Transcript: Pensions 101 – what's so good about the Civil Service pension?

ROB Hello. I'm Rob Walker.

EMILY And I'm Emily Eccles.

ROB And this is the brand-new Civil Service Pensions podcast.

EMILY We work for my CSP, the scheme administrator for the Civil Service Pension Scheme. We're communicators and we're passionate about making the complicated seem straightforward.

ROB But we don't everything there is to know about pensions.

EMILY That's why we're using this podcast to learn alongside you. We'll go back to basics to help you get to grips with your Civil Service Pension and make more informed choices about your future.

ROB In every episode, we'll be chatting to expert guests and members of the scheme to find out how you can get the most out of your pension and why it's one of the best in the UK public sector.

ROB Today, we're going back to basics. Pensions 101. What is a pension? How does it work? Why is it better than using a savings account or storing your money in cash in a safe? And what makes this particular scheme so good?

EMILY Exactly. No question is too small. So, with us today are Dominic Arthur, Director of Pensions and Government Recruitment in the Cabinet Office, and Duncan Watson, chief executive of My CSP.

ROB Dominic and Duncan, thanks for being here today. Can we start with you each tell us a bit about yourselves and your roles? Dominic let's start with you.

DOMINIC Thanks, Rob. Thanks, Emily. It's great to be here. Hi everyone. I'm Dominic, Director for Pensions and Government Recruitment Service in the Cabinet Office. And I'm delighted to say that I've been in pensions about 20 years, both in the private sector and in the public sector. On this occasion, in the civil service.

ROB Duncan.

DUNCAN Thanks, Rob. Thanks, Emily. I'm Duncan Watson. I'm CEO of my CSP. My CSP is the organisation that supports the Cabinet Office in running the Civil Service Pension Scheme. I've spent 30 years of my career in the pensions industry, helping pension schemes provide benefits to their members and helping to communicate and advise members of the benefits they can get.

EMILY Wow, so we've got about 52 years in the room in pensions experience.

EMILY Just to point out. So, the difference the Cabinet Office is the scheme manager for Civil Service Pensions and MyCSP is the scheme administrator. That's how those two organisations kind of fit together.

ROB All right, first question. So, let's go really, really basic with this first question. Duncan, what's a pension?

DUNCAN In simplest terms, a pension is your income once you've stopped working. So, it's money that gets put aside. So, when you stop working, you're not earning anymore and the pension provides that support, financial support when you're retired.

ROB So it's kind of a salary.

DUNCAN Think of it that way. Deferred pay, so pay that you're putting aside. So, when you've finished your career or your careers, you've got something that then you can rely on to support your financial needs and your lifestyle in retirement.

EMILY Okay, that makes sense. So, you mentioned that you put pay aside during your career into your pension and then you get it later. So how does that actually work?

DOMINIC Hmm, one of the things that I think is really useful as a pension is that apart from, you know, why wouldn't, one would ask - and I have actually been asked that before - about keeping the money in a bank account and or even under my pillow. But actually, the reason why it's even better in a pension scheme is that the Government also contributes to it. So, you know, you put money away through your pay and your employer contributes to it and then the government, because the contribution becomes grossed up. So, the tax that you would otherwise have paid on it to get your net pay, the government gives that back to you and invests it in your pension scheme. So actually, you know, in some ways there are three parts to that pension contribution, whereas you won't get that if you took that as pay or if you put that under your pillow.

ROB Okay, so you make a contribution from your salary into the scheme, but then that is kind of matched or added to, in addition, by your employer?

DOMINIC That's correct. So, there are different types of pension really. But broadly speaking, most employers would contribute to it. So, you'll pay a proportion of your salary, a percentage of your salary into your pension, and then your employer will make a contribution to it. And government will give you back the tax that you would otherwise have paid on it if you were to take the money away.

ROB So different types of pension. What are the different types of pension?

