What exactly is a Defined Contribution Pension Scheme?

A Defined Contribution (DC) pension scheme is a type of workplace pension where a fund of money is built up consisting of your own contributions, those your employer makes and tax relief from the Government.

You have various options on what to do with this fund on your retirement, such as those listed below:

- Draw 25% of the fund value as a tax-free cash sum and use the rest to purchase a pension for life (known as an annuity)

- Draw the whole lot as a lump sum payment. Please note however that significant amounts would be lost in tax under this option. You would be able to claim 25% of your fund value tax-free but the remaining 75% would be subject to tax at your marginal rate of income tax

- Use your fund like a bank account making withdrawals from it whenever you want to. Again, 25% of the value of each withdrawal would be paid tax-free and the rest would be taxed

- Draw 25% of the fund value as a tax-free cash sum and leave the rest of the money invested, drawing down an income every so often when you need it (although this would potentially be taxed)

Retirement Age: This will be specified in the rules of your scheme but you can draw from age 55

Tax relief: You get full tax relief on your contributions at your marginal rate of income tax. In a net pay arrangement, this means your contributions are deducted from your gross pay, lowering the amount of income that is subject to income tax.

How a DC scheme works in practice

You start employment and your employer enrols you into their workplace DC scheme on a net pay arrangement where they contribute twice what you pay up to a maximum of 10%. Hence if you contribute 5%, they will pay 10%. You earn £30,000 a year and elect to pay 5%. Therefore:

- You contribute £1500 into your pension a year
- Your employer contributes £3,000 (i.e. double yours)
- You've saved £300 in income tax through the tax relief afforded on your pension contributions (i.e. 20%, the basic rate of tax relief)

The total that gets added to your pension each year is therefore £4,500 (and you've saved a further £300 in income tax).

This amount will be invested in a fund selected by you and will go up or down depending on investment performance. Charges can also apply to the fund and reduce the overall value. The most common charge is an Annual Management Charge (AMC). The Government has capped charges at 0.75% for all auto-enrolment workplace pension schemes.

UNISON would hope for employer DC schemes to fulfil the following criteria:

- Default contributions are designed to deliver at least adequate pensions for all
- Employers incentivise saving by paying more than the member
- Receipt of the Pensions and Lifetime Savings Association's (PALSA) Quality Mark and particularly the Pensions Quality Mark Plus, which requires an overall 15% contribution with at least 10% being from the employer
- Trustee Boards or Governance Committees routinely demonstrate to members how they achieve value for money, engagement levels and how money is invested in a socially responsible way
- Life assurance and protection in the event of ill-health form part of the overall benefit offering

How big a fund/pension might you build up?

The Money Advice Service provide an interactive Pensions Calculator that enables you to get some sort of idea of the size of fund and possible pension (including the State Pension) you could build up at your retirement, which you can access at https://www.moneyadviceservice.org.uk/en/tools/pension-calculator/info.

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