



Pension jargon buster

The pensions debate can be full of technical jargon, often leaving people scratching their heads at some of the jargon used.

This jargon buster is designed to help you get round that and help you understand some commonly used pension terms and what they mean.

Public sector pension scheme

A pension scheme for workers in the public sector – central government, local government, the NHS and other statutory bodies – but they may also have members working for private companies providing public services (see 'Admitted bodies').

Active member

A worker who is paying into a pension scheme.

Accrual rate

In a defined benefit pension scheme (see below), this measures the rate at which a member's pension builds up.

It is usually written as a fraction or a percentage of pensionable pay (for example, a 1/60th accrual rate is the same as 1.67%), which refers to how much pension you get for each year you're a member of the scheme

If the accrual rate is 1/60th, you will get 1/60th of your final pensionable pay (see below) for each year of your qualifying service. So, after 30 years pensionable service, you earn you half your final pensionable salary as your pension.

For example, if your final pensionable salary was £30,000, 30 years of paying into the scheme would man a pension of 30/60ths, or one half, of that salary, or £15,000 a year. Similarly, 10 years service would get you 10/60ths, or £5,000 a year.

Actuaries

Financial and statistical experts who calculate the cost of the pension scheme, making judgements about its value and liabilities, and work out how much needs to be contributed to pay for the pensions that are being built up in the scheme.

The do this by estimating how long they think members will live in the future, and predictions of average pay increases, inflation and how much will be earned from investments.

Pensions schemes undergo a regular 'actuarial valuation'. This happens every three years in the Local Government Pension Scheme and every four years in the NHS scheme.

The actuaries will then decide whether they need to change any of their assumptions about life expectancy, earnings etc. They will also decide on how much the employer's contribution should be, until the next valuation.

Additional voluntary contributions

Often referred to as AVCs, these are extra contributions, over and above what members normally pay. Occupational pension scheme members may choose to pay these to get extra pension benefits when they retire.

Admitted bodies / admitted body status

Public service pension schemes have rules on which employers can join the scheme. This can include employers that are not part of the public sector.

In the Local Government Pension Scheme, for instance, the 'admitted bodies' may include many types of voluntary-sector organisations and even private sector employers.

These employers can apply to join the LGPS if they take over a public service, which means their employees will stay in the LGPS even though they don't work directly for a council.

Basic state pension

A flat rate pension, payable from the state pension age, that is paid to everyone who has made the minimum of National Insurance contributions. The minimum number is 30 years and the maximum basic state pension in 2011/12 is £102.15 a week for a single person.

Career Average Revalued Earnings (CARE) pension schemes

Like final salary pension schemes (see below), these are 'defined benefit (see below) pension schemes where the pension a member gets depends on their wage and how long they are a member of a scheme.

In a CARE scheme, you still get a proportion of your salary as a pension when you retire (the proportion depends on the accrual rate) - but instead of the final pensionable pay (see below) being based on earnings near retirement as in a final salary scheme, it is based out on how much you earn in each year you're a member (adjusted for inflation).

So if you're in a career average scheme with an accrual rate of 1/60ths and pay into it for 30 years, your pension will be 1/60th of your first year's salary, plus 1/60th of your second year's salary, plus 1/60th of your third year's salary etc, all the way up to 1/60th of your final year's salary.

Obviously, inflation means that what you earned 30 years ago will be worth very little now, so the pensionable pay for each year is increased, in line with either inflation or average earnings, until you retire or leave the scheme.

Commutation

This is where a member gives part of their annual pension (normally up to a maximum of 25%), in exchange for an immediate tax-free lump sum when they retire

Cost sharing

All the public service pension schemes were reformed in 2007/9, with an agreement that, in future, members would share any increases in the costs of the schemes, especially when it came to people living longer.

In the NHS Pension Scheme, employers' contributions are capped at of 14.2% of salary – if costs rise higher than this because of increased life expectancy, then members' contribution will be increased to pay for them.

There is no agreed cap on employers' contributions in the Local Government Pension Scheme.

However, the government has suspended these cost sharing agreements while it tries to push through major changes to the schemes.

Deferred member

A member who is no longer contributing to the pension scheme, but is due a pension from the scheme when they reach normal pension age.

Defined benefit (DB) pension scheme

This is where the rules of the scheme decide how much pension you will get – in other words, the benefits are defined.

There are different ways of working this out, but members will know which method their scheme uses and can work out what their pension will be.

For instance, in the examples used above of a scheme with an accrual rate of 1/60ths, it is 1/60th of your pensionable salary times the number of years you've been in the scheme.

Both final salary and career average schemes (CARE) are defined benefit schemes.

Defined contribution scheme (DC)

As the name suggests, this is a pension scheme where how much you pay in each year – the contributions – are defined, but the pension you get at the end – the benefit - cannot be predicted.

They are also called money purchase schemes.