DUNCAN There are two main types of pension. There's defined benefit or DB, and there's defined contribution or DC. In a defined benefit pension scheme, your benefits build up as you work for that employer. So over time your benefits build up based on the time you're there, but also the salary that you earn over that period. And then when you retire, you get a defined amount of pension which is payable as long as you're alive, and then in most cases payable to your dependents, your spouse or your children after you die. In a defined contribution or DC pension, you and your employer pay a set amount of contributions each month into the pension scheme and it goes into a pot and that pot is invested. You have some control and some choice over those investments, but that investment builds up over time until you reach the point where you want to retire and your pension will be based on how much that pot has grown by to the point you retire.

ROB So there's a bit of risk involved then, I suppose with the DC.

DUNCAN So there's a bit of risk and in the latter there's a bit of risk in terms of the investment term. In the former, your employer is taking the risk that they pay you that defined amount until you die. So, in the civil service pension scheme, alpha is a defined benefit (DB) scheme and partnership is a DC scheme.

DOMINIC And that's a good thing is that in the civil service we have both options. You don't get both options in other parts of the industry. So if you go to the private sector, you tend to have mainly defined contribution one which comes as you said, Rob, with investment risk. But in the civil service we have both. Most members though get auto-enrolled, so they get automatically enrolled when they join the civil service into the defined benefit which is secured by government. But you do have an option if you prefer, for various reasons and it'll be a personal reason, you could opt out of the defined benefit into the defined contribution.

ROB So are there any sort of, I don't know, industry, kind of, accepted opinions about which is better, you know, defined benefit or defined contribution?

DUNCAN I think it depends on individual circumstances, but generally a defined benefit scheme is secured income. It's there, it's backed by your employer. So as long as your employer is strong, then your pension is guaranteed and will be paid until you, until you die. And it's based on a defined percentage of your, of your working salary and your working career service with that, with that employer. In the case of the Civil Service Pension Scheme, the employer is the government. So, the pension scheme is actually backed by the government. So, it'll be, it's one of the most secure DB pension schemes in, in the UK. In a DC scheme you've got a little bit more control of where your investment is placed. You've got a bit more control about the contribution flow, but you're taking the risk that your investments will grow at a particular rate until you retire. So, there's investment risk that you are shouldering as the employee in a in a DC scheme.

ROB You know, we've sort of talked about why it's so good. It's great, obviously, that the Civil Service offer defined contribution as an option, but it's not as good or it's more risky. So, I guess why, why is it that some civil servants choose to be in that scheme instead?

DUNCAN I think it's sometimes it's a choice, personal choice. I think majority of times it's a lack of understanding of what they've actually got with the DB scheme. DB schemes aren't tangible in some ways. With a DC scheme you can see your investments, you can see your, fund building up and you can watch that overtime and it's very, it's very apparent. With a DB scheme you've got this, this promise of a, of a benefit of prescribed benefits maybe 30 or 40 years in the future. That's very hard to put into a tangible context. So, I think some people, through lack of understanding, come out of the DB scheme, the lack of understanding, the benefit they're actually getting, the contribution that the employer is actually making to that scheme and therefore opt out. Some will see DC as more flexible, more visible and having slightly more control. But I think the that it's a lack of understanding of the real benefit of the DB scheme, especially if they're going to, if their long-term career is with the civil service. The power of accumulation of, of those DB benefits over time is exceptionally beneficial to them.

DOMINIC Mm, yeah. Duncan is right and that's one of the reasons why we're very keen to talk a lot about the, the benefits of the Civil Service Pension. The good news is that if colleagues haven't actively chosen to go into the defined contribution, they will be automatically enrolled, automatically added to the defined benefit. So, if you haven't made an active choice to join the defined contribution, then you're okay. You're in the defined benefit. Another reason why people may choose to go into a defined contribution might be for tax purposes and tax reasons and for higher paid people, that perhaps for, you know, and I'm not going to go into the details, but for annual allowance, tax reasons may choose to opt for the defined contribution.

ROB For a lot of people, you know, they're working for, you know, over 40 years of their life. So, if you're saving even a small amount over that period of time, it's going to it's going to build up, isn't it?

ALL Yeah.

DOMINIC And we do talk about this a lot is that it's never too early to start your pension. The earlier you start the better. Yeah. So, it's very important that you contribute to your pension but I same time you start as early as you can. Yeah.

