

SPECIAL REPORT: OCCUPATIONAL PENSIONS

Over the last five years the face of pensions has changed considerably, even before taking into account the emotive subject of supposed pensions mis-selling.

One thing remains constant, however; there is still much that is misunderstood regarding the basics of the subject. The technical phraseology and jargon used by the drafting legislators and Inland Revenue Savings, Pensions and Share Scheme section is, inevitably, adopted by the pensions adviser. All parties, occasionally, forget to use plain English when talking with the lay public. It is easy to see why misconceptions occur and 'popular myth' takes over.

We hope, therefore, that this brief question and answer session will confirm what you already know, and clarify some of those hazy areas of knowledge.

If you have a general query which you think may be of interest to other visitors to the site please email your query to us at info@financial-planning.uk.com. (Please note that whilst we can attempt an explanation, we cannot offer advice).

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Q1 Is there any difference between an occupational pension scheme, a superannuation scheme, a company scheme and a personal pension?

A. They are all means to the same end, namely, income in retirement, but there are minor differences.

An occupational pension scheme is generally taken to be one which has Inland Revenue approval, and so has a particular legal basis governed by the Income and Corporation Taxes Act 1988

A superannuation scheme is generally taken to be a pension scheme operated by a large corporation, or an industry sector (e.g. such as for teachers or doctors) or for government employees. Both may be referred to as a 'group scheme'.

A company scheme may be the same as both of the above, but could also refer to a collection of personal pensions administered by the company for the convenience of employees. Both may be referred to as a 'group scheme'.

A personal pension is generally taken to be a pension arranged by an individual (either employed or self employed) on their own account without the involvement of an employer.

Q2. What is the difference between a pension scheme, a pension plan and a pension fund?

A. A pension scheme is generally taken to refer to a situation where more than one scheme member is involved.

A pension plan generally refers to a pension scheme for one person.

A pension fund is the underlying investment fund which provides the money to generate the pension payments.

Q3. Can anyone set up a pension?

A. Generally, anyone with a source of earned income can set up a pension relating to that source of income. A doctor with earnings from the NHS and from private practice can set up separate pension arrangements for each income source. Directors of investment companies, on the other hand, can set up pension arrangements only under very stringent rules. With effect from 6 April 2001 people without earned income have been able to contribute to stakeholder pensions.

Q4. What is meant by the 'earnings cap'?

A. It is the maximum salary which can be used to calculate pension benefit, pension contribution and certain other benefits. It changes each year, and for tax year 2002/03 is £97,200.

Q5. What is the 'married women's stamp'?

A. For a period up to April 1977 married women and widows were given an option to pay reduced NI contributions. Unfortunately, this meant that those who chose the option have no right to a state pension in their own name. By claiming on their husband's NIC payments they can claim a 'Category B' pension worth about 60% of the full single person's pension.

If you pay this reduced rate ask the local DSS office if it is worth reverting to the full payment. Completion of form BR19 will enable you to receive a forecast from the DSS of the benefits which will become payable from the state when you reach State Retirement Age.

Q6. What is an 'insured pension scheme'?

A. Unfortunately, it is not quite what it sounds like i.e. some sort of insured or protected pension. It is essentially a pension arrangement run by an insurance company using insurance policies to build up the pension fund.

Q7. If I leave work temporarily on maternity leave, will my pension entitlement suffer?

A. If you are a member of an occupational (but not personal pension) scheme then during your absence your benefits will continue to accrue as though you were still in full time employment, even where your income during this period was reduced. This would apply to any period of paid leave where an employer continues to pay the contractual remuneration.

Q8. Articles about pension which appear in the press use phrases like 'remuneration', 'final pensionable salary', 'scheme earnings', 'P60 earnings', and similar phrases. Are they all talking about the same thing? Why can't there be standard definitions to make things easier to follow?

A. On the whole the 'pensions industry' does use standard definitions, but from time to time the odd phrase is used incorrectly.

It all comes down to the definitions used within the particular pension scheme.

