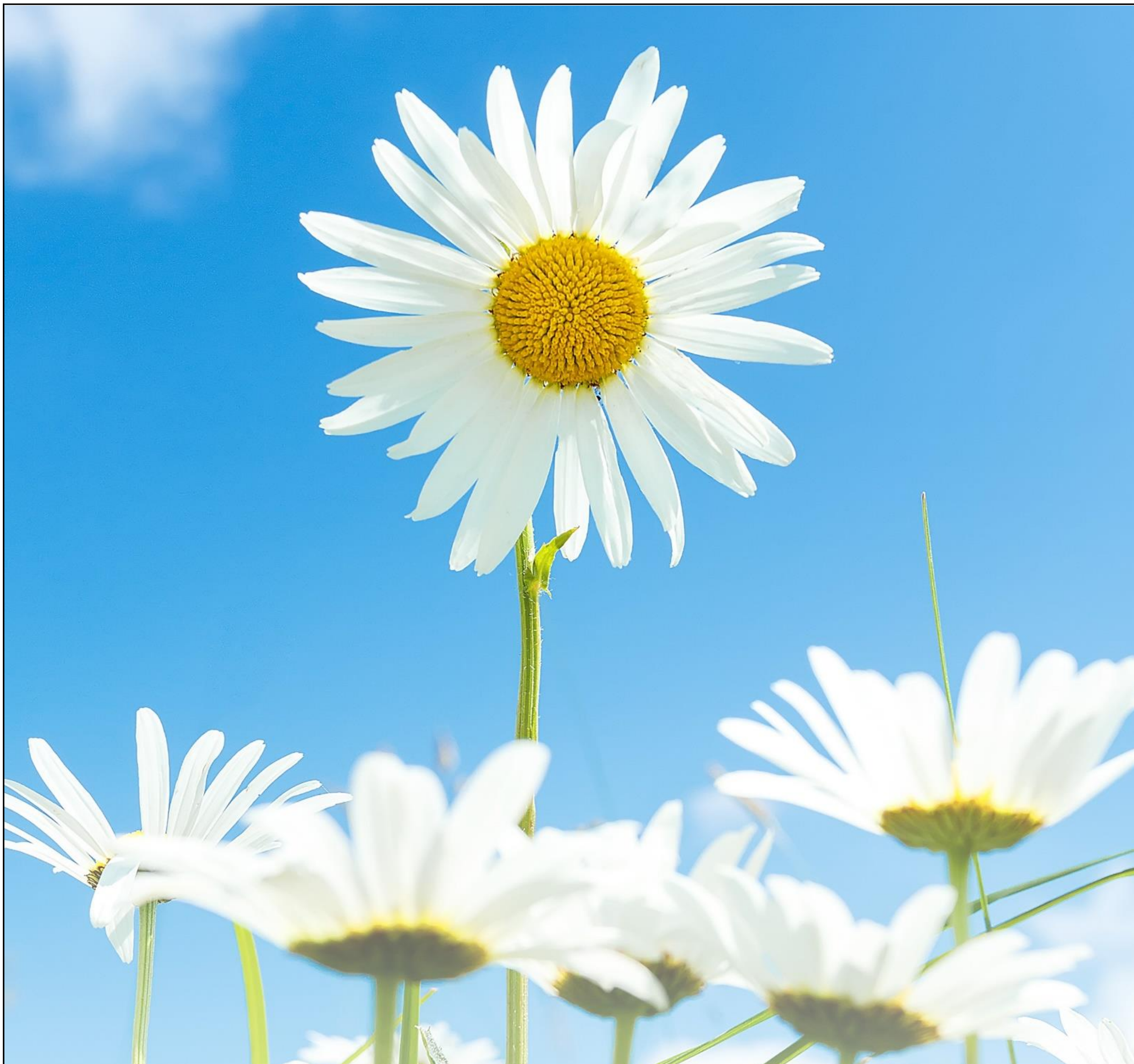

vouchedfor

PENSION GUIDE

2015

An introduction to saving money for your retirement

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Introduction

As we approach a very important date talking about pensions has become a hot topic. From April 6th 2015 savers will be able to access their retirement savings in full.

This guide will talk you through the changes and is for everyone who has ever wondered how they will keep a roof over their head, buy their petrol and help their children when they've stopped working.

If you're already saving for your retirement and want to know if you're saving enough, or more about what will happen when you actually retire, it will help too.

We've tried to keep it as simple and jargon free as we can to help prepare you for a better informed – and a wealthier – working life and retirement.

Adam Price
Founder, VouchedFor

PENSION.

/ˈpɛnʃ(ə)n/

noun

A regular payment made or endorsed by the state and financed by public or private means, to people of or above the official retirement age, or to widows or disabled people.

1. What is a pension?

As people live longer it becomes ever more important to ensure they have a source of income to live off when they quit the work force. The idea behind a pension is to do just that.

Some people may plan to rely solely on retirement income provided by the state. However, the low level and uncertainty of the state pension means this is not ideal. As a result most people will want to put money aside themselves while working that they will receive after they retire.

Because you will be saving up this money over many years, a pension is typically a type of long-term investment that comes with valuable incentives. These perks are provided because the government and employers want to encourage people to save. In practice this means you will receive additional contributions or 'top ups' to your pensions savings from the government and often your employer.