EMILY That makes a lot of sense. That makes a lot of sense. So, I guess one thing you mentioned earlier, Dominic, that I'd really like to just kind of go back to is why a pension is better than saving your money in other ways. So, you know, what would you say are the benefits of a pension over a normal savings account or, you know, like Rob mentioned earlier, saving all your money in a safe under your bed or something like that?

DOMINIC So I can think of three things, but there is more than three reasons. The first one is the fact that, as I mentioned earlier, your employer contributes to it. If you're building up a savings, whether it's in a bank account or under your bed, to quote, Rob, your employer will not contribute. Erm, the civil service, for example, you know, in the defined contribution part of it, if you don't contribute or if you contribute, say, 8%, your employer would contribute between 15% and beyond

15%. So it's quite a huge contribution for employers. The defined benefit is even higher. On average, employers pay into the scheme about 27% for members. And again, the member or the employee's contribution ranges depending on their salary, but huge contribution compared to what you would typically see in the private sector, which will be around 4% for especially for defined contribution schemes. So that's one reason is that you get contribution from your employer and of course, the other one. The second one is the government refund off your contribution, if you like, you know, so your contribution is paid gross and by doing that, the tax that you would otherwise be paying to government is paid into your pension scheme. And the third one is especially with a civil service scheme, but more broadly with most defined benefit and some defined contribution schemes, is that you get life cover with it. So, in the event that you know something happens to you. Again, I think Duncan mentioned that earlier, you get a lump sum payment. If you are still employed in the civil service, your family would get a lump sum payment and that comes with the pension. If you were to finish, to retire or to leave the civil service, you still there will still be a sort of payment either through pension or some sort of lump sum, refund of contributions or lump sum to your family. So, there are huge benefits for being in a pension rather than just putting your money under your bed.

ROB Yeah, I'm definitely not going to do that anymore. Think of a bank.

DUNCAN Two extra bits for me, I think. One is it's safe, particularly the DB scheme, you know, the alpha scheme, because the Government is backing it. The Government is guaranteeing that they're going to pay that defined amount in retirement. If you're saving your money in the bank account or keeping it under your bed, there's a risk you get broken into and it's stolen or you won't earn very much bank interest on the on the amount you've got in the bank. So, it's a very, very safe investment towards your retirement. I think the other thing about a pension is it's slightly hidden. So, you're not tempted to do anything with it, it's very difficult to do something with it. So, if you can have the discipline of staying in the scheme and saving for it, then it's there and it builds up and it will be there for your retirement. If you've got cash in another investment or an accessible investment like a bank account, there's always that temptation to take it out before the rainy day. And it's very hard to put back. But with a pension, it's there. It's, it's sitting in the background, you know, accumulating, earning money whilst you carry on working.

EMILY And growing. Yeah, that's a really good point.

DOMINIC That a very good point actually. And on safety, I mean moving away from putting it under your bed, even if it's in a savings account, there is a limit to the protection isn't there? I can't remember, I think it was, last time I checked, it was up to about £85,000 in one savings account is how much the Government will guarantee in the event of the bank going under. We've had that in the past, you know, off the back of the financial crisis with Northern Rock and other banking organisations. But with the pensions, your pension, as soon as, you know, it goes in, it's your, you are entitled to it throughout your career, really.

EMILY That makes a lot of sense. I didn't actually know that and that's a good point about what the government will guarantee with a normal savings account. I hadn't even thought of that. So basically, what we're saying is a pension is really safe.

ROB Yeah, yeah. I suppose the other thing is that that's just kind of coming into my head now is that all the cash I've got under my mattress, which is admittedly quite small pile of cash at the moment, you know, that's going to run out, isn't it, at some point? Whereas obviously with a pension, you're going to get that paid to you for the rest of your life once you put it into payment.

EMILY That's true.

DUNCAN I think Dominic talked about, you know, benefits, death benefits there or life benefits with a DB scheme in particular, it's guaranteed. As long as the government is there and it exists, that pension is guaranteed, it will be paid to you. It'll get increases every year, and should you unfortunately die, it will continue to your spouse after your time. You don't get that with a with a bank account. When it's gone, it's gone.

