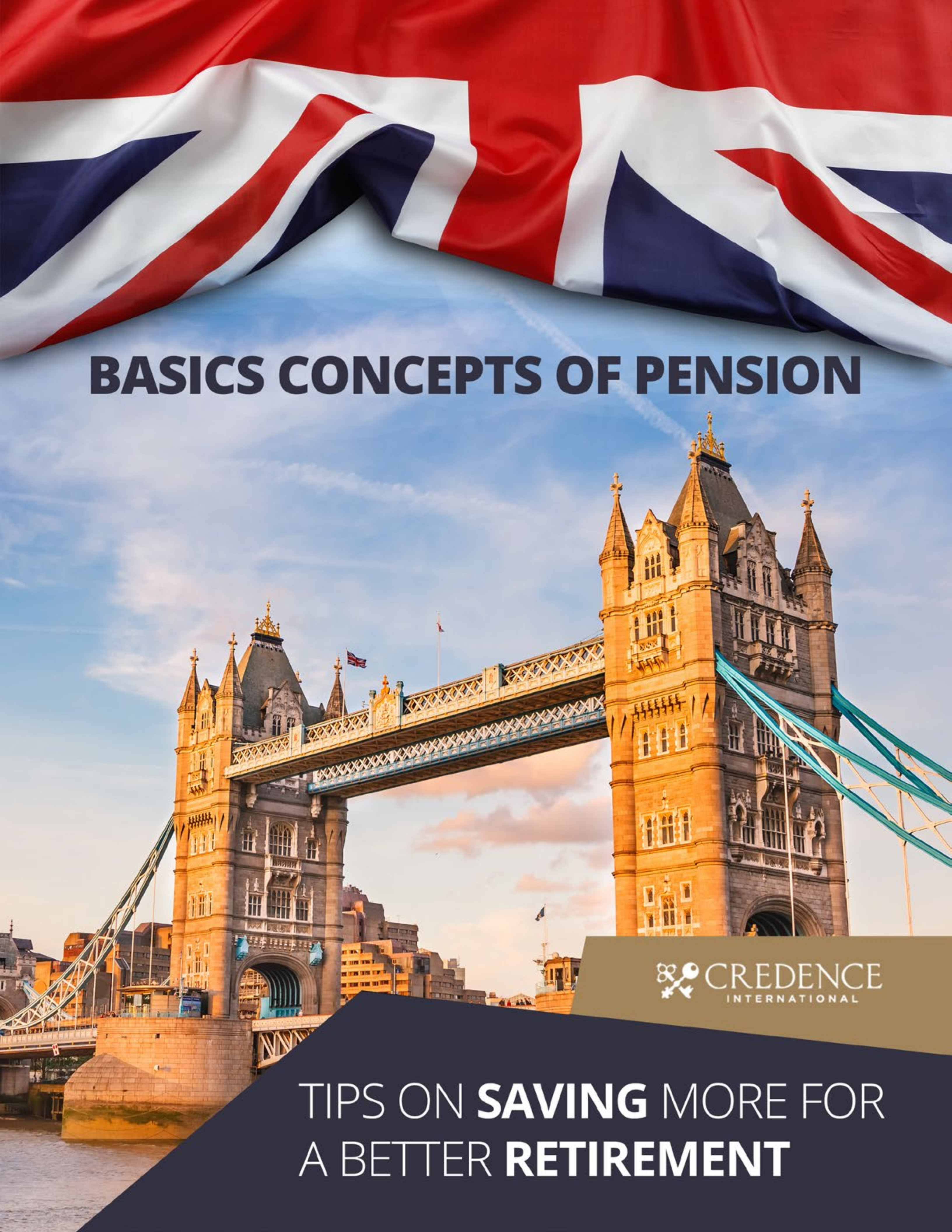

BASICS CONCEPTS OF PENSION

CREDENCE INTERNATIONAL

TIPS ON **SAVING** MORE FOR A BETTER **RETIREMENT**

Basics concepts of pension:

Tips on saving more for a better retirement

Presented to you by Credence International

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Basics concepts of pension: Tips on saving more for a better retirement

- Know everything about your retirement saving with the help of our pension guide
- Start saving early for yourretirement for a better return - take full benefits of the work contributions
- Know the difference between defined benefit and defined contribution pensions
- Take advantage of the tax relief on pension and take 25% of the pension tax-free

The very word pension puts off many with a feeling ofretirement and hence inactivity and as a result they do not consider savings to be of much significance.

