

Types of employer sponsored pension schemes

Occupational Pension Schemes



This Factsheet provides you with the basic information needed to identify your type of employer sponsored pension scheme from the many different types available.

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Introduction

Pension benefits can be designed in many ways, but essentially, they are either **defined benefit** schemes or **money purchase schemes**.

Some employers offer both types, while some have a combination of both types either within the same scheme (a **hybrid scheme**) or as separate arrangements.

Once you know what your scheme is, you can then progress to reading our Factsheet on that particular type of pension scheme.

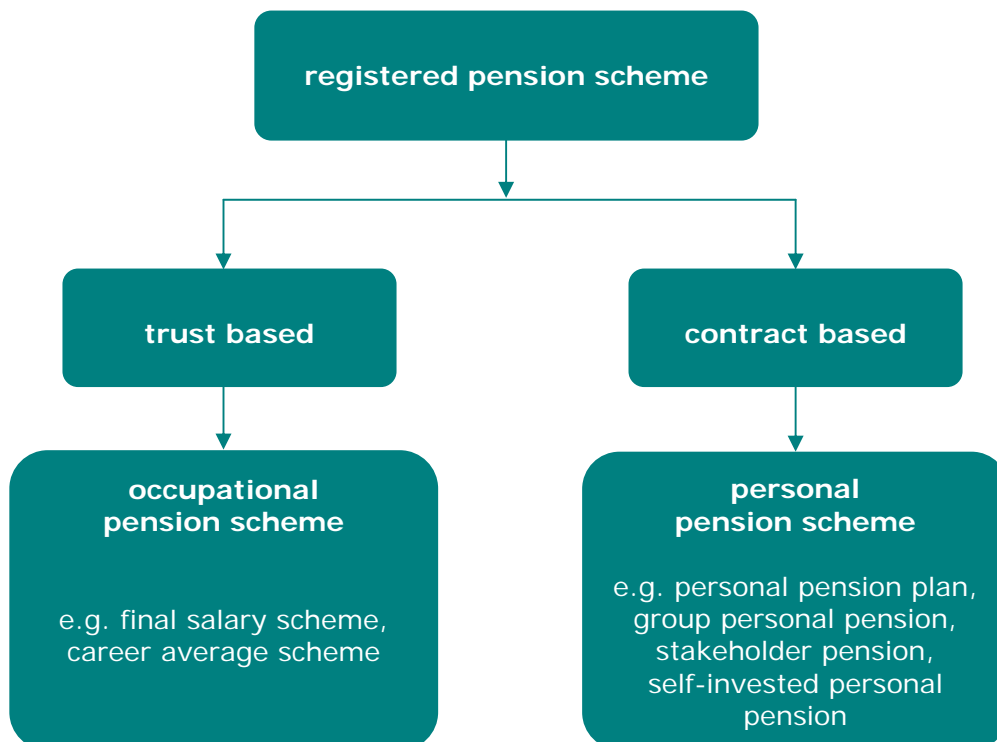
Since April 2006, all pension schemes registered with HMRC are now called **registered pension schemes**.

However, there are many types of scheme design which reflect how the scheme is set up, and what it is trying to achieve.

Registered pension schemes can be set up as a **trust based** scheme or as a **contract based** scheme.

An **occupational pension scheme** is set up by an employer to provide benefits for employees. They are typically set up under **trust** and will have a board of **trustees**.

You might have heard about Personal Pension Plans (PPPs), Grouped Personal Pension Plans (GPPPs) or Stakeholder Pensions (SHPs). These are **contract based schemes** to which the employer might contribute, but they have been set up with banks or insurance companies as the pension providers. Apart from setting the schemes up, and perhaps paying contributions, the employer has little involvement with the operation of these particular schemes. These are registered pension schemes although they are not occupational pension schemes.



What is a pension scheme?

