



## GUIDE TO PENSIONS

# PLANNING FOR RETIREMENT

Back in 2006, 'A' Day was supposed to be the day when 'once-and-for-all' the rules for pension saving were simplified and everyone would be able to work out how to make the most of their retirement arrangements. Sadly, that dream has proved elusive as different governments have continued to tinker with the regulations. You can therefore be forgiven for being overwhelmed by the complexities.

However, even after all the recent changes, for the majority of people they still represent one of the most tax-efficient ways to save for your retirement. The aim of this guide, therefore, is to help you understand the options available.

## WHAT IS A PENSION?

At its most basic, a pension scheme is simply a savings scheme which offers very attractive tax benefits in exchange for you agreeing not to touch the proceeds until you are older. In other words, you put your money in, that money is invested, its value (hopefully) grows and at the end, you withdraw the proceeds and use it to pay for goods and services. In this case, however, you cannot touch the proceeds until you are at least 55 – and at least 75% of the value it achieves must be used to provide an income for the rest of your life.

# THE DIFFERENT TYPES OF PENSION

## 1. The State Pension

The Basic State Pension came into being officially via the National Insurance Act of 1946 and is designed to provide a minimum amount of income. This year (2011/12), the payment for each pensioner who has met the minimum National Insurance contributions is £102.15. Or, for a married couple where one partner has not met the minimum NI contributions, the amount is £163.35.

On top of this, if you were making contributions to SERPs or, more recently, S2P (the state second pension) you may also receive an earnings related top up to the state pension. The amount you receive is entirely dependent on how much you earned, how much you contributed and for how long – but for those who were earning over £40,000 a year (in today's terms), this is currently worth a maximum of about £6,000 a year<sup>1</sup>.

As you can see, however, these payments alone will not enable a wealthy and luxurious retirement. For this reason – and because, thanks to an ageing population, the Government is finding it harder and harder to meet even these levels of payment, we are being encouraged to make additional investments towards our own retirement as well.

## 2. Occupational pensions

An occupational scheme is a scheme set up and run for company employees and into which your employer may make some or all of the contributions on your behalf.

These could be 'defined benefit' schemes (otherwise known as final salary) where the amount you receive depends on the number of years service you gave to the company. Alternatively, they will be defined contribution where you and/or your employer make a fixed level of contribution and the final value depends on how well, or badly, the underlying investments you chose perform.

Thanks to volatile stock markets and additional regulation, the days of final salary

pension schemes are generally considered to be all but over – save for a lucky few in the public sector or those with unchangeable employment contracts in the private one.

## 3. NEST & 2012

To date, whether or not your employer offers a pensions scheme – and if they do, how much they have to contribute on your behalf – has been entirely voluntary. However, from 2012, the requirement for all employers to offer either an in house scheme or to auto-enrol employees to the new National Employment Savings Trust (NEST) is being phased in. Not only that but, from 2014, employers will also be forced to start making a minimum contribution, rising to at least 3% of your salary. In exchange, you will have to contribute 4% and the Government, by way of tax relief, will contribute another 1%.

For those employed in smaller companies, this might be the first opportunity they have had to get involved in formal occupational pension planning. For larger companies, however, these minimums might already be exceeded. Indeed, if you decide to contribute more than 4%, you may find your employer will match that higher amount. It is therefore worth checking what your current employer offers, if anything – and what they are doing about planning for 2012.

## 4. Personal pensions

Personal pensions are pension schemes effected by the individual for the benefit of the individual. It doesn't matter who you work for or how long you work for them, or how much you earn. You decide how much to contribute<sup>2</sup> and you decide where the money is invested. The more you put in, the more money you have to invest for your future – and the better your underlying investments then perform, the higher that value will be.

### There are three basic types:

**Stakeholder pensions:** The simplest pensions, these are designed to encourage lower earners to save for their future and are subject to restrictions on charging, meaning they can be a cheap and efficient way to start saving.

Because of the cost limits, the range of investments might be restricted, as may some of the additional options, but you will usually find index tracker-type funds and multi-asset managed funds which will suit most people's basic needs.

**Individual personal pensions:** These pensions offer access to a range of different funds and may have added benefits which will make your management of them easier if you are looking to add value over a basic managed or tracker fund, or switch around different types of investment. They are not subject to the same charging restrictions as stakeholder so the fund choice can be wider and they suit most pension requirements for most people.

**Self-Invested Personal Pensions (SIPPs):** These are the most sophisticated personal pensions and allow a huge amount of investment flexibility if you are either very active in your investment allocation or adventurous in your choice. SIPPs allow investors to access funds, shares, bonds, gilts, property and cash – and occasionally some more esoteric investments as well. They therefore allow you to build a portfolio specifically tailored to your needs and make adjustments to that portfolio whenever and however you like.

As a result, compared to the choices above, SIPPs have been relatively expensive. In some cases, however, charges have reduced and a new generation of 'low cost' Sipps have emerged, which offer the same switching and management flexibility but without quite the same access to the more esoteric investments.

