



**KEY GUIDE**

# Saving for retirement

## Thinking ahead

Retirement is something most of us look forward to – particularly on a Monday morning. However, those thoughts are often little more than a whimsical cocktail of not having to work and prolonged holidays. The reality could be rather different, particularly if your retirement date is some way off.

For a start, retirement now is often not the sudden change from work to enforced idleness that it used to be. It has increasingly become a gradual process, with part-time work playing an important role. The latest data from National Statistics show that 13.2% of men and 7.3% of women aged 65 and over are still in employment.

## A gradual process

The blurring of the work/retirement boundary is being accompanied by changes to the state pension age (SPA). The process of equalising SPA for men and women started in 2010 and by the end of 2018 both sexes will share a common SPA of 65. However, this will not last for long: further increases are planned, as the table below shows.

State pension age increase	Phasing-in starts	Phasing-in ends
65 to 66	6 March 2019	6 October 2020
66 to 67	6 April 2026	5 April 2028
67 to 68*	6 April 2037	5 April 2039

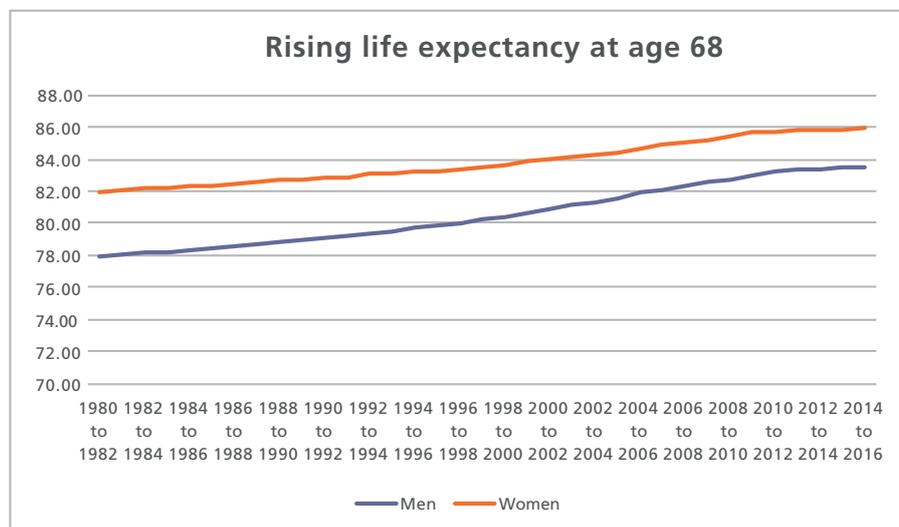
\* Not yet legislated for, but announced in July 2017.

### Action point

*The blurring of work retirement boundaries, a rising state pension age and increased life expectancy all need to be taken into account in your retirement planning.*

At the rate SPA is rising you may need to have reached age 70 by around 2050 before you can start to draw your state pension – food for thought if you were born after 1979.

The rise in SPA reflects some good news for retirees: the increase in life expectancies. Between 1980–82 and 2014–16 the average life expectancy in the UK at age 65 had risen by over five and a half years for men (to 83.5 years) and just over four years for women (to 85.9 years). These are average numbers based on historical data, so they don't tell the whole story. Other calculations made by National Statistics suggest that a man aged 65 today has a one in four chance of reaching age 94, while a woman of the same age has the same odds of reaching age 96.



Source: National Statistics

## The changing world of pension provision

The rapidly changing retirement arena extends to the nature of pensions, both state and private:

- In April 2016, the state pension system underwent a radical reform. The two-tier system of a basic state pension plus an earnings-related, state second pension (for employees only) was replaced by a single-tier, new state pension. This transformation involved highly complex transitional arrangements to allow for existing state benefits. The flat rate approach disadvantages higher earners, but creates some winners at the lower end of the pay scale.
- Traditional final salary pension schemes have all but disappeared for new employees in the private sector, although they have survived in the public sector, at least for now. In their place defined contribution arrangements, such as personal pensions, have come to dominate new pension provision.
- Automatic enrolment has introduced over 8 million employees into pension saving, many for the first time. However, the combined employer and employee contribution level is generally considered too low.