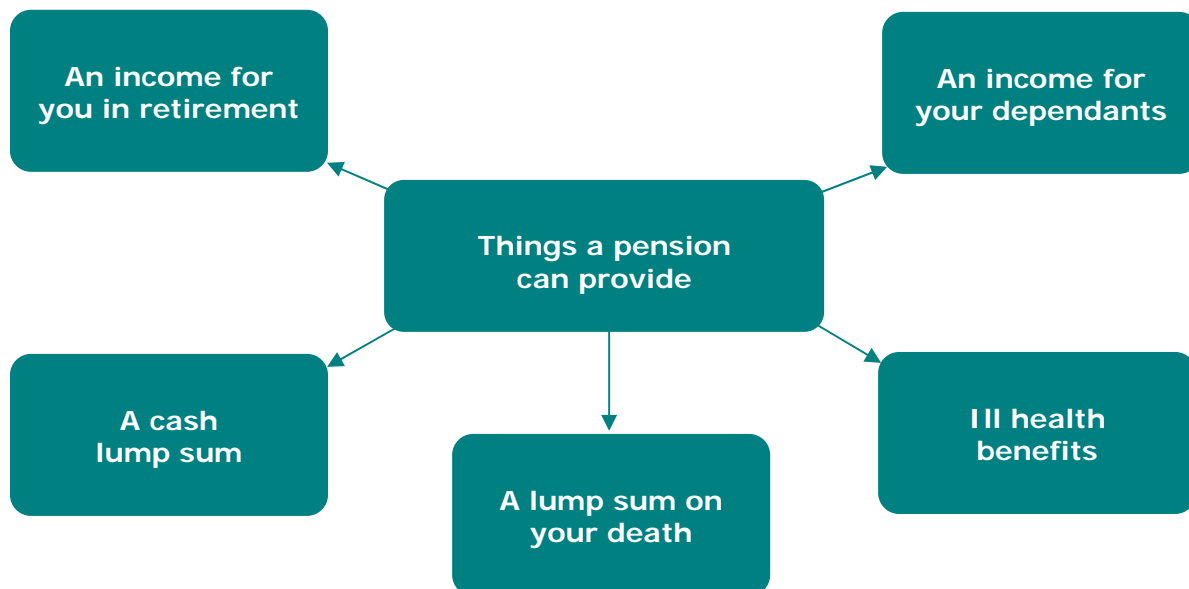
A 'pension scheme' is an arrangement that may provide benefits on:

- death
- ill-health
- serious ill-health (terminal illness to you and me)
- or on retirement having reached a particular age.

The benefits available from a pension scheme commonly take the form of a regular payment, usually monthly, or the payment of lump sums.

A pension scheme can provide one or more, or any combination of these benefits.

For more details, see our Quicknote in this module, [What is a pension scheme?](#)



Two main types of a pension scheme

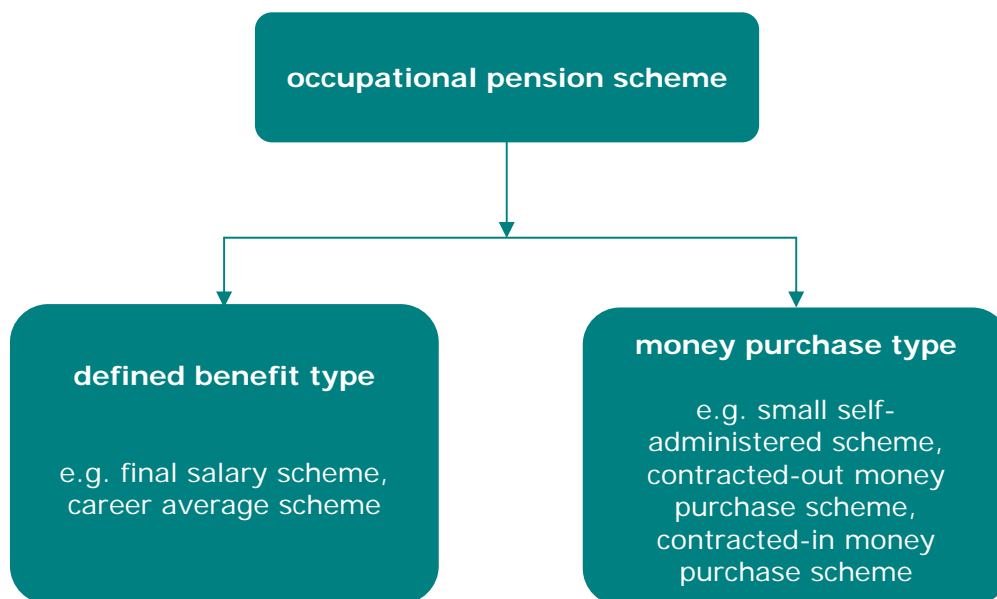
There are two main designs for a pension scheme.

Benefits can be designed in many ways, but essentially, they are either:

- **defined benefit schemes**, or
- **money purchase schemes**.

Some employers offer both types, while some have a combination of both types either within the same scheme (a hybrid scheme) or as separate arrangements.

Importantly, occupation pension schemes are written under trust and, with the exception of some public sector schemes, have a board of trustees whose job is to monitor and operate the scheme within the legal framework established by HM Revenue and Customs and in accordance with the Trust Deed and Scheme Rules.



What is a 'defined benefit' scheme?

Most **defined benefit schemes** provide benefits based upon 4 key elements:

- the length of the **pensionable service** you are credited with as being an active member of the scheme
- your **pensionable salary**
- the formula or rate of '**accrual**' which uses service and salary to work out your pension
- the circumstances under which benefits are taken from the scheme (retirement, early payment, early leaver, ill-health, death etc).