At a young age, no one really thinks of retirement and thus pension seems to be a long away.

During middle age, say your thirties or forties, you have innumerable pressing financial commitments, like wedding expenses, buying a homeor raising children, making savings for your pension goes much lower in the list of priorities.

Finally, when you have reached fifties andfoundretirement approaching fast,you may leave all existing efforts to start saving for your retirement in dismay, thinking it is already too late.

But,you mustn’t forget that savings for pension is your best option for a financially stable and fulfilling post-retirement life.

Post retirement, you will still have financial liabilities like accommodation, paying for bills, food and, most importantly, medical expenses. It will be really difficult to manage your finance then, if you don't plan it now.

Plan well in advance: Your pension pays off more if you start saving for it at a young age.

What is pension?

A pension is a financial instrumentin which you depositmoney during your service years so that it provides you monthly income post retirement.

Essentially, it is a retirement amountthat you built by investing forseveral years. Your pension savings also gettax relief and therefore, youeffectively enjoy on asaving on which you have already availed tax benefits.

After retirement, you can either opt for a lump sum payment or choose to have a monthly income. Alternatively, your employer promises you a well-defined benefit scheme –most often known as 'final salary', under which you receive a set amountevery month after retirement.

People generally start their pension plan through their workplace. But,you can also independently invest in a personal pension plan.

Two types of work pension options for you

Two key types of pension schemes that are available for the workers are Defined contribution and Defined benefit.

These terms may not explain much but let's try to understand how they work.

Defined benefit schemes

Under this scheme, you receive a fixed annual income after you retire. So, here the benefits you receive are 'defined'.

These schemes are also known as 'final salary schemes', because, in this you receive an income on the basis of your last drawn salaryfromyour employer before retirement. However, pensions under this scheme can also consist ofCARE orCareer average revalued earnings or some other specific methods of fixingthe retirement income.

The most important aspect of defined benefit scheme is the employer's promise to deposit a specificamount annuallyto the employee afterretirement and shouldagree for funding it.

When you opt for final salary scheme, you contribute an amount every month that goes into aamountwith other members of the scheme. Most of the employers, however, now avoid this scheme because it turns out to be quite expensive for them to fund the shortfalls andyou will rarely find any employer in private business offering it to its employees. Public sector organisations more often offer these benefits to their employees.

Defined contribution

Under Defined contribution schemes,no promisedamount is set after retirement. In its place, you have toinvest some amount to develop anamount that would provide you theincome after retirement. So, in this scheme, your 'contributions' are 'defined'.

In defined contribution pension scheme, employees are free to decide on the fraction of their salary they would like to set aside for their pensions and their employers would either provide some or the full percentage as their contribution.

The total moneywill be invested into some bonds or shares that would increaseover the years to provide the retirement amount.

In this pensionscheme,you will have to decide on the amount of amountyou would like to set for your retirement. You can decide on the investment instrument and track its performance and, if need be, may change it as well.

DEFINED BENEFIT VS. DEFINED CONTRIBUTION

DEFINED BENEFIT	DEFINED CONTRIBUTION
An employee consents to pay a specificamount,say 6% of their salary, everymonth into their final salary pension scheme.	Anemployee agrees to deposit a specificamount (say, 5%) of their salary, into their defined contribution pension scheme.
At the same time, their employer pays them a fixed percentage(say, 6%) of their lastremuneration for the number ofyears they have been employed in the organisation.	Their employer will then contribute equal amount, i.e., 5% and therefore, 10% of their salary will go into this fund every month. (Minimum levels may belower than this percentage).
So, an employee who has beena member of this pension scheme for,say 40 years, would receive 2/3rd of his/her final salary (40/60) after retirement.	The amountis then invested in bonds/ stocks so that the amountincreases over the years. Afterretirement, the member can eithertake a lump sum amount or a fixed monthly amount.

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Personal pension schemes

Other than pension fund maintained by your employer you can also save for it by setting up your personalpension investment plan.

This can be done along with your work pension or in place of it. There are several such personal pension schemes starting with aninexpensive and basic contract-based stakeholder pension.Under this scheme you can invest in various SIPP or self invested personal pension schemes.

Such pension plans also come under defined contribution plans in which you can decide on the amount of money you wish to invest every month to build up your amount.

