Pensions

A young person’s guide

Personal Finance Programme
Module 10

DHE Solutions Ltd
Educational Development, Research & Evaluation

PERSONAL FINANCE PROGRAMME

Erasmus+

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ERASMUS+ KA2 STRATEGIC PARTNERSHIP IN SCHOOL EDUCATION

What is a pension?

D: A pension is a way of saving for your retirement. You put money into your pension each month and, in return, you get a regular income once you've retired.

You don't have to pay tax on pension contributions, which is one of the reasons saving into a pension can be more effective than saving for your retirement in other ways.

What is a pension?

Why is it important? When you are young, it may seem boring to think or talk about pensions, as this is something for older people. But a pension is important, and the sooner you understand about pensions, the sooner you will be able to make a decision about starting one.

The point is, once you retire you stop earning income. Therefore you need to put something in place to help cover this drop in income.

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What types of pensions are there?

D: There are three types of pension: **state** pension, **workplace** pensions and **personal** pensions.

All three types are available to everyone, as long as you are in employment.

State pension

Currently, you can claim state pension when you reach the state pension age. For both men and women, this is currently 65. But the state pension age will rise to 66 in October 2020 and 67 between 2026 and 2028. For current Young People born around the millennium, you may well be 70 before you receive your state pension!

It used to be called the old age pension, but that phrase was dropped as people no longer regard themselves as old when they reach 65!

State pension – how much might you receive

The amount of state pension you receive can vary

Currently the "**full level**" of the state pension is **£164.35 per week**.
But the name is confusing, because you may get more or less than this:

- If you have made full National Insurance payments, building up additional state pension, you're likely to get **more**.
- If you 'contracted out', and paid reduced National Insurance contributions for several years, or had periods when you didn't work you're likely to get **less**.

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What does '**contracting out**' mean?

To cut the bill for the state pension, the government previously allowed pension savers to 'contract out' of being part of the national state pension scheme.

You paid less National Insurance (NI) and didn't get the additional state pension, and the money you saved in NI was put into your workplace or private pension.

This is regularly reviewed and can change, so it is important to check.

How is your state pension calculated?.

The Department for Work and Pensions (DWP) applies a formula, taking into account the number of full National Insurance years you have, contracted-out periods and the additional state pension you've accrued, to work out have much state pension you're due.

£150.12

Average payout

£151.84

Average payout for men

£143.85

Average payout for women

Quick example: how is your state pension calculated?.

If you've never been contracted out, or earned any additional state pension, calculating how much you'll get is straight forward.

For example,

...say you have **25 qualifying years** on your **National Insurance record**.

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For example,

...say you have **25 qualifying years** on your **National Insurance record**.

You divide **£164.35** by **35** and then multiply by **25**. Your new state pension will be about **£117.35** per week.

Quick example 2: how is your state pension calculated?.

Further examples,

...calculate the state pensions for people with **33 qualifying years** NI contributions
and **19 qualifying years** NI contributions...

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Further examples,

...calculate the state pensions for people with **33 qualifying years** NI contributions and **19 qualifying years** NI contributions...

You divide **£164.35** by **35** and then multiply by 33. Your new state pension will be about **£154.96** per week. Then, you divide **£164.35** by **35** and then multiply by 19. Your new state pension will be about **£89.22** per week.

Workplace pension

The state pension will not be able to provide all your retirement income, so most people take out a pension with their employer to top it up.

D: Workplace pensions take contributions from you, your employer and the government, and use them to provide you with a pension when you retire.

- Your contributions will take the form of a percentage taken from your salary each month, and your employer's will also be added as a percentage of your pay.
- The fact that your employer pays into your workplace pension is one good reason for having one (it is like extra pay).
- These contributions will be invested, with the aim of increasing the amount you have to retire on.

There are **two types** of workplace pension: **defined benefit** and **defined contribution**.

Workplace pension

Defined Benefit pension

Defined benefit pension schemes are being phased out in favour of defined contribution pensions.

They work by promising to pay out a certain amount when you retire, based on your salary. How the investments perform won't affect what you get.

Defined Contribution pension

Defined contribution schemes work by your employer selecting a pension provider who will invest the money you pay in. Many schemes operate moving your money into lower-risk investments as you near retirement so that you can maximise your income.

The amount you get at retirement will depend on: **administration fees** charged, **how much** has been paid in, **how long** you've been paying in for and **how well** the investment has performed.

Workplace pension

What happens to my pension when I change jobs?

You can transfer your pot to the scheme at your new workplace.