Your pension scheme will use a formula, to calculate your pension benefits using these elements. The formula (and the definitions for each part of it) will be set out in the Scheme Rules.

In a defined benefit scheme, the sponsoring employer (or the taxpayer for some public sector schemes) takes the investment risk as well as shouldering the risk of longer life expectancy for scheme members (called mortality risk).

The two most common forms of defined benefit schemes are:

- **final salary** schemes where your pension is based upon your 'final pensionable salary' which is normally worked out over the years immediately before you cease to be an active member of the pension scheme, and
- **career average revalued earnings** scheme (CARE scheme) where your pension is based upon your 'average pensionable earnings' throughout the whole of the time you are an active scheme member.

Because both types of scheme use your pensionable salary as one part of the formula in order to calculate your pension, they are both commonly referred to as 'salary related' schemes, but there is a significant difference between the two.

In a defined benefit scheme it is the sponsoring employer who takes the investment risk and the risk associated with greater life expectancy (or the taxpayer for certain public sector schemes).

Example of a 'final salary' scheme formula:

pensionable service x **pensionable salary**
accrual rate

$\frac{12}{60}$ x £30,000

Where: 12 is the number of years of 'pensionable service',
60 is the 'accrual rate' and
£30,000 is the scheme member's 'pensionable salary'.

You can read more about how exactly each type of scheme works in our Factsheets: [What is a final salary scheme?](#) and [What is a career average revalued earnings scheme?](#)

What is a 'money purchase' scheme?

Money purchase schemes, also called '**defined contribution schemes**', provide benefits based upon the money held in individual 'pots' specifically on behalf of each member.

The amount in YOUR 'pot' at retirement will depend upon how much was put in by your employer and by YOU, and the investment returns achieved on those contributions.

The value of your fund or 'pot', will rise (or fall) in line with the return on each of the individual investment funds where your contributions are invested.

When you decide to take your pension benefits, the scheme administrator will work out how much pension the money in YOUR 'pot' can purchase.

In a money purchase scheme, it is YOU who takes the investment risk as well as shouldering the risk of longer life expectancy (called mortality risk).

For more specific information, see our Factsheet in this module:

[What is a money purchase scheme?](#)

In an employer sponsored money purchase scheme your 'pot' will usually consist of -

employer contributions
plus
YOUR contributions
plus
investment returns
less
charges

What is in your 'pot' at retirement will be used to provide you with your pension benefits.

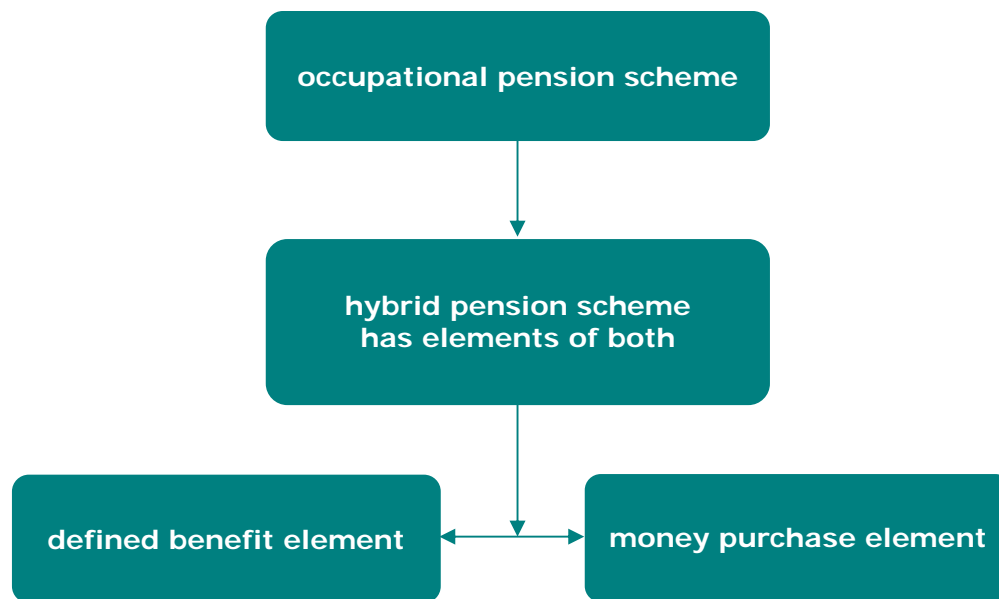
What is a 'hybrid scheme'?

A hybrid scheme is a defined benefit scheme which includes elements of money purchase pension design.

