

# Helpsheet

## Final Salary or Defined Benefit Pension Scheme

**Final Salary or Defined Benefit pension schemes are offered to staff by some employers although the number is diminishing as they are very expensive to fund.**

The size of pension that an employee may expect to receive when he or she retires is based on a formula typically related to their final salary and the number of years they have worked for their employer.

Importantly, all the risk attaching to a final salary pension scheme is borne by the employer not the employee. Typically, the employee is required to make a contribution to the scheme. The major risk to an employee with a final salary pension scheme "promise" is that his employer must be able to fund it.

Employees may make additional contributions to enhance their pension benefits – indeed some employers are now making this a prerequisite of membership. Contributions will attract income tax relief at the highest rate the member pays. This can therefore be anything between 20% and 50%.

Contributions and funds are invested by the scheme trustees in conjunction with a consulting actuary. The scheme investment strategy is determined by the age profile of the scheme membership and how well funded the scheme is when compared with its liabilities. Members will have no say over the scheme's investment strategy.

Final Salary Pension Schemes, like all UK authorised pension funds, grow free of all taxes. It is important however to bear in mind that any tax deducted at source cannot be reclaimed.

Pension benefits may be drawn at anytime between a member's 55<sup>th</sup> and 77<sup>th</sup> birthdays. A member of staff does not have to leave employment to draw his pension but he may forfeit the right to further pension contributions and may also lose other staff benefits if he chooses to do so.

If a member of staff elects to retire earlier than the scheme retirement date he will receive a smaller pension than he had anticipated for two reasons:

1. He will have accrued less years service (thus accrued a smaller pension) than anticipated
2. The pension benefits will have to be paid for longer than the scheme trustees had anticipated. There may also be early retirement factors that would apply.

When a policyholder decides to draw his pension he has the option to receive a tax free cash lump sum based on the scheme rules.

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