

Types of pensions and how they work

1) State pension

The state pension is a regular payment you can get from the government once a person reaches state pension age (currently 66 years for men and women).

To qualify you must have paid National Insurance contributions during your working life.

To receive a state pension from the government you need to have paid at least 10 years of National Insurance contributions to get any payout and 35 years to qualify for the full payout.

At the last time of counting the country's pensioners received an annual £96.7 billion between them, with State Pension payments making up almost half of the government's total welfare spending.

The full state pension is currently worth £203.85 per week (2023/24) totalling £10,600.20 per year.

Questions

- How does this type of pension work?
- How old must a person be to start receiving money from the pension?
- What must a person have done to get a state pension?

2) Defined contribution pensions (workplace pension)

An employee saves some of their wages into a workplace pension scheme and their employer makes a contribution. These contributions must be a minimum of 8% of a worker's qualifying earnings.

This money is usually invested in stocks and shares, along with other investments, with the aim of growing the pension pot over the years before a person retires. A person can usually choose from a range of funds to invest in. But it is important to remember that the value of investments might go up or down. Therefore there is a risk.

The size of a person's pension pot when they retire will depend on:

- how long a person saves for
- how much a person pays into their pension pot
- how much, if anything, their employer pays in
- how well their investments have performed

If you have paid into a workplace or personal pension, you can access the money at age 55.

Questions

- How does this type of pension work?
- Who contributes to the pension fund?
- What is the minimum amount that must be paid into the pension fund?
- Why is it good that the employer also makes a contribution?
- Why is there a risk involved?

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3) Workplace pension: Defined benefit pensions

This scheme pays an income after retirement which is usually based on a percentage of an employee's earnings, either in their last year of work or averaged over a longer three or five year period.

When a person retires they can normally take up to 25% of the value of their benefits as a tax-free cash lump sum. The rest they receive as a regular pension income, on which they might pay tax.

If a person has paid into a workplace or personal pension, they can access the money at age 55, increasing to 57 in 2028.

Questions

- How does this type of pension work?
- What is the benefit of this type of pension?

4) Private or personal pension

A person who may be saving into a workplace pension can also choose to buy into a private pension scheme to try to bridge the gap and maintain the standard of lifestyle they may have become used to.

These can also be used as an alternative to occupational (workplace pension) pensions and are a great option for the self-employed (if a person works for themselves).

These pension schemes vary hugely and a person must research the different companies that offer these and ensure they look closely into the terms and conditions of the schemes. A person can control how much and how often they pay into these personal/private pension schemes and where this money is invested to grow it further.

A person can access a workplace or personal pension at age 55, increasing to 57 in 2028.

Questions

- How does this type of pension work?
- Why might someone decide to take out a private pension?
- Who provides these pensions?
- Why might this type of pension be a good option for a person?