This guide explores the main type of pension provisions, both public and private, and the factors that you must consider when planning for your retirement. The complexities of today's pension legislation – which only shows signs of growing – mean that you will inevitably need further personal advice in meeting your retirement goals.



### Action point

*The new state pension is now single-tier, without any earnings-related element.*

## Today's pensions – what is on offer?

This is best considered in two parts: state provision and private provision. Both have been subject to many changes over recent years, with the state steadily backing away from its pension provider role in an attempt to limit future government expenditure as the population ages.

### New state pension

As mentioned above, if you have not yet reached your SPA, the state pension is now a single-tier arrangement, meaning that there is no longer any earnings-related element. In 2017/18, the theoretical maximum new state pension is £159.55 a week – a little less than two thirds of what the National Living Wage would provide for a 35-hour week. In practice, few people currently reaching their SPA receive this amount – many are receiving less and some more. The differences stem from the arcane transitional adjustments made to take account of the old state pension regimes, including the option to opt out (technically 'contract out') of the earnings-related element.

Unlike the old state pension regime, the new state pension is a purely individual benefit and does not incorporate any widow's or widower's pension. However, some may arise under the transitional provisions in respect of national insurance contributions (NICs) made or credited before 6 April 2016. Once payment starts – and do not forget that moving SPA – the new state pension is currently due to increase by the greater of the rise in average earnings, price inflation (as measured by the consumer prices index) and 2.5%. Most experts believe this so-called 'triple lock' will soon be replaced, with the 2.5% floor, the costlier element, removed.

To find out your projected state pension entitlement, start by visiting <https://www.gov.uk/check-state-pension>. Then you will need to consider your private provision.

## Final salary pensions

Final salary pension schemes, often referred to as defined benefit schemes, generally offer a pension benefit related to your salary around the date of retirement and the number of years of service with the scheme's sponsoring employer. In the private sector, the cost of running final salary schemes has prompted their widespread closure: as at 31 March 2016 only 13% of schemes were open to new members and more than a third were no longer accruing further benefits for existing members.

The public sector has continued to offer defined benefit pension schemes, which are largely funded on a pay-as-you-go basis, unlike their pre-funded private sector counterparts. Even so, these schemes have been subject to various cost-saving measures, such as higher member contributions and moving towards benefits based on career average earnings rather than final salary.

If you are a member – past or present – of a defined benefit pension arrangement, you should probably consider yourself lucky. Do make sure you understand what your eventual benefits should be and seek expert advice before taking any action, such as transferring to another pension arrangement.

## Defined contribution pensions

At their simplest, defined contribution pensions, sometimes called money purchase pensions, are similar to savings plans. Contributions made by you, your employer (if you have one) or even third parties are invested in your chosen investment funds. When you want to draw benefits, you cash in part or all your fund, either buying a pension annuity or directly withdrawing the cash. Reforms that took effect in April 2015 mean that there are virtually no restrictions on how you take your benefits, provided you have reached the minimum pension age (currently 55, but 57 from April 2028 and then increasing in line with SPA).

Defined contribution pension arrangements take a variety of forms, from highly tailored individual plans, such as self-invested personal pensions (SIPPs), to large multi-employer arrangements, such as the government-established National Employment Savings Trust (NEST).

The growth of defined contribution schemes has been given a boost by auto-enrolment of employees for workplace pensions. This started to be phased in from October 2012 and is now almost in force. If you have been auto-enrolled into a pension in the past five years, the chances are you became a member of a defined contribution arrangement.

## Lifetime ISAs

Lifetime ISAs (LISAs) are not pension arrangements, but a variant on the individual savings account (ISA) that was launched in April 2017. Their structure looks like pensions because there is a form of tax relief on contributions and a minimum age of 60 for drawing out funds without penalty, unless the cash is used for purchase of a first home. In some circumstances, a LISA is preferable to a pension arrangement, but the choice is best made with advice.

