There are many types of pension scheme with different tax relief and contribution arrangements, and varied ways of building up the pension. Some pension schemes are employer-sponsored, others are set up by an individual in their own right, and a small number are set up on behalf of another family member.

Most employers, except those with fewer than 5 employees, must offer their employees access to a pension scheme. Membership is on a voluntary basis and usually both the employee and employer make contributions.

The Survey asks adults about pension schemes because these pension schemes will be a source of income in retirement. FRS data are used to monitor eligibility to join employer pension schemes, membership across the different types of pension scheme, and the source of contributions (e.g. employer, employee).

What is a pension?
A pension is a source of regular income to live on in retirement. Most pensions come from the investment growth on the savings and interest payments made into a pension scheme.

While working, you pay part of your wages into the pension fund: these payments are called ‘employee contributions’. Some employers also make payments into the pension fund: these are called ‘employer contributions’.

There are a number of different types of pension:

• **State pensions** – these include the basic State Pension and the State Second Pension(S2P), formerly the State Earnings Related Pension Scheme (SERPS).

• **Private or non-state pensions** – these include occupational pensions (also known as work or company pensions) and personal pensions (including stakeholder pensions). People can have several different non-state pensions at once, but they may not be allowed to make contributions to all of them.

The basic State Pension
The basic State Pension is paid by the Government to people who have reached State Pension age. You qualify for it by paying or being credited with National Insurance (NI) contributions, or qualifying for Home Responsibilities Protection (HRP). Most employers take NI contributions out of your wages. If you are self-employed, you are responsible for paying your own NI contributions.

Occupational pensions
An occupational pension scheme is an arrangement an employer makes to give their employees a pension when they retire. Some pension schemes offer other benefits such as life assurance or a pension for dependants when you die.

Occupational pensions are also known as company or works pensions. Another term that is sometimes used, particularly for schemes set up before the 1990s, is ‘superannuation schemes’.

An occupational pension scheme is connected to your job. Self-employed people are normally not eligible to belong to an occupational pension scheme, the main exceptions being doctors and dentists.

When you leave your job, you may not be able to transfer your occupational pension to your new employer’s scheme. If you do not transfer your pension to your new employer, you continue to have entitlements to a pension from your previous employer’s scheme. These pension entitlements are usually called ‘preserved benefits’ or ‘deferred rights’.

People who have benefits in a previous employer’s occupational pension scheme can join a new employer’s occupational pension scheme, but they can not continue to pay into the old scheme as well as the new one.

There are two main types of occupational pension:

<u>1. Salary-related pension schemes (also called defined-benefit, DB or superannuation schemes)</u>

In a salary-related scheme, the pension is based on the number of years you belong to the scheme and how much you earn (usually, your earnings when you retire or leave the scheme). Your employer contributes to the scheme and trustees look after scheme members’ interests.

Employees often have to pay contributions into the scheme on top of those made by the employer. Some schemes are ‘non-contributory’: the employee either makes no contributions, or makes a small contribution, typically 1-2% of salary, for extra benefits for a surviving spouse if they die before normal pension age.

<u>2. Money purchase schemes (also called defined-contribution or DC schemes)</u>

In a money purchase scheme, employee contributions (together with any employer contributions) are invested and the amount you get when you retire depends on the total amount of money paid into the scheme over the years and how the investment has grown. When you retire, you use the fund to buy an annuity from an insurance company that gives you a regular income, usually payable for the rest of your life. The scheme is due to be reviewed pending its closure in 2012-5.

Generally, both employers and employees pay a regular contribution – usually a percentage of salary, or a fixed amount each week/month. In some schemes, including ‘Smart’ pensions and some salary-sacrifice schemes, employees don’t make any contributions.

Defined benefit pensions which are now paid as an annuity

The closure of Defined Benefit pension schemes over the last decade has meant that an increasing number of DB schemes have transferred their pension liabilities to insurance companies (possibly by means of a buy-out) with the pensioner being paid an annuity by the insurance company.

If an employee has a pension from a previous employer paid by means of an annuity this should be coded as an employer pension.

Personal pensions
Introduced in 1988, a personal pension is a kind of pension that people set up for themselves, with a pension provider such as a bank, life assurance company or building society. It is entirely your own, which means you can continue to contribute to it if you move jobs. Personal pensions are the most common pension arrangement for people who are self-employed.

Personal pensions are money purchase schemes (also called defined-contribution or DC schemes). As with occupational money purchase schemes, the money you save is put into investments such as bonds or stocks and shares and the amount you get when you retire depends on the total amount of money paid into the scheme over the years and how the investment has grown. This fund will then be used to buy an annuity from an insurance company that will give you a regular income when you retire. You can buy an annuity at any age from 50 to 75 although from 2010 the minimum age increases to 55.

Group personal pensions (GPPs) and Group Stakeholder Pensions (GSHPs)
Some employers who do not offer an occupational pension scheme may arrange for a pension provider to offer their employees a personal pension or stakeholder pension instead. Pensions arranged in this way are called GPPs or GSHPs. The employer may have negotiated special terms with the provider which mean that administration charges are lower than those for individual personal pensions or stakeholder pensions.

Although they are sometimes referred to as company pensions, they are not run by employers and should not be confused with occupational pensions, which have different tax, benefit and contribution rules.

