if you wish to take a tax free lump sum payment, however some offer the tax free lump sum in addition to an income.

Where the total value of all of your pension benefits (the defined benefit pension and any other private pension plans that you may have) is £30,000 or less, you can take the whole of your defined benefit pension as a lump sum. Currently 25% will be tax free and the remainder will be subject to tax at your marginal rate, this option is normally only available from age 55.

If you die when you are in receipt of your pension, a reduced pension will continue to be paid to your spouse or civil partner for their lifetime.

Depending on your employment history, you may also have one or more deferred defined benefit pension schemes. This is where you have been a member of a defined benefit pension scheme but may have left the company so you are no longer an active member and the benefits are 'deferred' until you retire or elect to transfer these benefits to a defined contribution scheme.

The value of a deferred pension in a defined benefit scheme will have some protection against inflation from the date of leaving the scheme up to your retirement age, or when you take the scheme pension, or elect to transfer out of the scheme.

Defined Contribution Schemes

A Defined Contribution (DC) scheme is a pension where you build up a pot of money which can be used to provide you with an income in retirement and can be in the form of:

- For individuals – a personal pension plan (PP), Stakeholder Plan, Self Invested Personal Pension (SIPP), Retirement Annuity Contract
- Through your workplace – Group personal pension (GPP), Group Stakeholder, Occupational Money Purchase Plan, Small Self-Administered Scheme (SSAS), Executive Pension Plan

You may have more than one of these.

You can get tax relief on personal pension contributions up to 100% of your annual earnings although if total pension contributions in a year exceed £40,000, there may be a tax charge on this excess. If you have already accessed some of your pension funds flexibly through an Uncrystallised Fund Lump Sum or through a Flexi-access drawdown then the Money Purchase Annual Allowance may apply. This will restrict your contributions to £4,000 in a year.

Defined contribution pension schemes invest the contributions, made by you and/or your employer in a range of different investments.

If you have a personal pension plan, you can choose your own contribution level and how your contributions are invested. If you pay Income Tax at a rate of 20% or less, your pension provider will automatically claim back 20% and add it to your pension pot. If you pay a higher rate of Income Tax, you will need to claim the additional tax yourself through your self-assessment return.

If you are a member of a workplace group personal pension scheme, the minimum contribution level will be determined by your employer but you are usually allowed to pay more than this and you should be offered a choice on how the contributions are invested. Your own contributions are deducted from your salary after tax has been taken off and your contributions are paid net of basic rate tax relief (currently 20%).

Another type of workplace defined contribution scheme is the occupational money purchase scheme. This is where contributions may be deducted from salary before income tax is calculated.

Defined contribution pension schemes are also known as 'money purchase schemes'.

Your pension pot is built up using your own and your employer's contributions (if applicable) plus investment returns and tax relief.

The benefits available on retirement are dependent on:

- how much has been paid in on your behalf (by you and/ or your employer);
- the length of time that monies have been invested and the fund's investment performance; and
- the level of charges deducted from the plan

You can access and use your pension pot in any way you wish from age 55. You can also keep saving into your pension and get tax relief until you reach the age of 75. If you have accessed your pension plan and taken an income, ongoing contributions may be restricted to £4,000 per annum.

The options currently available when you access your plan are:

- Take your whole pension pot as a lump sum in one go. A quarter (25%) will be tax free (this may be higher if you have applied for tax free cash protection or scheme specific protection applies) and the rest will be subject to Income Tax and taxed in the usual way. Bear in mind that a large lump sum could tip you into a higher tax bracket for the year you take your lump sum.
- Take lump sums as and when you need them. A quarter of each lump sum will be tax free and the rest will be subject to Income Tax and taxed in the usual way. Bear in mind that a large lump sum could tip you into a higher tax bracket for the year.
- Take a quarter of your pension pot as a tax-free lump sum, then place the rest in a drawdown plan which allows the funds to remain invested and withdrawn as and when required (this might be to provide you with a regular taxable income or to make ad-hoc withdrawals). Bear in mind that a large lump sum could tip you into a higher tax bracket for the year.
- Take a quarter of your pot as a tax-free lump sum and then convert some or all of the rest into a taxable guaranteed income for life (known as an annuity).

What do I do next?

When you have had time to digest the information in this guide and think about your own circumstances, it might be time to come along and speak to a bdhSterling financial planner.

We offer a free initial consultation which is an opportunity to talk through your circumstances and get an idea of what your options are and what is important to you.

We can either visit you or arrange a meeting at our offices.

Our aim is to find the right solution to make sure that your needs are met and goals are attained.

To arrange an appointment call 01372 724 249 or email infouk@bdhsterling.com

Features	Defined Benefit Schemes	Defined Contribution Schemes
Contributions	Your employer contributes to the scheme and is responsible for ensuring there's enough money at the time you retire, to pay your pension income. You may be able to contribute to the scheme too.	Defined contribution pensions build up a pension pot using your contributions and your employer's contributions (if applicable) plus investment returns and tax relief.
Investment Choice	The scheme trustees make all the investment choices.	With a personal pension plan or group personal pension plan you can usually choose from a range of funds to invest in. With an occupational money purchase scheme the trustees normally make the investment decisions.
Flexibility	It is not usually possible to reduce your contribution levels or suspend them. Contributions can usually be increased by using a separate plan (an additional voluntary contribution plan).	It is often possible to increase and decrease contribution levels or stop them. You can also change your investment choices on a regular basis with a group or personal pension plan.
Security	Defined benefit schemes are protected by the Pension Protection Fund.	These schemes are usually covered by the Financial Services Compensation Scheme.
Charges	There are no explicit charges or fees.	These will vary from scheme to scheme and often include an annual management charge, policy fee and, particularly for older schemes, a bid/offer spread.
What happens if you leave your employment?	You will become a deferred member of your pension scheme so you will be entitled to benefits on your retirement in line with your period of employment. You may transfer your accrued benefits to a new pension plan. Please note that if you were a member of a public service pension scheme, e.g. NHS or civil service, this may not be possible.	Your fund will remain invested until your retirement. You could transfer the accrued fund to another pension provider. With personal pension plans it is normally possible to continue your contributions, within allowable limits until age 75.