Pension basics explained

Making pensions and retirement planning simpler for you

Pension basics explained

Find out all you need to know about pensions and retirement planning.

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Understanding pensions

Generally speaking, a pension is a tax-efficient way of saving for your retirement. There are different types of pensions available, depending on your circumstances.

Workplace pension	Individual pension	State pension
This is a pension scheme that's arranged by your employer. If you're between 22 and State Pension age, work in the UK and earn more than £10,000 a year, your employer must enrol you in a scheme. A percentage of your pay goes into the pension scheme each payday and your employer adds money to the scheme for you too. There are 2 types of workplace pension: **Defined contribution** – The money paid into the scheme is invested by the pension provider. The amount available to you when the policy matures depends on how much has been paid in, the charges and how well the investments have performed. The value can go down as well as up and you could get back less than has been paid in. **Defined benefit** – The money you get back doesn't depend on investments, but is based on your salary and how long you've worked for that employer.	Personal pensions, stakeholder pensions and self-invested personal pensions (SIPPs) are all types of individual pensions. How regularly you pay in is usually up to you, and what you get back largely depends on how much you pay in, the charges and on how well your investments perform. The value of your pension can go down as well as up, and you may get back less than has been paid in. Other people like your partner or employer may also be able to contribute to your individual pension.	The State Pension is a regular payment from the government. To get a State Pension, you must first reach State Pension age, usually with at least 10 qualifying years on your National Insurance record. The amount you receive is also based on your National Insurance record and you'll normally get the full amount if you have 35 or more qualifying years of contributions. While the State Pension probably won't be enough to support you on its own, it can be a useful addition to your retirement income.

Reasons to pay into a pension

• **You get tax relief on contributions**

The government usually adds money to your pension in the form of tax relief, so if your pension scheme operates the ‘relief at source’ method of tax relief, the government will add £20 to your pension for every £80 you pay in. If you’re a higher rate taxpayer, you may have to claim any higher rate tax relief you’re entitled to through your self-assessment returns. For some workplace pensions, you can choose to give up part of your salary in exchange for your employer making an equivalent contribution to your pension, on top of what they would normally pay in. The reduction in salary means you save on tax and National Insurance contributions.

• **Employer contributions**

With auto-enrolment fully in place, all employers must contribute to pension schemes on behalf of eligible employees. Some employers may also allow you to ‘sacrifice’ or ‘exchange’ part of your salary in return for additional pension contributions from them. In this way, both you and the employer will save on tax and National Insurance contributions.

Paying into a pension

• For individual and workplace pensions, you can make regular and one-off payments. This will vary depending on both your provider and the type of pension you have, so check in advance that you can pay in the way you want to.

• You can usually make payments through your employer too. Either contributions will come out of your salary, or your employer will pay into your pension themselves. Speak to your employer to see what they offer.

How you can receive money from your pension

You can currently start to take benefits from individual and workplace pensions from the age of 55, although most workplace pensions will have a normal retirement age set by your employer.

They will also have rules for when you can take your pension earlier than normal, for example if you become seriously ill or unable to work.

If you’ve got an individual pension or a defined contribution pension, you can take up to 25% of its value as a tax-free lump sum. You’ll usually pay tax on the rest, which you can either take as cash, use to buy an annuity (a guaranteed income for the rest of your life) or leave invested and make regular or one-off withdrawals over time. Different ways of taking your money have different levels of risk and security and potentially different tax implications too. As with all retirement decisions, it’s worth getting advice on what’s best for you personally.

With a defined benefits 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.

How the State Pension works

The State Pension is a regular payment you can claim from the government when you reach State Pension age.

Your age and National Insurance records will affect the amount you'll get and when you'll be eligible to start receiving it.

Claiming the State Pension

You can claim your pension when you reach State Pension age. You can find out how at the **government's website**. You'll also find a simple calculator to show you when you'll qualify for the State Pension.

If you wish, you can **defer your pension** until a later date. By doing this, your payments could be higher when you do decide to claim.

The amount you could receive

The amount you'll receive in State Pension payments depends on how much National Insurance you've paid. If you haven't yet reached the State Pension age (or if you reached it on 6 April 2016 or later) and you're eligible, you'll get the new State Pension.

You'll usually need at least 10 qualifying years on your National Insurance record to get the new State Pension. If you have a 35-year National Insurance record, you may qualify for the full New State Pension. For the 2021/22 tax year, the full new State Pension level is £179.60 per week. For more details, see the **government's website.**

You might also be able to claim pension credit. This is an income-related benefit which could top up the amount you receive each week. There's more information about this on the government's **Pension Credit** page.

This information is based on current understanding of legislation and may change.

Understanding your pension statement

Ups and downs in the investment market might make you want to take a fresh look at your pension savings. A good place to start is to look at your annual pension statement.

Just remember your pension statement will show how your investments have performed over one year. But pensions are long-term investments — so there are likely to be highs and lows along the way.

Investment decisions made in a rush are rarely good ones, and you shouldn't let short-term market movements dictate long-term plans. For more information about how to manage your investments during periods of heightened volatility, **read our quick guide.**

When looking at your pension statement, it's important to understand what type of pension you have.

Are you saving into a defined contribution or defined benefit pension?

If you're saving into a defined contribution pension, or you've saved into one in the past, your pension provider(s) must send you a pension statement on an annual basis. You should be sent a statement for every defined contribution pension you hold. If you're not sure if you are saving into a defined contribution or defined benefit pension, ask your pension provider, or employer if applicable.

If you haven't been receiving your statement(s), it may be because your provider(s) records are out of date and they don't have your current home address. If this is the case, you should get in touch with your provider(s). You can ask them to send you your latest pension details at the same time as updating your details.

For people in defined benefit pensions, it's not mandatory for these statements to be sent on an annual basis. If you're in a defined benefit pension, you do have the right to ask for one, regardless of whether you're still building up defined benefits or not.

If you think you have a defined benefit pension, you can contact the administrator concerned, and they must supply you with your defined benefit pension details within two months of asking. The defined benefit statement should outline the prospective income it's set to provide when you reach retirement.

Given that the majority of pension savers are in defined contribution pensions, these are the annual statements we'll focus on.

What does the annual pension statement tell you?

The statement will include lots of valuable information such as:

- The amounts paid in over the last year by you, your employer (if applicable) and by the government in the form of tax relief
- The value of your pension pot at the start and end of the statement year
- Details of any charges
- Details of the fund(s) your money is invested in

The statement should also include a projection of what you might get back at retirement. You should consider this projection as a rough guess rather than an accurate expectation of what you will actually receive. No one knows what future investment returns will be as they depend on a huge number of different economic factors. But, regardless, this projection can be a helpful indication upon which you can plan.

For more information on pensions and planning your retirement, visit our retirement planning hub.

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