NAPO's BEGINNERS' GUIDE TO PENSIONS
Dean Rogers (Assistant General Secretary)
Updated November 2019

INTRODUCTION – PENSIONS MATTER!

Pensions are very important for all workers. Workplace pensions should bring peace of mind for when you retire, affording security and some degree of choice.

However, pensions can seem complicated. They've acquired a language all of their own that isn't easily accessible. As government's constantly review and tinker with workplace pensions, it's important people know how they work and have some basis to understand the choices they're asked to make.

Pensions are also under attack. Although unions fought off government attempts in 2012 to undermine and reduce public sector pensions, financial pressures mean many are tempted to review if paying into a pension's worth it. Years of low pay rises, the rise of student debts, the enormous costs of securing a home, the likelihood and costs of supporting dependents for longer can all make saving for a rainy day during your career seem less urgent. But without a workplace pension, security in retirement will be beyond most people.

That's why Napo's publishing this ***Beginner's Guide To Pensions***. The aim's simple. To firstly, demystify pensions – they really don't need to be complicated. Secondly, by doing so to help people have a better understanding of the choices they can make around pensions. Thirdly, to point to where people need to get independent financial advice and support – available to Napo members via our comprehensive Members' Benefits package.

If, after using the guide, you have any questions or require further direction then please contact Napo either via your local Representatives and contacts or via Napo HQ using info@napo.org.uk Please remember, Napo membership affords you pension support and guidance. For pensions, and other financial advice, you can access this via our members' benefits package (insert link)

Napo's Beginner's Guide to Pensions

What is a pension?
A pension is when some of your earnings are put aside *(or deferred)* and invested so you can use them when you retire. The amount set aside is known as a pension contribution.

In most cases, the employer and the employee will make contributions, in part due to tax incentives from Government to encourage saving for retirement.

Since 1908, the Government has also paid most people a State pension funded from general taxation, and since 1946 from specific National Insurance contributions. This has always been intended as a minimum safety net with incentives for employers and workers to save for an additional work-based pension.

Pension funds have themselves become an important driver in post-war financial markets being a major source of investment capital across the globe.

How does my pension work?
For members of the local government pension scheme *(the LGPS)* a new scheme came into effect in 2014. This is called the CARE scheme.

The scheme offers guaranteed returns (*aka defined benefits)*, based upon fixed contributions (aka *defined contributions)*. The guaranteed return in the CARE scheme is 1/49th of salary during each year of service. That means 1/49th of everything you earn is allocated to your pension fund each year. These sums are then added together and the total amount equals the value of your pension, paid until you die when a proportion of it will continue to be paid to your next of kin. You can trade some of this for an upfront lump sum payment. You get £12 lump sum for each £1 of your pension you trade in.

Members of the LGPS prior to April 2014 will also have some of their pension paid using the old model. This calculated an annual pension based upon the number of full years in the LGPS (up to 1st April 2014) and your final salary - 1/60th of your final salary being multiplied by the number of full years in the scheme. In the old model you also got access to a lump sum worth 3 ½ times your final annual pension.

People who are not members of the LGPS can choose to join a pension scheme offered by your employer. These private sector schemes operate on broadly the same principle – part of your wages are set aside and the employer also makes a contribution which is invested for you to draw down when you retire. However, there's unlikely to be a guaranteed return (or defined benefit) and the contribution you make is likely to be variable – i.e. you can probably pay more or less at different times. Your employer will pay less than they'd pay into the LGPS.

When you retire, you gain access to your pot and choose either to buy an annual pension *(aka an annuity)* based upon how much you've saved and the value at that point, or choose to invest the money in other ways, or a combination of the two. Napo strongly advise anyone at this point to access our independent financial advice.

When can I access my pension?
Under the LGPS you can now access your pension anytime between aged 55 and aged 75. However, individuals have an anticipated Normal Retirement Age, aligned to the State Pension Age (65 to 67 depending upon how old you are). Anyone retiring before their Normal Retirement Age will usually see their pension reduced, although exceptions can include cases of redundancy or ill-health early retirement.