However, this can be **complicated**, depending on the type of pension scheme. If you are transferring out of a **defined benefit** scheme into a **defined contribution** scheme, for example, you should consider the fact that you are giving up a promised payment at retirement.

Transferring **defined contribution** schemes is much **easier** – you can just take the funds with you. However, it's worth watching out for any **exit fees** imposed and the **annual management charges** on the new scheme, which could decrease your pot.

Personal pension

A personal pension is a type of pension scheme and, like other pension schemes, offers a tax efficient way to save for retirement.

- These work by you paying money into a pension scheme from a provider **selected by you** (rather than your employer, unlike a workplace pension).
- Like workplace pensions, personal pensions invest your money with a view to increasing it.
- Personal pensions are particularly suitable for the **self-employed** or people who **aren't in work**, who don't have access to workplace pensions. But anyone can save into a personal pension.

Pensions and Compound Interest.

This is where the interest your savings have earned goes on to earn interest itself. For example,

...say you save **£1,000 every year** for **5 years**, with **no interest growth**, after five years you've got **£5,000** i.e. that's what happens if you hide it under the mattress.

Pensions and Compound Interest (II).

This is where the interest your savings have earned goes on to earn interest itself. For example,

...say you save **£1,000 every year** for **5 years**, with **no interest growth**, after five years you've got **£5,000** i.e. that's what happens if you hide it under the mattress.

But If you put the same **£1,000 every year** for **5 years** into a pension fund. An interest growth of **5%** a year turns it into **£5,801**.

This is because at **5%** growth **£1000** becomes **£1,050** after the **first year.**
Add the next **£1,000** = **£2,050**.
This, increased by **5% again**, in the **second year** becomes **£2,152.5** and so on.
So after **5 years you have £5,801**, an increase of **£801** on hiding it under the mattress.

Pensions and Compound Interest (III).

Year No.	Amount Saved	C/f	At 5% interest growth Rate
1	1000	1000	1050
2	1000	2050	2152
3	1000	3152	3310
4	1000	4310	4525
5	1000	5525	5801

Pensions and Compound Interest (IV).

Exercise 2:

Calculate the compound interest of investing £1000 per year at 7% per year for ten years.

Pensions and Compound Interest (V).

Exercise 2:

Calculate the compound interest of investing £1000 per year at 7% per year for ten years.

If you put the same **£1,000 every year** for **10 years** into a **pension fund**. An interest growth of **7%** a year turns it into **£14,783.60**.

This is because at **7%** growth **£1000** becomes **£1,070** after the **first year.**
Add the next **£1,000** = **£2,070**.
This, increased by **7% again**, in the **second year** becomes **£2,214.9** and so on.
So after **10 years you have £14,783.60**, an increase of **£4,783.60** on hiding it under the mattress.

Pensions and Compound Interest (VI).

This is where the interest your savings have earned goes on to earn interest itself. For example,

… Calculate the compound interest of investing **£1000** per year at **7%** per year for **ten years**.

Year No.	Amount Saved	C/f	At 5% interest growth Rate
1	1000	1000	1070
2	1000	2070	2214.9
3	1000	3214.9	3439.94
4	1000	4439.94	4750.74
5	1000	5750.74	6153.29

Pensions and Compound Interest (VII).

This is where the interest your savings have earned goes on to earn interest itself. For example,

... Calculate the compound interest of investing **£1000** per year at **7%** per year for **ten years**.

Year No.	Amount Saved	C/f	At 5% interest growth Rate
6	1000	7153.29	7654.02
7	1000	8654.02	9259.80
8	1000	10259.80	10977.99
9	1000	11977.99	12816.45
10	1000	13816.45	14783.60

Automatic Enrolment:

Automatic enrolment is a recent UK Government initiative to help more people save for later life through a pension scheme at work.

In the past, many workers missed out on valuable pension benefits, because their employer didn't offer a pension scheme, they were not eligible to join it, or they didn't apply to join their company's pension scheme.

Automatic enrolment changes this. It makes it compulsory for employers to offer a pension scheme and automatically enrol their eligible workers into it. The employer must also pay money into the scheme.

automatic enrolment

Typical pension providers in the UK

These are the most common pension providers in the UK.

You will probably recognise some of these companies.

But there are more, and it is useful to use free online comparators to study their differences and find which one suits better to you.

AEGON	AVIVA	creative pension trust	Legal & General	nest
NOW: Pensions	the people's pension	ROYAL LONDON	SALVUS	SCOTTISH WIDOWS
simply! Auto Enrolment Solutions	Smart Pension fast secure free	Standard Life	true potential	TRUST Pensions
welplan	Workers pension trust			

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