'Remuneration' is generally taken to mean all forms of income from employment, including those taxable, non-pay benefits that are shown on the P11D form.

'Final pensionable salary' in all cases will mean the salary on which your pension will be based. The actual definition will differ from scheme to scheme. One scheme may have a deduction to take into account state pension benefits; another may take the last years income; another may average the last three years' income, including or excluding overtime and bonuses. A careful reading of the scheme details (the Rules or explanatory booklet) should reveal all.

'Scheme earnings', like final salary above, will depend on the definition used by the scheme, but is generally used to refer to the earnings which determine personal contributions, if any.

'P60 earnings' are total PAYE earnings which appear on the tax-year end P60 form issued by the tax office.

Q9. What is a 'final salary' scheme?

A. A pension scheme where the pension is based on 'final salary'. (See Q8)

Q10. What is a 'formula based' scheme?

A. Many occupational schemes are based on a formula to calculate your pension entitlement. The formula is not standard, but those most often encountered are $1/60^{\text{th}}$, $1/80^{\text{th}}$ or $1/100^{\text{th}}$ of 'final pensionable salary' (See Q8) multiplied by the number of years of scheme membership.

Q11. What is a 'money purchase' pension?

A. This is simply a type of pension arrangement which produces a pension at retirement totally dependent on money invested in the pension fund, pension fund investment performance and annuity rates at retirement. So, if you invest enough, and investment performance of the fund is good enough, and annuity rates are 'good' at retirement, you should be reasonably pleased with your pension.

This is unlike the 'final salary' or 'formula based' scheme pension, where you know from the day of joining the scheme exactly how much income you will have at retirement, at least as a percentage of income, if not the exact pounds and pence.

Q12. What is a defined benefit scheme?

A. This is a pension arrangement where you can predict from the start what level of pension you will receive at retirement. Final salary and formula based schemes are defined benefit schemes.

Q13. What is a defined contribution scheme?

A. This is a type of pension arrangement where scheme members are asked to contribute a fixed amount of salary, either alone or along with an employer's contribution, to invest in the pension fund. At retirement their portion of the pension fund is used to purchase an annuity to provide their pension. It is only at this point that you know what your pension will be.

Essentially, it is another name for a money purchase scheme.

Q14. What is the maximum pension I can take?

A. The general rule of thumb is two thirds of total earnings in the year prior to retirement date.

BUT

This figure is limited by the earnings cap. In certain circumstances, where you have worked for 40 years and you retire after normal retirement date and so earn additional years service, up to another 5/60ths of earnings can be added to your pension.

Q15. How much can I contribute towards my pension?

A. As a member of an occupational pension scheme you will need to abide by the scheme's rules as to what you can actually contribute to the company scheme. Provided your contributions don't lead to overprovision of pension you are, under existing legislation, permitted to contribute up to 15% of total taxable earnings towards pension provision. If your scheme is non-contributory, or if you cannot contribute above a specified limit, you will need to look at other contracts which can accept them, (such as AVC or FSAVC contracts).

Q16. What is the difference between an AVC and an FSAVC contract?

A. AVC is short for 'additional voluntary contribution' and is an arrangement operated by an employer so that its pension scheme members can make additional contributions

and so build up additional pension benefit.

FSAVC is short for free standing additional voluntary contribution, an alternative to using the arrangement made available by the employer. FSAVCs are offered to individuals by pension providers and operate effectively as stand alone, single person pension arrangements.

Q17. What is the difference between a Top Hat scheme and an Executive Pension Plan?

A. These are generic titles given to single person pension arrangements, and the main difference is one of fashion and era. 'Top Hat' arrangements became popular in the 1960's and 1970's but the term was gradually replaced by the less (only just) elitist phrase Executive Pension Plan or Scheme.

Essentially, both are aimed at the higher paid employee, and as such had higher minimum contributions. Both were governed by the same legislation that governed group occupational pension schemes.

Q18. If I want to leave the company, I suppose that all of my contributions and all of the company's contributions can be transferred to the scheme my new employer runs?