How much does it cost me?
If you're in the LGPS your contributions are:

Pay Bands	Contribution Rates
Up to £14,100	**5.5%**
£14,100 - £22,000	**5.8%**
£22001 - £35,700	**6.5%**
£35,701 - £45,200	**6.8%**
£45,201 - £63,100	**8.5%**
£63,101 - £89,400	**9.9%**
£89,401 - £105,200	**10.5%**
£105,201 - £157,800	**11.4%**
Over £157,801	**12.5%**

If you're in a private sector scheme your contribution will most likely be fixed but vary from scheme to scheme and may allow you to contribute more or less at different times. From April 2019, total contributions from you and your employer must be at least 8% of your salary. Contact your HR department and/or your local Napo Rep for more information.

Does my employer pay anything into my pension?
You and your employer make a contribution each month. Both get taken out of your wages before being taxed to make them worth more. In the LGPS, the employer contributes roughly 3 times the employees' contributions. In the private sector or in charities, the employers also make a contribution but these will almost always be less than with the LGPS.

What is an Added Voluntary Contribution or AVC?
Some people want to save more for their retirement and top-up their pension, especially if they have gaps in service. Government encourage this by offering tax breaks on additional pension payments taken from wages. Additional Voluntary Contributions (or AVCs) are paid into separate funds which broadly work like a private scheme - when you retire the AVCs can be used to purchase added years in the LGPS, additional lump sums or an additional annuity, or for wider investments.
Before purchasing an AVC Napo advise members to seek independent financial advice.

What does 'deferred benefit' mean?
If you are a member of the pension scheme for two years or more and leave before your Normal Retirement Age the benefits are protected so you can access them when you retire.

Can I move my LGPS pension?
You can choose to transfer your pension into another fund but this may not always be possible (e.g. if the scheme is vastly different from the LGPS) or worthwhile. You're advised to get independent financial advice before transferring a pension.

Can I move my private pension?
If you transfer from one private employer to another, or a private employer into the public sector, you will probably not be able to transfer your pension. However, it's benefits will be protected. If you are in this position, Napo strongly advise that you contact your new employer's provider and ask for information about if you can transfer and then contact existing fund provider to tell them you are moving to ask about your investment options.

What's a 'Stakeholder' pension?
By the 1990's many people were changing jobs regularly and so unlikely to work 30 plus years for the same employer or in the same pension fund. With more people employed in small companies who didn't offer a company pension scheme, or working for themselves, the number of people without a work based pension was rising.

To encourage people to save for retirement Government encouraged 'stakeholder schemes'. These allowed people to save flexibly, supported by tax incentives for employers and employees. The number of people with private pensions has grown significantly but hopes they'd be more transferable, moving with you when you moved employers, have not been fulfilled.

What is auto-enrolment?
Regulations now mean all employers' must make some form of workplace pension available for workers and assume they want to contribute – known as auto-enrolment, unless the worker specifically chooses not to. If you opt-out you must also be asked if you wish to opt-in again periodically.

How safe is my pension?
In probation, all contributions to the LGPS are administered by the Greater Manchester Pension Fund (aka GMPF), who also invest the monies on scheme members' behalf, the aim being to make sure there's enough in the pot to meet the guarantees in the scheme when people retire. This is monitored independently by actuaries. They report on the size of funds and if there's a forecast shortfall or fund deficit they recommend either higher contributions or changes to benefits.

The GMPF was chosen to administer all of probation pensions when the National Probation Service and CRC's were created. ***They are one of the largest and most secure funds in the UK*** worth many £millions and no deficit. ***The Secretary of State has further underwritten the arrangement*** so if a CRC owner fails to maintain contributions the state will guarantee the defined benefits. In short, these are very, very safe.

Family Court members are in the same position but with their fund being administered by the West Yorkshire Pension Fund.

Even those in private pensions have the security of knowing the industry is heavily regulated, including protection from illegal activity (such as Maxwell's stealing from pension funds) being underwritten by industry and the State.

How is the new LGPS scheme different from the 'old' local government scheme?
The pre-2014 LGPS was known as a final salary scheme. It also made guaranteed payments based upon defined contributions and rules. However, what you received was calculated differently.