 **Action point**

*Defined contribution pensions have largely replaced final salary schemes and allow you to cash in all or part of your fund as an annuity or cash withdrawal.*

## Contributing to pensions

Contributions to private pensions, whether made by you and/or an employer, generally attract full income tax relief, so if you are a higher rate taxpayer, a contribution of £100 will cost you a net £60. The income tax relief is so generous that there is a raft of legislation – some of it still going through parliament – which places limits upon it.

### Annual allowance

One example of these limits is that your total pension contributions, including employer contributions must be kept within an annual allowance to avoid tax charges. For the tax year 2017/18, the basic annual allowance is £40,000, but it is gradually reduced if you are a high earner. As a very broad guide, phasing starts to bite if your income (not just earnings) plus your employer pension contributions exceed £150,000, and at £210,000 or more hits a £10,000 contribution floor.

### Carry forward

There are some special rules that may allow you to catch up on the pension contributions you could have made in the previous three tax years and thus contribute more than one year's annual allowance. This process is known as 'carry forward' and in 2017/18 you can exploit it to mop up your unused annual allowance dating back to 2014/15. The rules are relatively complicated in their application, but, in theory at least, if your earnings are high enough and you have not paid into a pension in recent years, it would be possible to make up to £160,000 of pension contributions in 2017/18 with full tax relief.

### Lifetime allowance

Alongside the annual allowance, there is an effective limit on the tax-efficient value of your overall pension benefits. If this is breached, then a tax rate of 55% could apply to the excess. The standard lifetime allowance is currently £1 million. That may sound more than enough, but at current annuity rates it would not provide a 65-year-old with an inflation-proofed pension of £3,000 a month (before tax).



#### Action point

*If you are entitled to a higher lifetime allowance, the transitional rules are complex and you should always take advice.*

You may be entitled to a higher lifetime allowance, thanks to one or more of several sets of transitional rules. These have a labyrinthine complexity and advice is vital to maximise tax savings and avoid losing any entitlement.

Expert advice is also essential if the lifetime allowance and/or annual allowance mean that you cannot build up an adequate pension fund for your retirement. There are many ways to create retirement funds outside of the pensions arena, some of which offer tax reliefs similar to those provided by pensions.

### Making contributions

Whether or not you wish to maximise your pension contributions, it is well worth taking some trouble to decide how they should be made. If you are an employee, then you (and your employer) can save NICs. The secret is for you to reduce your salary or your bonus and ask your employer to use the money, including the NIC saving, to make the pension contributions for you. The technical name for this is salary or bonus sacrifice and it is all perfectly legal, provided you do it correctly. If you pay basic rate tax, the result could be an increase of nearly 34% in the amount being paid into your pension. If you are a higher rate taxpayer, the uplift is nearly 18%.

You should note that this reduction in your salary would not have the same effect as asking your employer to make the contributions on your behalf. Your cash salary will be reduced and replaced with the pension benefit. Before taking this out you should consider the effect this may have on:

- Your ability to borrow money, for example for a mortgage.
- Your entitlement to redundancy payments or other benefits such as statutory maternity pay, working tax credit or child tax credit.
- Any life insurance or income protection where the amount paid is linked to your salary.

## Investment decisions

Unless you solely have a defined benefit pension arrangement, your pension will require you to make and regularly review investment choices.

### Default funds

All auto-enrolment pension arrangements and some other pension plans offer 'default' funds or investment strategies, designed to spare you the task of making investment decisions. Research has shown that as many as 90% of newly auto-enrolled savers opt for their provider's default investment solution. If you do the same, remember:

- You are still making an investment choice, which is to follow the decisions made by the manager of the default fund or strategy.
- By definition, the default option is not personalised to your particular circumstances. For example, it takes no account of your other investments.
- There is no such thing as a standard default fund or strategy: a recent survey found one large pension provider holding 85% of its default fund in shares, while a major competitor, literally a few miles down the road, had just 45%.