ROB So it carries on even after you’re gone. You know, it's amazing. So, I just want to pick up on one thing and this is on the sort of contributions. So, we talked about kind of, you know, as a member, you might in the alpha scheme, the DB scheme, you would, might make contribution yourself of between [sort of, you know] 4 and 8%. And then your employer on average is going to make a contribution of 27%. Does that mean that that money that is being contributed is in a pot for you? Or does it work differently to that?

DUNCAN So the civil service pension scheme works differently. So, there's that there's effectively a contribution that is there that the government is setting aside, but they're guaranteeing to pay your pension regardless of what happens to that money. So, they are effectively taking the investment risk, whereas in the DC scheme, you're taking that investment risk. As Dominic said, your assets, so your investments could go up, they could go down, they could vary. If there's a market crash in a particular year, you know, two or three years before retirement, you could see, you know, your DC benefit halved in a very short period of time. With defined benefit, the Government is guaranteeing that pension so, the cost of running the scheme is the 27% and your own contribution, but the benefits are guaranteed.

DOMINIC And that's a huge distinction, isn't it, between a defined benefit and a defined contribution is that whereas and as Duncan explained earlier, whereas the contribution that you put into the pot for your defined contribution is what builds up, and then the investment returns on that is what you get at the end of your career. For defined benefit it’s the benefit that is calculated. So i.e. it's normally linked to the number of years you work and the salary that you're on. So, it’s the eventual benefit. So that is the benefit that you get at the end is defined, not the contribution. So, for defined contribution it’s what you put into the pot that defines that the what you get at the end of it. So that's the main distinction.

EMILY We talk a lot about, I mean, Rob and I communicators so it's my job to talk about how great the scheme is and how it's one of the best in the UK public sector. But what specifically would you guys say makes it so good?

DUNCAN I think first and foremost, it's still open. The DB section, it's still accepting new members and it's still accepting new benefits growing over time, most private sector defined benefit schemes in the UK are closed. They're not allowing anyone else to join it. And even for those members that are still employed by their employer, they're not allowed to generate anymore benefits. So, most active employers in the private sector in the UK are in a defined contribution scheme. They may have some defined benefits that are that are sitting dormant, if you like, or deferred, but generally they're their active contributions are now into a DC scheme. So that's one of the, the absolute benefits of the civil service scheme. It's still open to anyone who joins the civil service and it's still accruing benefits.

ROB Presumably that other benefit, the other DB schemes that you referenced there that aren’t open anymore, aren’t open because they're too expensive, frankly, for those employers to run.

DUNCAN Yeah, that's correct. And that's why most private sector companies have taken the steps to close them. And, if you like, protect their risk, protect their contribution. So that's one of the biggest values of the civil service pension scheme. And it's the guarantee, you know, defined benefits are as secure as the employer that's guaranteeing them, in this case it's the UK government.

ROB Okay. So those decisions that those employers have made are really good decisions for them because it means it's cheaper for them to service the pension. But it's not so great for the member because they're going to get a smaller pension at the end, whereas the government has taken the view, well we're not going to do that and we want the best for the people that work for us and we're going to keep this DB scheme alive.

EMILY Yeah, it sounds like they’re essentially a guarantor for all of these pensions, right?

DOMINIC That's correct. I would say the government is the guarantor for civil service and other public sector pensions.

ROB Okay. So, we talked about benefits for loved ones and we've obviously the original question was, was, you know, what makes this scheme so good? So, is it really the case that your loved ones are going to still be able to get some of the pension that you've been getting in retirement after you die? Does that actually happen?

DOMINIC That's absolutely correct, yes. So, it depends on whether you die whilst you're still in service, in which case you get a lump sum and pension. Or if you die and, you know, when your pension is frozen, i.e., you're no longer a civil servant, but you haven't taken retirement, again, you will get benefits, including perhaps a lump sum of some sort, which could be a refund of some contribution, but also a pension. And then the third one is, if you are in retirement, receiving a pension, then your spouse and or children could get a pension scheme. So, there will always be something to pay out when one passes on. But it depends on what stage in the process that they're at. Either they are still an active member i.e. still employed, a deferred member which is where the pension is frozen, or a retired member.

EMILY Okay.