In the old scheme only your final salary (or the best salary in your last three years of service) was used to calculate the value of your pension and lump sum. You received 1/60th of your final salary for each full year of service.

The value of 1/60th was based on people contributing for 30 years and so their pension would be a maximum of ½ their final salary (i.e. 30/60's). Those working longer than 30 years had their pension capped at 30 years.

If you got promoted several times across your career or in the last few years you could do relatively well in this model as your contributions would've been relatively lower over the course of your career than someone who didn't have as many promotions. Indeed, some senior executives in local government and other parts of the public sector were retiring with six-figure pensions based upon huge salary hikes in the last few years of service. On the other hand, if you earned less at the end of your career than at other times (for example working part-time or dropping down a grade as many women did in local government after returning from career breaks) you did comparatively less well. Therefore, the new CARE system, offering a higher 1/49th annual return *(aka the accrual rate)* was seen as both fairer and more equitable.

What is 'accrual rate'? Why is it important?

In schemes that guarantee a fixed return *(aka defined benefits)* like the LGPS, the accrual rate is how much your pension is guaranteed to grow. In the current CARE model the rate is 1/49th of your earnings each year. In the old model it was 1/60th of your final salary for each full year of service. In an even older model it was 1/80th, based upon someone working 40 years to get a pension worth half their final salary.

It is important in defined benefit schemes because it dictates how much your pension will be. In private sector schemes there is no fixed accrual rate, with the pension value being dependent upon the success or otherwise of investments at the point when you retire.

Why do I lose some of my pension if I retire early in the LGPS?

In schemes that offer a guaranteed return *(or defined benefit)* you will almost always have to sacrifice some of the value of the pension if you draw it before your normal retirement age. The earlier you retire the higher the sacrifice expected.

Remembering that your pension is late payment for deferred wages this makes sense, protecting the value of the fund. If you retire early the amount being paid in for your retirement is reduced whilst the length of time that the scheme would expect to be paying you the pension increases. It is natural that the monthly sum you get is reduced accordingly.

Do those in private pension schemes also get less if they retire early?

Yes – whilst not seeing any guaranteed sums reduced, the value of the pension they look to buy with their pension fund *(aka the annuity)* will be less if they are buying one as a 55 year old rather than as a 65 year old as there will be an assumption that the annuity will be paid for longer and so the fund needs to stretch for longer. They will also have accrued less in their pension fund by retiring early.

How is the lump sum worked out?
Under the old 80ths LGPS final salary scheme you received a one off lump sum of broadly 3 times your annual pension. In the 60ths scheme there was no guaranteed lump sum. You could however buy or sell some of your pension / lump sum. Accrued lump sum entitlements were protected when the new scheme started on 1st April 2014.

In the new LGPS scheme, you can still choose to buy a lump sum if you wish. Every £1 of your pension fund that you transfer to a lump sum is multiplied by 12.

Napo advise members to obtain independent financial advice before making decisions around buying or selling elements of their pension fund.

What is 'the 85 year rule'?
If you were a member of the LGPS on 30th September 2006 you qualify to access the 85 year rule. This gives added protections or benefits where someone's age and length of service added together comes to more than 85 years, allowing early access to a pension..

Broadly speaking:

- If you qualify for the 85 year rule and are under 60 you can access early retirement but some or all of your benefits will be reduced.

- If you were 60 or over on 31 March 2016 and choose to draw your pension between age 60 and your Normal Retirement Age and you satisfy the 85 year rule when starting to draw your pension, the benefits built up until 31 March 2016 will not be reduced.

- If you are under 60 by 31 March 2016 and choose to draw your pension between aged 60 and your protected Normal Retirement Age, and you satisfy the 85 year rule when you start drawing your pension, benefits built up to 31 March 2008 will not be reduced.

- If you will be aged 60 between 1 April 2016 and 31st March 2020 and meet the 85 year rule by 31st March 2020, some or all of your benefits built up between 1st April 2008 and 31st March 2020 may not be subject to the full reduction.