Tax savings: The good thing about pension contributions is that you get tax benefiton it

Tax benefit on your pension

You receive tax benefit on your pension contributions and this increases the total amount in the amount. Therefore, the money you invest in your pension account isyour untaxed income!

Every investor of a pension plan automatically gets a tax benefitof 20%.If you are a higher rate tax payer, you can claim your balance tax relief of 40% separately, while filing your income tax return.

The calculation works in your benefit and you receive more than the 20 or 40% additional to your contributions.

If you consider the amount received in the form of tax benefit,it adds up to 100% from either 80 or 60%.

- For a basic rate taxpayer, the Government would add up £25 as tax benefit for every £100 deposited on a pension account by an investor, effectively making it £125.
- For a higher rate taxpayer, £67 will be added on every £100 deposited and therefore making a total deposit of £167.

However, this tax benefit has a limit.

There is a cap on the amount of annual allowance of tax benefit in case ofdefined contribution pension schemes.For defined benefit pension scheme the annual amount of benefits can be builtup.

At present, the limit is £40,000, which is wayaboveone can think of saving in their pension account. The lifetime limit for total allowance in pension is of £1million. No one puts more than that in their pension account because of the heavy tax charges if they cross the amount, which makes it uneconomical.

How to start your pension scheme?

Generally, individuals start theirpension during their employment.

Employers enroll their employees for workplace pensions with the help of auto-enrolment, unless the employee voluntarily opts out of it.

Thiswork pension can be started eitherunder defined benefit scheme in which,as stated earlier, you receive a fixed income once you retireor under a more prevalent defined contribution scheme.

Underdefined contribution scheme, your contribution will be managed by a provider chosen by your employer. The contribution you make from your salary towards the scheme will be matched by your employer.

The money deposited through this scheme is then invested in low-risk government or private bonds orstocksso that it yields high return and swells up over the years.
At the time of starting your pension, you will have to fix a strategy for investing the money. Like any other investment decision, it will depend on the amount of risk you are willing to take.

Employers mostly offer a variety of options from which you can choose one depending on your cost of living post retirement and the age at which you are starting with the scheme.

Schemes vary depending on the risk involved. Some comprises of balanced or cautious portfolio having lowest risk;some are on established company shares having medium risk and on lesser known companies' stock or foreign stock markets that are more risky and, to some extent,high on risk.

The decision to choose the fund will be on your employer and the provider who has been employed by your company to manage the scheme. Your employer would ensure that the cost of operating the scheme is low and therefore viable, because of the total amount deposited in it with the contributions of its employees.

For more options and control on your money, you can start investing in a personal pension scheme in which you can choose your provider and a wide range of investment plans.

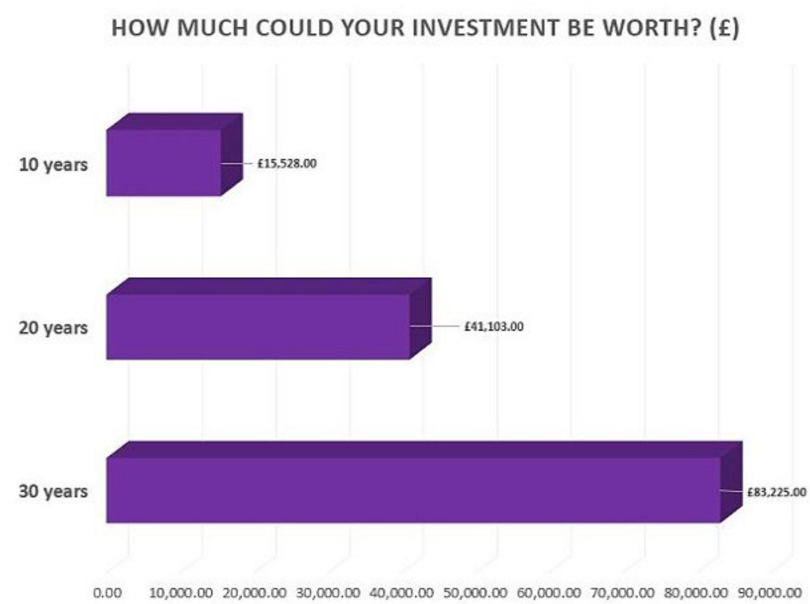
You will surely have a variety of options in such personal pension funds and this could be in addition to your work pension scheme. But, naturally, you will have to monitor the performance of the fund and switch schemes, in case the fund/scheme is not doing well.