Some employers do not make contributions to a GPP, but usually both employers and employees pay a regular contribution – usually a percentage of salary, or a fixed amount each week/month.

When you leave your job, you can continue contributing into your GPP or GSHP as a personal pension, but your employer will stop making contributions, and you may lose any special terms that your employer has negotiated for the group scheme.

Stakeholder pensions (SHPs)

Introduced in 2001, SHPs are a special type of low-charge personal pension. As with other types of money purchase pensions, the money you save is put into investments such as bonds or stocks and shares and the amount you get when you retire depends on the total amount of money paid into the scheme over the years and how the investment has grown. This fund will then be used to buy an annuity from an insurance company that will give you a regular income when you retire.

SHPs are suitable for people who are self-employed, moderate and low earners, and those who do not have an income of their own but can afford to save for a pension (e.g. women on a career break). SHPs can also be set up for children.

Like personal pensions, SHPs are sold by insurance companies, banks and building societies, as well as by some trade unions. As with GPPs, employers can make an arrangement with a pension provider and offer their employees a group SHP scheme (GSHP).

There are some differences between SHPs and other types of personal pensions. SHPs have to meet certain standards set by the Government to make sure they offer value for money, flexibility and security:

• the charges are capped;

• there are low minimum payments;

• they are more flexible than many other private pension schemes – you can choose when and how often you pay into the scheme and there are no penalties if you miss a payment; and

• other people, as well as an employer, can pay into a SHP on your behalf. That means that partners or other family members can help you to save for your retirement.

Some pensions introduced shortly before 2001 adopted these SHP standards and were called 'Stakeholder Compliant' pensions. These should be treated as stakeholder pensions.

Self Invested Personal Pension Schemes (SIPPs)
SIPPs are a type of personal pension where the person who sets up the pension has control over the management of investments. SIPPs are designed for people who want to manage their own fund by dealing with, and switching, their investments when they choose. They decide which assets are bought, sold or leased and when assets are acquired or disposed of.

Retirement Annuity Contracts (RACs)
RACs were pension schemes open to the self-employed and employees who were not members of their employer's occupational pension schemes. These pension arrangements were withdrawn from 1 July 1988 when personal pension schemes were introduced. Although no new RACs can now be set up, some people still have these pension arrangements as individuals who were already contributing to an RAC at that date were permitted to continue to make contributions.

Additional Voluntary Contributions (AVCs) and Free-standing Additional Voluntary Contributions (FSAVCs)
AVCs are employee contributions made by an employee in a salary related occupational scheme. Contributions are paid at a level over and above the normal contributions required by the scheme, and made to obtain additional benefits, usually a higher pension in retirement. FSAVCs are similar, but the employee contributions are paid to a pension provider and are separate from the occupational pension scheme. Benefits paid by the pension provider at retirement come from employee contributions only.

Contracting out
All employees with earnings above an annual Lower Earnings Limit (LEL), are automatically included in the additional State Pension scheme – State Second Pension, formerly the State Earnings Related Pension Scheme (SERPS).

Since 1978, members of an occupational pension that meets certain requirements can 'contract out' of the additional State Pension scheme. Employers and employees pay lower NI contributions, but the employees get a reduced entitlement to the additional state pension.

Since 1988, employees with a personal pension (or since 2001, a SHP) can also opt to 'contract out' if they think it will give them a higher income, or other benefits, when they retire. They pay standard rate NI contributions, but an annual NI rebate is paid into their personal pension or SHP in addition to other contributions. For some personal pensions, the NI rebate is the only contribution – these are often called 'rebate only' pensions.

Useful publications
The Pension Service publishes a series of free guides about pensions. You can order them by calling 0845 731 32 33 or by visiting the resource centre of The Pension Service website at www.thepensionservice.gov.uk.

• **A guide to your pension options (PM1)**

• **State pensions – your guide (PM2)**

• **Occupational pensions – your guide (PM3)**

• **Personal pensions – your guide (PM4)**

• **Pensions for the self-employed – your guide (PM5)**

• **Pensions for women – your guide (PM6)**

• **Contracted-out pensions – your guide (PM7)**

• **Stakeholder pensions – your guide (PM8)**

• **State Pensions for parents and carers (PM9)**

• ***How to get extra weekly State pension or a lump sum payment: Your introduction to State Pension Deferral* (SPD2)**

More detailed free guides about pensions are available from the Financial Services Authority. Call the FSA Consumer Helpline on 0845 606 1234, or visit their website at www.fsa.gov.uk/consumer

• **FSA guide to pensions 1 – Starting a pension**

• **FSA guide to pensions 2 – Reviewing your pensions**

• **FSA guide to pensions 3 – Annuities and income withdrawal**

• **Stakeholder pensions and decision trees.**

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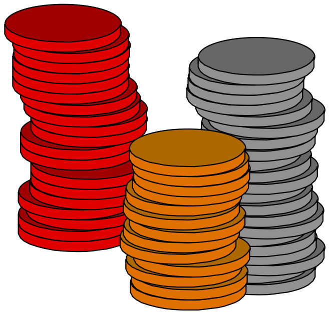
Interviewers' Pocket Guide To Pensions



Note: this Guide is for interviewer use only. It is not intended to be an authoritative statement on pensions; it is designed to give FRS interviewers a brief description of those pensions for which details are required from respondents to the survey.