Why and how did the '85 year rule' change?
Under the old final salary schemes the rule made a lot of sense. Pensions were capped at half of someone's final salary and once someone had been in the scheme for 30 years they couldn't accrue any more pension, so reductions for accessing the pension early seemed unfair.

Under the new CARE model, where there is no cap and where the retirement age is later for everyone the rationale for the 85 year rule made less sense. It was also increasingly discriminatory, as more men had the necessary continuous service than women, who were more likely to have had career breaks.

So in 2014, the rule changed. Anyone over 55 was allowed to take early retirement without their employers permission. Those who had reached 60 when choosing to retire and who qualified for the 85 Year Rule were afforded some protections with reduced reductions on their pension (especially the pre-2014 elements) as set out above. However, if you were under 60, and 85 year rule applied, the employer had the discretion to "switch-on" the rule and meet the costs to the scheme arising from allowing someone to go early and benefit from reduced pension reductions.

This is not a discretion that the employers use very often, if at all, as it is very expensive. This in effect neutralises the 85-year rule until someone is over 60.

The Government sometimes refer to my 'career average pension'. Is this accurate?
No – the term career average is misleading, especially if referenced against a final salary scheme. In the CARE model, sometimes referred to as a career average scheme, there is no link to someone's average salary either annually or over a career.

The pension will be based upon a guaranteed proportion of someone's total pensionable earnings during each year (in the LGPS 1/49th), regardless of if this goes up or down. In principle, all contracted pay should be classed as pensionable (and subject to contributions) unlike the old model where occasional overtime tended to not be pensionable as it couldn't be guaranteed in any final salary calculations.

If your pay goes up or down the amount going into your fund will go up or down accordingly but will always be 1/49th of your salary in that year.

Can you show me how the LGPS now calculate my pension?
Here is a basic examples of how the new scheme works -
A joins the NPS on 1st January 2017.
A earns £20K in 2017. 1/49th of £20,000 = £408.16 which goes into A's pension fund.
A earns £25K in 2018. 1/49th of £25,000 = £510.20 which goes into A's pension fund.

A's pension fund now guarantees an annual pension of £918.36 a year when A retires.

A continues to earn £25K in 2019, 2020, 2021, 2022, and 2023. So their fund increases by £510.20 for each of these 5 years. 5 x 510.20 = £2551. Added to the £918.36 means A's guaranteed pension is now £3,469.36 a year when A retires.

A then goes part time for five years, earning 50% of their salary meaning £255.10 (1/49th of the reduced ½ salary) is transferred to A's pension fund each year or £1275.50 over the five years. A's fund therefore now stands at £4744.86 per year.

A then gets a promotion and returns to full-time working. A's new salary is £35,000.
1/49th of £35,000 = £714.29
This is added to A's pension fund   £4744.86 + £714.29 = £5459.15 pension p/a.

This continues until A leaves the service or retires. Each year the value of the pension fund is also increased by CPI for that year to protect against inflation.

We'd also recommend looking at the GMPF guides on their website (www.gmpf.org.uk) These are very clear and helpful.

How does inflation impact on my pension?
The value of the pension fund is increased in line with inflation annually, using the CPI measure. This will also apply once you are drawing your pension.

What happens if I leave before being in the LGPS 2 years?
You only qualify to draw an LGPS pension if you have more than two years' contributions to the LGPS. If you leave voluntarily before completing two years in the scheme then your contributions should be re-paid to you. If you are a Napo member and are dismissed then Napo would aim to negotiate with the employer to recover pension contributions.

If I go on strike does it impact upon my pension?
When you go on strike you lose pay so, in the LGPS, the value of the 1/49th of your annual salary is very marginally reduced and in private sector schemes you contributions are also fractionally reduced. However, the loss of 1 day's service is not as critical as it may have been in the old LGPS scheme where pension payments were based upon the number of full years' service. The cost of making up the loss in the new scheme is greatly increased due to the higher employee and employer contributions and the higher accrual rate.
Members will therefore want to think carefully as to the value of making up such a loss and should contact Napo directly if in doubt.