Hybrid arrangements come in many forms, but there are two common themes:

- 'Sequential' hybrid arrangement (commonly called 'nursery schemes') and
- 'Combination' hybrid arrangement.

There are many variations to 'combination' hybrid arrangements and for more information, see our Quicknote in this module.



What is an underpin?

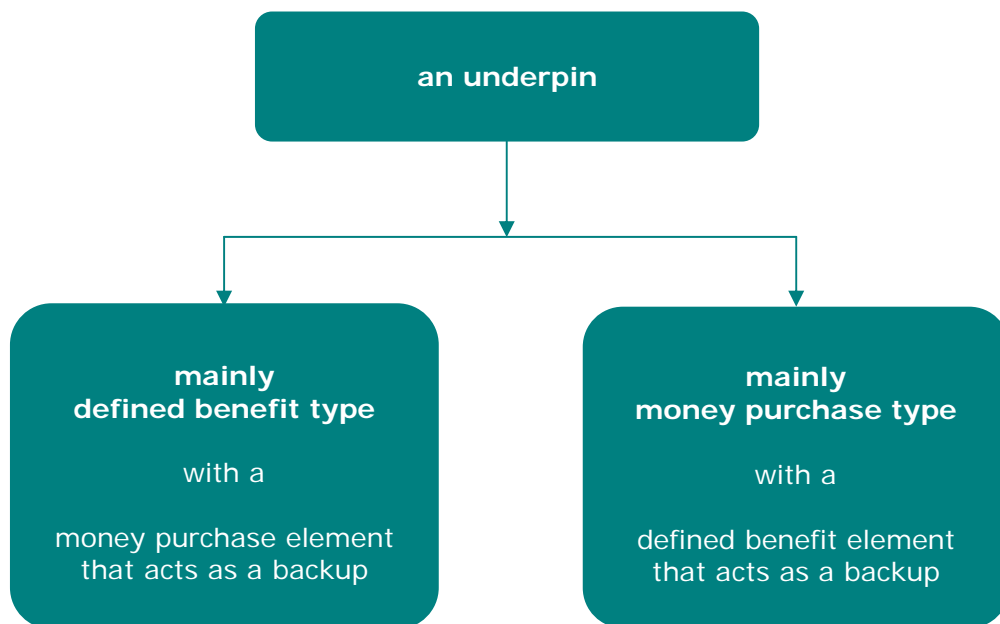
A pension scheme may have its main element as either money purchase or defined benefit, but your sponsoring employer could have chosen to give members the 'backup' of an **'underpin'**.

You can have:

- a money purchase scheme with a 'defined benefit underpin' or,
- a defined benefit scheme with a 'money purchase underpin'.

You would not receive two pension benefits: just the better pension from one of the two alternatives.

For more information, see our Quicknote in this module: [What is an underpin?](#)



Summary & Key Points

When making enquiries about your pension benefit it is very important that you make it clear whether you are an active member, a preserved member or pensioner member.

Active, preserved and pensioner are different classes of membership of a pension scheme. Any definitions and paragraphs contained within your Scheme Rules or scheme literature relating to any benefit may differ considerably between these categories.

In summary:

- A **defined benefit scheme** is an arrangement which is financed by the employer (except for some public sector schemes). The benefits are calculated using a combination of pensionable remuneration, length of pensionable service, accrual rate and the circumstances under which benefits are taken from the scheme.
- A **money purchase**, or **defined contribution scheme**, is a 'fund' based pension arrangement where the members' and/or scheme's (where applicable) contributions are invested in a 'fund' or selection of funds. On retirement the member's pension 'fund' or 'pot' is used to purchase benefits.
- A **hybrid scheme** is a combination of defined benefit and money purchase.
- An **underpin** provides the scheme member with the better of the two benefits from either the money purchase or the defined benefit elements of the scheme, when the benefit becomes payable.

Keep informed and seek advice

Your scheme may modify benefits and Rules. Legislation may change. Your circumstances may alter.

Rules differ from scheme to scheme and are wide and varied in content. Don't assume that what applies to one of your pension schemes will necessarily apply to others that you may have.

HMRC impose rules which registered pension schemes must conform to.

People seldom have identical pensions and you should avoid drawing comparisons with colleagues whose circumstances may at first appear the same but could emerge as having significant differences.

This Factsheet forms part of our module [Types of pension scheme](#) and should be read alongside the other Factsheets and Quicknotes in the series.

This is not an authoritative document.

This Factsheet contains general information on particular points of interest associated with pensions but is not intended to be a complete or authoritative guide.

This Factsheet does not constitute any form of advice or recommendation and should not be relied on in making (or refraining from making) any specific personal or business decision.

You should seek independent legal, financial and other professional advice from an appropriately experienced and qualified adviser before making any such decisions.

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