However, as with any product in any industry, you pay for the bells and whistles. Therefore, if you don't need them or do not have either the time or experience to take proper advantage of them, then paying for such a product could be a waste of your money.

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*1 This is based on full contributions to S2P over your working life, starting at age 16 and retiring at State Pension Age, currently 65 for men. 2 Subject to an annual contribution limit - see opposite*



# THE RULES OF PENSION INVESTMENT

## 1. Tax benefits

The rules on pensions can change with the seasons, but some basic things have remained constant in recent years:

- a) Investors get income tax relief on their contributions into a pension scheme (up to certain limits – see below);
- b) the income and gains made by that fund roll-up free of additional tax whilst the money remains invested;
- c) At retirement, you can take a tax-free lump sum of up to 25% of the total fund value;
- d) the remainder of the fund is then used to provide an income which will be taxable at your marginal income tax rate.

The things that have changed, however, are the contribution limits, the age at which you can retire and, to an extent, the tax relief you can receive on the contributions you make. Now that the previous Government's changes have been implemented and the new Coalition Government's intentions are known, however, there is a little more certainty, at least for the time being.

## 2. Annual contribution limits

This tax year (2011/12), the maximum amount you can invest into your pension, personal or occupational, is 100% of your income or £50,000, whichever is the lower<sup>3</sup>. For these purposes, income is defined as your UK derived taxable earnings, including salary, dividends, interest and trading income. You

will receive tax relief on the entire investment, up to that limit. However, if you try to invest more than £50,000, you will have to pay tax at 40% on the excess.

This limit, incidentally, applies to the combination of both employee and, if applicable, your employer's contributions.

You can, however, carry forward up to three years unused allowance to subsequent tax years.

## 3. Lifetime allowance

The lifetime allowance applies to the total value of all private and work pensions (not state pensions) that you build up over your lifetime, including the investment growth you achieve. For 2011/12, this value is £1.8 million.

If your pension funds grows above this value then you will be liable to tax charges on the excess. And these charges are quite onerous - 55% if the amount over the lifetime allowance is paid back to you as a lump sum and 25% if the amount over the lifetime allowance is taken as some form of income.

If you have a large pension fund already, therefore, even if it has not yet reached the lifetime allowance, you have to consider whether there could still be some investment growth to come. For example, if your pension fund is valued at £1.4m and you have 10 years still to go, it might be time to stop making

contributions and find somewhere else to put your savings.

## 4. Building a pension portfolio

Choosing a type of pension is important, but the contribution you make and your choice of underlying investments will have the greatest impact on your long-term wealth. The investment choice within pensions has evolved from the days of the traditional life office products with a selection of one or two balanced funds. Now, most pensions offer a sufficiently broad choice of investments for you to build a truly individual portfolio.

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*3: there was an allowance for people previously paying in more than £50,000 a year. Please ask for details of the Annual Allowance Charge if you think this affects you.*



# STARTING THE PROCESS

The four big questions you have to ask yourself before you take any steps to invest, are:

- What do I want for my retirement?
- How much can I afford to pay?
- How long do I have to go until I need the money?
- What risks am I prepared to take, or not as the case may be?

When you speak to an adviser about this, he will normally work backwards with you. You will therefore need some idea of the level of income you will need, just in today's terms. He/she will then assess what that means in terms of fund value, consider how many years you have over which to invest and work out how much, on a standard set of assumptions, you will need to pay to achieve it.

Once you have some realistic figures available, you can then start to work out whether or not you can afford the contributions, whether the potential benefits affect the way you feel about the risks you are taking and whether the age at which you plan to retire and expectations about how you intend to live are achievable.

Ultimately, however, there is absolutely no substitute for getting started. The earlier you begin putting money away, the more those contributions will add up over time and the longer they will have to grow. Our advice therefore is simple. Speak to someone. Today.

Please note: The content of this guide is based on our understanding of tax and pensions legislation as of April 2011, which is subject to change.

## A BRIEF HISTORY

The word 'pension' originates from the mid 14c when it is recorded as having been used to describe a payment for services, particularly a 'reward, payment out of benefice'<sup>4</sup>.

However, it is not until much later that we find pensions appearing in the way we understand them today. According to records, the very first organised scheme was set up in the 1670s for Royal Navy Officers. Even then, it is not until the Old Age Pension Act of 1908 that we see evidence of anything specifically aimed at helping the welfare of older people.

Since then, different Governments have introduced many different pieces of legislation, all of which have helped develop pension schemes from what was a basic, means tested welfare benefit into the tax efficient, ubiquitous saving schemes that we see today.

<sup>4</sup> Source: [www.dictionary.reference.com](http://www.dictionary.reference.com)

## CONTACT US

We hope you found the information in this guide useful and informative.

If any of the points are of interest, or you would like to discuss your own situation in more detail, please call us on the number enclosed.

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