What happens to my pension if I have periods of reduced pay?
LGPS scheme members who have periods of reduced pay or no pay because of sickness or family leave (such as maternity or paternity leave) see no reduction in their pension. They only pay contributions on pay received but the amount transferred into their pension fund will be calculated to meet their normal pay for the reduced periods.

In private sector schemes this is not guaranteed and advice should be sought from your HR department and Napo Reps.

How does ill-health retirement work with my pension?
Retiring early because of ill-health means you can have immediate access to your pension. At this point the pension becomes a kind of insurance scheme. ***Also read the wider Napo guidance on Ill-Health Retirement on our website.***

In the LGPS, if the pension funds occupational health advisors recommend that you are not likely to be able to work again before your Normal Retirement Age then you and your employers' full contributions are made up and you can access your full pension, as if you had worked until your Normal Retirement Age. This is referred to as a Tier 1 retirement.

Tier 2 is where the assessor says you are likely to improve and be able to work before your normal retirement age but not within the next 3 years. This is a very high threshold. Napo would normally advise any member receiving a Tier 2 to contact us for advice on appealing this outcome.

If the LGPS occupational health advisors think that you currently meet the retirement threshold (unable to do any work for more than 30 hours a month) but that you may recover then they can grant a Tier 3 pension. This grants immediate access to your pension at the value accrued to date. Usually after between 18 months and 3 years you will be reassessed. If you are then well enough to work your pension benefits will stop. If you are still unable to work you may have your payments upgrade to Tier 1.

If you are not successful in getting IHER but your condition fails to improve, you can apply for a reassessment through your old employer and potentially have your pension made up from the point where the re-assessment is successful. These will not be enhanced but can allow you to access your accrued benefits early without further reductions. This is called a Deferred Member application.

In private sector schemes, you may or may not be able to access ill-health early retirement, via an occupational health assessment, depending upon the scheme. Private Sector Scheme benefits will depend upon those set out in the specific scheme, but can include compensation for loss of earnings. Some private pensions schemes combine this with salary protection whilst ill. Many private sector schemes also include life insurance.

In any case where you think you may need to access ill-health early retirement Napo members are advised to contact Napo via your local Representatives or contacts as soon as possible.

What happens if I am made redundant and I'm near retirement?
If someone is a member of the LGPS and are made redundant (either voluntarily or on a compulsory basis) and are over 55 then they will be able to seek to access their pension early. The terms for doing so will depend upon the circumstances of the redundancy but can include potentially having their full pension made up to any Normal Retirement Age or protected Normal Retirement Age (for some 60). However, since the CARE scheme came into effect enhancing pensions by adding years in redundancies has become increasingly rare, due to the higher costs to the scheme (based upon a 1/49th scheme instead of a 1/60ths scheme). It is more common for the employer to afford only the costs of giving immediate access to pension without reduction. In cases of compulsory redundancy there is a legal requirement for the employer to do this as a minimum if someone is over 55 when the redundancy takes effect.

For those in a private pension scheme they could also expect to be able to access their pension from the age of 55 (even if they are not made redundant and still in work should they wish). If being made redundant, Napo would hope to negotiate enhancements for those outside the LGPS.

However, if someone anticipates continuing working after being made redundant (especially if they are in a private sector scheme which could be transferred to a new employer or if they think they may soon get another job within a local authority where they could continue to access the LGPS), they should consider their options carefully - as drawing a pension early will reduce the benefits later.

Any member of Napo who thinks they may be made or offered redundancy are advised to contact their local Napo Representative as soon as possible and Napo will afford further specific advice and support during any negotiations to protect your job and/or seek to maximise your package.

OTHER USEFUL SITES:

GMPF website: ***www.gmpf.org.uk***

LGPS website: ***http://lgpsregs.org/***

Also:
www.yourpensionservice.org.uk/local-government-scheme/members-active-deferred-pensioner/guides-leaflets-and-forms/

State Pension Support: ***www.which.co.uk/money/pensions-and-retirement/state-pension***

www.gov.uk/browse/working/state-pension

www.moneyadviceservice.org.uk/en/articles/pension-information-guide-to-the-basic-facts

www.citizensadvice.org.uk/debt-and-money/pensions/types-of-pension/state-pension/