DUNCAN So, so if you think, the comparison with a defined contribution scheme, if you die with a defined contribution scheme, then effectively the pot that is accumulated will pass over to your, to your spouse or your estate like an inheritance. So, but if you've retired and if you've lived for 20 years in retirement and taken that pot down through taking a retirement income, the pot is going to get smaller. So therefore, what is left for your loved ones, your spouse, at the point that you die is much, much smaller, whereas in the defined benefits scheme it's defined the spouse's pension is defined and guaranteed and payable.

ROB So for the rest of their life, regardless.

EMILY That's amazing.

DOMINIC I think what's also important though, is that colleagues tell us who their choice of person is, i.e., whether if it's your spouse or your children. There's something that we call death nomination. And it's very important that colleagues keep that up to date. And that's a lot of information they gave on the Civil Service Pensions dot org website about how one can do that so long as the scheme knows who your preferred person or group of people are, will be able to make arrangements for that to happen.

ROB I'm just trying to summarise why it's so good. So, it's a defined benefit scheme, which there aren't many of those left. The employer pays a whacking great amount of money into that, as in the government in this case. And you're basically guaranteed effectively an unlimited pot of money. If you live forever, you'd get that money paid forever. And then when you die, eventually your wife or your partner or whoever that might be, maybe even your children, are going to continue to get some of that money. Wow.

DOMINIC That's yeah, that's absolutely correct. Depending on the age of your children.

ROB Some of the people who listen to this, you know, they might be in their twenties, thirties and, you know, thinking, you know, I'm 40 years away from retirement potentially. You know, why should I, why should I care about that now? You know, what would you say to those people, Dominic?

DOMINIC Two things. The first one is, as we've talked about, it's never too early to start. In fact, it's important that you start early and the fact that you are automatically included in the scheme, automatically enrolled into it means that you don't really have to take any action unless you want to come out, in which case you have to take an action. But if you don't take any action, you automatically include it in that as soon as you join the civil service and when you move around civil service departments that pension comes, so it's portable, it follows you effectively throughout your civil service career. So, it's very important that you keep that, you know, whether you're young or not, it's very important that you start early. The second reason is the benefits that we've talked about is that, you know, for example, if you're not in the pension scheme, that, you know, that death cover that we talk about that you might get, your family will get a lump sum if the unfortunate happens, you don't get that. So, it's very important that for that reason you are in the pension scheme. Whether that is the defined benefit or the defined contribution, it's very important that you are in.

DUNCAN I think the other thing for me is, and again, Dominic referenced the effect of the 27% that the government is putting aside to make sure they can pay the defined benefits. That's free money. Okay. So, if you if you if you're not starting early to think about that or you're opting out, then you're giving away 20% to 27% of your pay. And I think the sooner you start, the more choices you will have later in life. The later you start, you're limiting your choices, or you'll find yourself working a lot longer before you've got to a point where you can make some of those choices about your retirement time.

ROB So when they say it's the biggest benefit after your pay, they aren't joking are they?

EMILY Yeah, and opting out is like turning down free money, essentially.

DUNCAN Correct.

EMILY Wow. That is really powerful. No, that's really interesting. I mean, it's, I know we talked about people in their twenties and thirties. I'm in my thirties now as of April and I think, my retirement feels so far away at the moment, I wouldn't even know where to begin, like, planning for that part of my financial future. You know, where… Duncan, where do you think I would start?

DUNCAN I think it's the three things you need to start thinking about. One is how your lifestyle is going to evolve over the next 20 or 30 years. What kind of responsibilities might you acquire? Be it children, be it houses, etc., be it a taste for holidays and work out, you know, the second thing is work out, what do you see yourself doing in retirement? Do you see yourself travelling more, going on more holidays, you know, buying different things? They all cost money and you're not working. So, think of retirement. Think of as we said earlier, your pension is your pay that will allow you to do those things in retirement. So have a really hard think. I know it is hard sometimes at your age but think about what the thing what you might want to do while you're retired. And I think the second really important thing is, is when do you think that maybe, you know, do you want to retire at 55, at 60, at 65? So, think about the earlier you want to retire and enjoy life post work, the more you're going to have to accumulate in your pension. So, it's really important that you start thinking about that now and get used to that pension saving, you know, leaving your pay slip and accumulating nice and quietly and in the background. And there's some great tools from great modellers on the pension scheme website that allows you to think about when and how much you're going to need to, if you like, you know, afford that lifestyle that you've, you've dreamt about in retirement.