A. Your entitlement will depend on a number of things, in particular whether the scheme you are leaving is defined benefit or defined contribution.

Broadly speaking, if you leave your company with less than two years membership of the pension scheme, all you may be offered is a refund of your own contribution. (See Q25). Your options may differ if you have already transferred previous pension entitlement into the scheme, or you have a personal pension.

If you are leaving a defined benefit scheme, your transferable entitlement will be the current cost of providing the pension entitlement you have earned to date, when it becomes payable at the scheme retirement age. If you are leaving a defined contribution scheme, you will be able to transfer your own and the company's contributions, plus accrued investment returns.

Q19. Is a transfer as described in Q18 a right?

A. Until April 1997, the right to a transfer was available as of right only to those who left their employer's pension schemes on or after 1st January 1986. Since April 1997, however, this right has been extended to those who left before January 1986.

Q20. I've heard colleagues referring to their pension rights being 'frozen' and even 'pupped'! I have a deferred pension. What is the difference between them?

A. They are all ways of saying that when you left an employer you left your pension entitlement behind, to be paid out when you retire. 'Pupped', by the way, is short for 'paid-up' pension

Q21. What is a 'Section 32 buyout'?

A. This is an option open to someone transferring pension entitlement, where the pension scheme of the new employer will not accept the transfer; or where the new employer does not have an appropriate pension arrangement in place; or where the person leaving is become self employed or redundant.

Q22. Can a pension be joint life, or life of another, like life assurance?

A. No, although in some circumstances, at retirement it may be possible to reduce the main benefit so that in the event of death, an element of benefit may continue for a dependant. Most defined benefit schemes permit such as option.

- Q23. Does my employer have to contribute to the occupational scheme I belong to? Does he have to contribute for each member?**
A. Yes. A minimum of 10% of the contribution in respect of each member.
- Q24. How do I get income tax relief on my pension scheme contributions when I join my employer's scheme?**
A. Normally a scheme member obtains tax relief on contributions via the net pay arrangement operated by your employer through the PAYE system. This means that your contributions will be deducted from your pay before income tax is worked out.
- Q25. If a member leaves the scheme that I belong to with less than two years' scheme membership, they are entitled to a refund of their contributions. If they were to "opt out" of the scheme but still work for the company, can they receive a refund of their contributions as well?**
A. Yes. The refund is subject to a 20% "stand alone" tax charge. The gross refund is paid to the scheme, trustees of who then pay the net amount to the employee. The trustees then pay the tax deducted to the Revenue. The employer receives the refund of their contributions less a 40% tax deduction, unless the refund remains within the scheme in which case there is no tax charge. The 20% tax charge cannot be reclaimed by the member, even if he is a non taxpayer.
- Q26. When averaging salaries to calculate final remuneration, is the earnings cap applied before or after averaging?**
A. After
- Q27. I joined my current company in 1982, but didn't join the company's occupational pension scheme until 1992. Does pensionable service for Inland Revenue maximum benefits start from 1982 or 1992?**
A. 1982, although it is likely that benefits under the scheme itself will only be granted in respect of service from 1992.
- Q28. Can I take a tax-free cash sum but defer taking the pension from my company scheme?**
A. Yes; provided you joined the scheme before 1st June 1989. However, the cash can be taken on or after your normal retirement date, and the pension can only be deferred if you continue to work. It is also possible to take the pension on or after normal retirement date and defer taking your cash. If you joined after the above date, both the cash and the pension must be taken TOGETHER when you actually retire, or when you attain age 75 if earlier.
- Q29. What is the maximum rate by which a pension in payment can increase?**
A. The Inland Revenue maximum pension can be increased in payment by 5% per annum compound or the rise in the Retail Prices Index (RPI) if greater. Where a pension in payment is less than the Inland Revenue maximum, it can be increased at any rate until it reaches the IR maximum increased by RPI.
- Q30. Can dividends be included in pensionable salary?**
A. No
- Q31. Can an employee pay for the life cover under an occupational pension scheme?**
A. No. In most circumstances, the cost must be met by the employer, but AVC's/FSAVC's/ can be utilised to increase an individual's life cover up to the maximum of 4 times salary.