Essentially how these schemes work is that a worker (and sometimes their employer) pays money into an individual pension pot. This money is then invested until you come to retire, when it is used to buy an annual pension, or 'annuity'.

How much that pension is will depend on a number of factors, mainly:

- how much money is in your individual pension pot (this won't simply be the amount you put in - but will depend on investment income, whether shares the money has been invested in have gone up or down in value, and what charges have been made for managing that investment);
- what sort of annuity is available to buy at the time you retire – which will depend on something called the annuity rate, or how big an annual pension a given pot of money will buy at any one time.

Basically, if someone retires when the stock market is high, they are likely to get a better pension, for the same amount of money, as someone who retires when the market is low. Charges can also mean for every £1 paid into the scheme, as little as 40p is available to buy a pension when you retire.

Early retirement

This is when a member retires, and collects their pension, before the scheme's normal pension age.

Taking your pension early will usually involve an 'actuarial reduction' – in other words, because you can be expected to be drawing your pension for longer, you will get a smaller amount each year.

Fair Deal

In 1999 the government set up the 'Fair Deal on Pensions', which means private sector employers taking over public service workers have to provide a pension scheme which is 'comparable' for the public service scheme those workers are forced to leave.

It also allows workers to transfer their public service pension to the new 'comparable' scheme at special rates.

The Local Government Pension Scheme also allows private-sector employers join it (see admitted bodies above), so workers can stay in the LGPS after they have been outsourced, rather than having to join a comparable scheme.

Final pensionable pay

This is the pensionable pay that is used to calculate your pension when you retire from a defined benefit scheme.

In a final salary scheme, it is usually the pensionable pay you earn in the last 12 months of work, although there are variations.

In the new NHS Pension Scheme, final pensionable pay is an average of the last three years.

Final salary scheme

A final salary scheme is one where your pension is a proportion of your pay near to retirement, as opposed to a career average scheme (see above) that calculates a

pension on your average earnings over the whole time you've been a member of the scheme.

The Local Government Pension Scheme and NHS Pension Scheme are both final salary schemes: the pension you get is linked to how long you've been in the scheme and what your pensionable pay was when you leave it (either to retire or to change jobs and become a deferred member (see above)).

Funded scheme

A pension scheme where the contributions from members and employers are put into an fund, which pays out pensions and benefits as they fall due, and which is invested to earn extra income.

The Local Government Pension Scheme is the only “funded” public service pension scheme.

Ill-health early retirement

This is where a member retires early because of ill health. They may get higher pension benefits than a member normally gets when they retire early.

Index-linked pensions

This is where a pension that is being paid, or a pension that is left behind in a scheme when a member leaves employment, is increased each year by the general increase in the cost of living – ie, by inflation, usually measured by either the Retail Price Index or the Consumer Prices Index.

Investment

This is when the money paid into a pension scheme is used to buy things like shares, bonds (a loan, usually to governments, at a fixed rate of interest and for a fixed period) and properties to get more income into the pension funds

Liabilities

These are amounts, which the pension scheme will have to pay now or at some time in the future.

The most common liability is paying a member's pension benefits. Total liabilities include the total pension payable to every member of the scheme for as long as they live - on its own, this can be a scarily big number, but liabilities need to be looked at in relation to income and the amount of time over which they are due.

Lump sum cash payments

Members of public service pension schemes will often have to take part of their pension benefit as a cash lump sum at retirement. All members can decide to exchange more pension for a one-off cash payment at retirement (see Commutation above), subject to certain restrictions. These lump-sum payments are tax free.

Opting-out

This is where a member decides they don't want to join, or no longer wish to remain, in their pension scheme.

Pay as you go (PAYG) schemes

A public-sector pension scheme where benefits (pensions) are paid out of current income (contributions). There is no separate fund with money in it. These are also often referred to as 'unfunded schemes'.

Employer and member contributions are paid to the Treasury and money is released from the Treasury to pay pensions.

Although there is no dedicated fund, the contributions paid by members and employers are based on what would be needed if the scheme was funded to cover benefits as they are earned. The NHS Pension Scheme is a pay as you go scheme.

Pensionable pay

The pay that you pay contributions on as defined in the rules or regulations of the pension scheme. Final salary schemes usually exclude overtime and one-off payments.

Preserved or frozen benefits

These are the benefits an occupational pension scheme member has already earned from the scheme when they stop being an active member (because, for example, they change jobs) – or if the scheme closes – before their normal pension age.

The member will then get these preserved benefits when they retire, increased by inflation according to the particular scheme rules.

Pension fund

This is the money saved and turned into assets of the pension scheme.

Pensioner

Someone currently receiving a pension from the scheme they previously paid into.

State second pension (S2P)

An additional state pension on top of the basic state pension. At the moment, this is related to earnings and used to be called the State Earnings Related Pension Scheme, or SERPS.

Members of both the Local Government Pension Scheme and NHS Pension Scheme are unlikely to get a state second pension for the period they are members of these schemes, because they are “contracted-out” of the state second pension.