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Defined benefit schemes

Some employers offer these schemes, also known as **salary-related pension schemes**. When you retire the scheme will pay you a pension where the benefit is based on rules set out by the scheme.

How defined benefit schemes work

Defined-benefit schemes usually provide a pension income based on:

- **the number of years you've been a member of the scheme** – known as pensionable service
- **your pensionable earnings** – this could be your salary at retirement (known as 'final salary'), or salary averaged over a career ('career average'), or some other formula, and
- **the proportion of those earnings you receive as a pension for each year of membership** – this is called the accrual rate and some commonly used rates are 1/60th or 1/80th of your pensionable earnings for each year of pensionable service

These schemes are run by trustees who look after the interests of the scheme's members. Your employer contributes to the scheme and is responsible for ensuring there is enough money at the time you retire to pay your pension.

Example of a defined-benefit scheme

Bill belongs to a defined benefit scheme. The accrual rate is 1/60th. This means Bill can expect a pension of 1/60th of his pre-retirement pensionable earnings for each year he belongs to the scheme.

Bill retires at 65 on a salary of £24,000 a year, having been in the pension scheme for 10 years.

His pension is: 10 x £24,000 divided by 60 = £4,000 a year (less if he takes any cash lump sum).

The benefits of these schemes

Defined-benefit schemes tend to provide valuable benefits. If you get a chance to join one, you'll probably be right to do so. At the very least, think very carefully if you are planning not to join your employer's scheme – you might regret it.

The benefits of defined-benefit schemes are that:

- your pension benefits are linked to your salary while you're working, so they automatically increase as your pay rises
- your pension entitlement is not dependent on the performance of the stock market or other investments, and
- the pension scheme will often increase your pension income each year in line with inflation or by a fixed amount

Defined-benefit schemes are protected by the Pension Protection Fund. This pays some compensation to scheme members whose employers become insolvent and where the scheme doesn’t have enough funds to pay members' benefits. The compensation may not be the full amount, and the level of protection varies between members already drawing benefits, those who are still contributing to the scheme, and deferred members who have left the scheme but have built up an entitlement.