### The tailored approach

As an alternative to the default 'choice' you can actively take investment decisions designed to match your retirement goals. Many people who adopt this route rely upon their financial adviser either to make fund recommendations, manage the whole process or appoint a specialist external investment manager. You always have the option of DIY management, but in practice this requires time and expertise to avoid serious mistakes.

A major advantage of the tailored approach is that it allows your pension investments to be integrated into your overall investment portfolio. Otherwise you could find yourself, for example, selling Japanese funds from your portfolio while your default investment manager buys into Japan.

The more refined the tailored approach, the more likely it is that your pension plan should be a self-invested personal pension (SIPP). The key differentiator with other defined contribution arrangements is the range of investments available under a SIPP. These vary among providers, with insurance companies typically offering a relatively limited range that will suit most investors, while specialist providers may offer the full range. Typically, investment options include:



#### Action point

*Taking a tailored approach allows you to integrate your pension investments with your overall investment portfolio.*



### Action point

*Given the frequency of Government reforms to pensions, plus your own changing circumstances, regular reviews should be built into your financial planning.*

- A very wide range of investment funds.
- Direct investment in stocks and shares.
- Cash deposits.
- Commercial property.

## The need for regular reviews

If you were to wait for a time when there were no changes just made, in the process of implementation or being considered to pensions, your retirement date would be likely to arrive first. Governments of all hues have regularly revised the tax and other rules surrounding pensions. Often the motivation has been to save money, either by reducing the tax relief cost (estimated at £38.2bn in 2015/16) or by cutting expenditure on the state pension (for example by the recent announcement of an earlier start date for a state pension age of 68).

Government changes to pension taxation have meant that for some people, there is no longer any financial sense in making pension contributions, a reminder of how important reviews can be. For others, recent reforms have transformed pensions into a key estate planning tool.

Aside from government interventions, regular reviews are also necessary for other reasons:

- Your circumstances could change. For instance, you may want to alter your retirement date, use an inherited lump sum to make a one-off contribution or move to a new employer offering a different pension arrangement.
- If you have a defined contribution plan, the underlying investments will need to be reviewed in the light of market conditions and any changes in your circumstances. Usually it is best to do this as part of an overall portfolio review.
- As you approach retirement your pensions will usually need to be recast as plans to provide income rather than build up wealth. This could mean a different investment strategy and/or in some cases a switch of pension provider.

## How we can help

Retirement planning is complicated, and has been made even more so by constant changes to the rules. We make it our business to stay up-to-date with the latest developments, and to help clients take full advantage of the available tax breaks. In particular, we can give guidance on:

- Assessing your financial priorities and choosing suitable ways of saving for retirement.
- Integrating any auto-enrolment pension provision from your employer with your own private provision.
- Maximising pension contributions, using carry forward where appropriate.
- Advising whether salary sacrifice could increase the amount invested in your pension at no extra cost to you or your employer.

- The appropriateness of a SIPP, and the right investment strategy.
- How to deal with pension arrangements from previous employments.
- Managing the move from saving to withdrawing from your pension.

The value of tax reliefs depends on your individual circumstances. Tax laws can change. The Financial Conduct Authority does not regulate tax advice.

The value of your investment can go down as well as up and you may not get back the full amount you invested. Past performance is not a reliable indicator of future performance. Investment in a registered pension fund is subject to many restrictions on access on how the funds can be used.

*This publication is for general information only and is not intended to be advice to any specific person. You are recommended to seek competent professional advice before taking or refraining from taking any action on the basis of the contents of this publication. The Financial Conduct Authority (FCA) does not regulate tax advice, so it is outside the investment protection rules of the Financial Services and Markets Act and the Financial Services Compensation Scheme. This publication represents our understanding of law and HM Revenue & Customs practice and the contents of the Finance Bill 2017–19 as at 12 October 2017.*



**Bulley Davey Wealth Management**  
1-4 London Road Spalding Lincs PE11 2TA

Tel: 01775 718850 Fax: 01775 710078  
bdwadmin@bulleydavey.co.uk www.bulleydaveywm.co.uk

**Darren Wakefield Dip. F.A. – Director**  
**Robin Bates APFS – Director Chartered Financial Planner**

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