EMILY Okay. So, there's actual, like, calculators and, and tools I could use to kind of input, you know, I want to retire at 60, for example. And, you know, it will help me kind of figure out what I would need to do with my pension now, to get there?

DUNCAN I think it surprises a lot of people, in particular people in defined contribution (DC) plans. It is a shock to most people when they do that modelling, working out the pot of money they're going to need at say 60 and then work out what they've got to contribute to now or when they start contributing. So, they've got that pot at retirement. Somebody told me a rule of thumb is if you start a pension at 20, then roughly contribute half your age for the rest of your life and you should be okay. If you think about starting saving when you're 50, then you can do the maths and work out how much you're going to have to start saving when you're 50 to get anywhere close to being a decent pot at retirement.

ROB So it's kind of saving for like a big long 20-year holiday, really isn't it?

EMILY A big, long, rainy day.

ROB Yeah.

EMILY I know, like Duncan, you said earlier, with all the types of savings, it can be really easy to dip into it, but it's, with a pension, you're lucky in that the decision is made for you. It's hard to touch it if you wanted to.

DUNCAN The law makes it very hard. The law makes it very hard to touch it before you get to 55. So, you've got that protection there that even if you want to dip into it, it's really difficult to do so.

ROB Oh so there's laws surrounding it. It's not like a normal savings account, there's actually laws that will stop you from taking that money out to protect you.

EMILY Save you from yourself if you like. Yeah, that makes sense. But I guess it's, but it's not necessarily hidden away from view. It's actually really easy to track where your, how your pension’s doing, how it's growing, is that right?

DUNCAN It is, yeah. For a DC scheme It’s very easy. You should be able to log on and see your pot accumulating so you can see the cash value if you like, of that, of that DC scheme. For a DB scheme you've got annual statements you can use the modelling tools to project what you might get should you work for another 20, 30 years in the civil service. So, there are tools out there that make it very easy to see what your projected benefits are at your chosen retirement age.

EMILY Right. And all of that's accessible through the website, isn't it? Through the, through the pension portal?

DOMINIC It is, yes. And the pensions modeller that Duncan is talking about is absolutely brilliant. And I would encourage colleagues to go and have a look, because one of the other advantages with the pensions modeller is that, you know, if you feel that actually, you know, instead of 20 years, you know, holiday, I don't just want a holiday. I also want to holiday with the rest of my family. You can decide to contribute more so, you know, add more to the actual contribution and then get more in retirement. So, what we call added pension, so you can actually do more in that space and the modeller will give you various options that you can that will help you decide on that. But I can certainly tell you, apart from the annual benefit statement that you get on an annual basis that Duncan touched on, you can also use the modeller to determine not just where things are now but projecting into the future what things would look like, whether you contribute more or the same.

EMILY Okay.

ROB Wow. That's been super enlightening.

EMILY Yeah.

ROB So thanks, Duncan. And thank you to Dominic as well for being here. It's been really great to have you both with us today. I think both Emily and I feel like we've really learnt something from you and hopefully the people listening have too and yeah, it's been really good having you just to kick off this this podcast.

EMILY Thank you so much for joining us.

DUNCAN Thanks both. It's been a really good episode.

DOMINIC I agree. Thank you both. It's been great talking to you about pensions and if you'd like to see more, go on to civilservicepensionscheme.org.uk. If you’ve got any questions, let us know but hopefully the podcast will be listened to by many and will prompt people to continue contributing to their pensions.

EMILY Great. Thanks, guys. So if you want to find out more about any of the topics that we've talked about in this episode, or if you want to tell us something that you want us to cover in a future episode, you can head to civilservicepensionscheme.org.uk/podcast

ROB If you've enjoyed today's episode, make sure to follow or subscribe so you never miss an episode. You can also leave us a review wherever you get your podcasts.

EMILY Well, thanks again for listening and thanks for joining us.