However, you may have to pay higher charges and will not receive the benefit of extra contribution from youremployer.

For self-employed people, personal pension is a good option.

One advice we have for those who opt for personal pension: Please monitor your investment plan regularly so that some changes in rule or change in the scheme does not affect your returns.

Know more about personal pensions and SIPPs in our guides



Take advantage of timely investment: The chart hereshows how by investing £100 every month you can enjoy a steady 5% return as it grows over the years

The right time to start investing in a pension scheme

Longer time horizon is your key to a financially stable and fulfilling retirement years.

You get more in retirement you when start saving early for it.

Start with a small amount at the beginning and let it grow over the years.

The above chart shows the huge amount you can save for your retirement pension if you save for10, 20 or, undoubtedly the best option, for 30 years.

If you invest for 20 years at the rate of £100 everymonth, it reaches £41,000 at 5% growth rate. When the tenure becomes 30, just 10 years more than that, the amount becomes more than double making it £83,000.

This is possible because of compounding, when the return increases due to the amount you have already received as returns. Like a snowball rolling down a hill, your investment grows in size with all the accumulated returns on the initial investment.

When you start saving early, you have another great advantage: In case your investments fail to grow as per your expectations, you have enough time in your hand to make up for the loss.

This is not possible when you start saving quite late and don’t have many options to compare.

What is the ideal amount for pension savings?

There are two factors that ensure you lead a comfortable life post retirement and you don’t need to compromise on your standard of living: One, to start early with your savings and second to contribute more from the beginning to make a huge amount.

Generally, the schemes set a range, say 2 to5%.

Since your employer matches the percentage of contribution you make, you get a total contribution of 4% when you deposit 2% and 10% when you deposit 5%.

There are some great employers who deposit more than the employees’ contribution, at times even double their percentage!

Usually, employers set a limit for your contribution that they are going to match or surpass, say, 5% of your wage. This means, when you pay more than that percentage, the employer does not match it and you do not gain anything extra.

This percentage of contribution can be changed over time as well. But, be aware of the charges as that can impact your returns.

When the money would become accessible and what can be done with it?

Keep aside: You can not touch your pension until you have reached

As per the current rule, the earliest age for accessingyourpension is 55.

When you are in your twenties and have just started saving for your pension it may seem far away, but this rule ensures that you are not tempted to use up your amount.

It shows how our Government values the tax benefits it offerson pension contributions and the relief from the tax.

The restrictions have been imposed only to ensure that you get the benefits in return of this.

Pension rules have changed and have become more flexible from April 2015.

Earlier, people had the option of accepting a one-time sum of up to 25%of their amount that was tax-free.

Members opting for defined benefit pension schemes used to receive their money from their pastemployer, and the amount depended on the lump sum money they had taken at the time of their retirement.

In defined contribution pensionschemethe members used the remaining amount of their amountto managetheir retirement expenditure. Most of the people used to buy an annuity to cover their expenditure, when they kept their pension invested and had the limitations on their withdrawal amount.

Pension freedom rules from April 2015 changed this.

In the first option, one can still take out a lump sum of 25% that will be tax-free.But, then you will either have to buy an annuity or invest the remaining amount with the help of a process called drawdown. When you take out the money then you will have to pay the income tax at the normal rate.

The other alternative will be to give up the 25% tax-free one time money and keep the entire amount invested in some fund. Whenever you withdraw any amount from this investment, the first 25%will be tax-free and you will have to pay income tax at the usual rate on the remaining amount.

You are free to choose your pension plans but your financial planning will be dependent on few factors like your age, health orspending habits. It is therefore better to consultan expert and experienced financial adviser who can help you in understanding any financial or tax implication.

Spending little amount in seeking professional financial advice may save a huge sum for you in the long run.

You must know everything about State pension.

You get basic state pension from the Government once you retire.

After you reach your state pension age, which depends on your gender and your date of birth,and if you are eligible, you can receive state pension.

From April 2016, a new flat-rate state pension is available, which is£155.65,but everyone is not eligible for this. Take help of HMRevenue and Custom's state pension calculator to know your age for receiving it as the age has been increased in last few years.

You would receive the full state pension only when you meet certain eligibility criteria.

State pension may not be a big amount, but it can work out to be a good base for building your retirement income, by strengthening it with your own savings.

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