Q32. Is it possible to retire on a “2/3 pension” before Normal Retirement Date (NRD)?
A. Yes, under the 1989 Finance Act Regime, an accrual rate of 1/30th of Final Remuneration for each year of service can be provided, on retirement at any age between 50 & 75, irrespective of normal retirement date, subject to the earnings cap. Under previous Regimes, you can have only a proportion of the maximum 2/3 if you retire early but the earnings cap does not apply.

Q33. What legal documents govern a pension scheme?
A. A pension scheme is established and governed by one or more of the following documents;

- a. Interim Trust Deed
- b. Trust Deed. The first Trust Deed following the interim Trust Deed is generally referred to as the Definitive Trust Deed.
- c. Declaration of Trust
- d. Rules
- e. Letters of Exchange.

Q34. What sort of powers do the Trustees of an occupational pension scheme possess?

- A.
1. Power to augment members' benefits with the employer's consent.
 2. Power to borrow money
 3. Power to amend the Trust Deed
 4. Power to extend the scheme to associated employers
 5. Wider power regarding investments than those granted under the Trustee Act 1925
 6. Power to reinsure benefits with an assurance company (e.g. death-in-service benefits)
 7. Power to buy annuities and deferred annuities

The powers are conferred on the Trustees by statute and by the scheme's Trust Deed. Some of the powers may involve the employer but this does not reduce the Trustees' responsibility to ensure their actions are carried out with the utmost good faith for the members' benefit. Under general law Trustees must act unanimously. However, the Trust Deed normally makes provisions for a majority decision of the Trustees to prevail. The power to appoint and/or remove Trustees may lie with the employer.

Trustees have a responsibility to 'whistle blow' if they become aware of any inappropriate dealings. This responsibility also extends to the Pension Scheme Auditors and Actuary (if applicable).

Q35. What does the Term “Free Cover Level” mean in respect of an Occupational Pension Scheme?

A. Where the death-in-service cash and spouse’s pension available under the Occupational Pension Scheme are insured, most insurers allow a substantial amount of life cover to be provided without the need for evidence of health. This is because the majority of lives to be covered will be “good lives” and any “under-average” lives will not necessarily affect the insurance terms.

NB: Free cover does not mean that members get life cover at no charge.

Q36. I have been told by a friend that the State Pension Age for women is now 65. I am now 56 and was looking forward to retirement in 4 years time. Is this information correct?

A. The state retirement age for women born prior to 6th April 1950 will remain 60. Those born between 6th April 1950 and 6th April 1955 have a retirement date between 60 and 65, the actual date depending on their date of birth.

Women who have a date of birth of 6th April 1955 or later will have 65 as their State Retirement Age.

Q37. What are stakeholder pensions and who can contribute to them?

A. Stakeholder pensions were introduced on 6th April 2001. They are money purchase type schemes and can be either personal or occupational schemes.

They are available to most people aged under 75, even children. There is no need to have earned income to be able to contribute to a stakeholder scheme.

Q38. How much can be paid into a stakeholder pension each year?

A. Up to £3,600 p.a. can be contributed to a stakeholder pension regardless of earnings.

Higher amounts can be contributed based on earnings and personal pension contribution limits.

Q39. I am a member of my employer’s group money purchase scheme, can I contribute to a stakeholder scheme?

A. Yes. The rules are complex but in simple terms if you are not a controlling director and do not earn more than £30,000 p.a. you can contribute to a stakeholder scheme as well as being in your employer’s scheme. The contributions to the stakeholder scheme are limited to £3,600 p.a.

Q40. What is the State Second Pension?

A. The State Second Pension, often called S2P, was introduced from 6th April 2002. It replaced the State Earnings Related Pension Scheme (SERPS) for future accrual of benefits