

# PENSION BASICS

## What is a pension?

Put simply, a pension is a long-term savings arrangement that aims to provide you with an income when you reach your retirement age.

There are two main types of pension schemes, defined benefit schemes and defined contribution schemes, each with their own variations. The MNRPF is a defined benefit scheme.

## Defined benefit schemes

A defined benefit scheme is called so because the pension payable at retirement is 'defined' based on a formula in the scheme's rules.

How much a member's pension at retirement will be is usually determined by three key things:

- The member's earnings
- The scheme's accrual rate(s)
- How long the member has been in pensionable service in the scheme

Defined benefit schemes can be complicated because there are various types, and each scheme has its own set of rules that outlines how the pension is to be calculated.

Unlike a defined contribution scheme where the funds are held in an individual account for the member, contributions to a defined benefit scheme are paid into a communal pot that is then used to pay the benefits that are due to all the members and beneficiaries of the scheme, including the spouses or civil partners of members who have passed away.

This communal pot of money is usually looked after by a group of trustees, who must run the scheme in a way that is in accordance with the scheme's rules and in the interests of all its members.

## At retirement

Generally speaking, members of defined benefit schemes get one or both of the options listed below, however different schemes may offer different options:

- **A pension payable for life**

The scheme will calculate the pension payable to the member. This is a guaranteed amount and will be paid for life. The annual pension amount may increase annually, but this is dependent on scheme rules and cost of living increase rates.

- **A cash lump sum and a pension**

In exchange for giving up some pension, the member can take a one-off cash lump sum that is (currently) tax free. The member will then get an annual pension as detailed above, but it will be a lower amount.

Alternatively, if the member does not want to take the pension offered by the defined benefit scheme, they have the option to transfer the value of their pension to another arrangement; this may then allow them to take a more flexible option, such as those detailed in the defined contribution schemes section of this factsheet.

# PENSION BASICS

## In death

Generally speaking, defined benefit schemes automatically allow for a pension to be paid to the member's spouse or civil partner in the event of the member's death. How much is paid will depend on the scheme's rules.

In some instances, a lump sum may be paid to the member's beneficiaries, depending on what the scheme's rules allow.

## Defined contribution schemes

Sometimes known as money purchase, this type of pension consists of an account held in the member's name, and contributions being paid into it by the individual and/or their employer.

The member will then use the money to buy units in their choice of funds, such as global equities or government bonds. The price of a single unit will vary day to day depending on market activity, in a similar way to stocks and shares.

The aim of defined contribution funds is to grow the value of the units that have been bought over time so that the overall value of the savings when the member retires is over and above what has been paid in.

## At retirement

When a member retires from a defined contribution scheme, they will use the value of their savings to provide their retirement income.

The options they may have include:

- **Buying an annuity**

Using the value of the pension savings to buy a regular income, called an annuity, with a pension provider.

Annuities allow the member to choose a range of options to tailor the income, including taking a cash lump sum, allowing for annual increases and providing death benefits to dependants.

- **100% cash**

Taking the full value of the pension savings as a one off lump sum.

Depending on the value of the lump sum, there may be tax implications, and the member needs to think about their income if this money runs out.

- **Drawdown:**

Taking out lump sums regularly or when needed, and leaving the rest invested until a later date.

What isn't taken out remains invested with the aim of growing to replace some or all of what has been taken out, although investment growth can't be guaranteed.

## In death

When the member dies, what is paid to their spouse or dependants will depend on what options they took when they retired.

For example, if the member took the full value of their pension savings as a one off lump sum, there will be nothing left to be paid out to anyone. If, however, the member chose an annuity that allowed for a pension to be paid to their spouse in the event the member died first, then the pension will be paid to the spouse for the remainder of his or her life.

It's very important that the member considers their dependants financial needs when deciding what to do with their pension savings.