In the past, a pension was normally associated with a particular place of work and was one of the benefits offered by an employer to coax people to join a company. Nowadays the level of pension provision will depend on your employer. If the scheme is less than generous, many people make additional savings into a non-employment related personal pension, for example through a self-invested personal pension (SIPP).

In the simplest of terms, here's how pension saving might work for a typical employed person:

1. You agree to set aside a certain amount of money from your pay each month (or effectively get paid slightly less in order to receive a final salary based pension – see Section 3.1).
2. Your employer will add a certain amount to your contributions.
3. The money you save gets 'topped up' by the government at your marginal tax rate. This may be done either automatically by your pension company or through the self-assessment tax system for higher rate taxpayers. Depending on your income, this could mean the money you are putting aside has effectively been earned without paying tax on it.
4. The money saved is placed in an investment scheme.
5. Whoever manages the investment tries to make it grow.
6. By the time it comes time for you to retire you will ideally have a healthy pot with which can fund your retirement.
7. You receive an income in retirement, generated from that savings pot, paying tax as necessary.

How is this different?

What sets a pension apart from other investments – aside from the added employer and government top-ups – is that it is locked away from you and inaccessible until you reach an agreed age, which is currently 55.

This is a prime example of one of the basic principles of investment: the sacrifice of liquidity (or how easy it is to access what you've invested) for value, in this case the tax benefits and the 'free money' from the employer.

When you finally reach retirement age and decide to take your pension (in some cases you can continue working beyond pension age and thus continue to build your pot), there are several options available to you.

COULD A FINANCIAL ADVISER HELP ME?

As you begin learning about pensions you might well decide that you need some professional help to set you on the right path. One set of people who can help are **Independent Financial Advisers** (often called "IFAs") – see Section 8 of this guide for more information.

2. Should I get a pension?

Should you start saving into a pension? Well, the benefits are clear: first of all, it will help you avoid poverty in old age and help you achieve the lifestyle in retirement that you desire. Secondly, pensions are a very efficient form of long-term saving - with effectively free money from the government and your employer.

Are there any circumstances in which you should **not** save into a pension? Perhaps but these are few and far between. For example, a pension might not seem sensible if you are currently paying off debt or close to retirement. However even in these scenarios it can be a good idea. Why?

1/ If you're paying off-debt: The prospect of investment returns compounding over time (let alone the free money) means you could get back significantly more than you put in. So it may be a prudent to try and pay down your debt at the same time as starting up a pension, instead of waiting until the debt is cleared.

2/ If you're close to retirement age: It may seem like you've left it too late but there are few better alternatives to the benefits a pension will bring, even in the short term, because of the valuable tax breaks. Also, remember that the closer you are to retirement, the fewer years your money will be locked away.

3. What types of pensions exist?

There are three main ways you might fund your retirement:

- a pension linked to your employer
- a pension you set up yourself
- the pension the state will provide (state pension)

If you are saving into a pension through a scheme set up by your employer, chances are you are in one of two types of pension: defined contribution (aka money purchase) or defined benefit (aka final salary).

It is also possible to set up a scheme individually, separate from an employer, called a personal pension. If you want greater control over what your pension is invested in you might turn to a self-invested personal pension, or SIPP.

Finally, the state pension, which should be viewed only as a very basic provision.

In the following pages we'll take a closer look at each type in turn.

3.1 Employer Pensions

DEFINED CONTRIBUTION or MONEY PURCHASE

This is the most common type of pension that a new member can join and how they work is pretty straightforward: the employee contributes a certain amount of their salary each month, the government tops it up by the employee's tax rate, and the total is matched by an equal contribution from the employer. So for example, if you contribute £80 in a month as a basic-rate taxpayer the government will add £20 to your pension pot making a total of £100. Then your employer could, for example, match that with another £100, for a grand total of £200 added to the retirement pot. That means that, as a basic-rate taxpayer, for every £0.80 you contributed, your pot grows by £2.00. In other words, free money! Chances are there will be limitations on the percentage of your salary you can contribute. The government also sets limits on how much can be saved each year and still benefit from the tax top-up.

DEFINED BENEFIT or FINAL SALARY

Final salary schemes are the holy grail of company pensions, and it's no surprise that they are becoming closed to new members or wound up entirely. In a final salary pension, the employer calculates your pension based on your final salary and how many years you've worked at the company. So if your employer offers you 1/60 of your final salary per year worked, and when you retire after working for the company for 10 years you are earning £30,000 per year, you would get one-sixtieth of your final salary (£500) times the number of years at the company. This would be a total income of £5,000 per year, every year, for the rest of your life. Although these pensions offer a big incentive to stay at a given company with life expectancy increases outstripping rises in retirement age they are incredibly expensive to maintain, which explains their current rarity.

3.2 Do-it-Yourself pensions

PERSONAL PENSION

A personal pension is set up by – you guessed it – an individual with no tie to a specific employer. These pensions are run by you, the individual, although sometimes employers can offer to make a contribution into your personal pension rather than into their scheme. Any contributions you make to your own personal pension will still receive the tax top-up from the government. One of the benefits of a personal pension is that it follows you from job to job, so if you change jobs often you won't have to deal with the hassle of keeping track of multiple small pots. On the other hand, because employers don't have to contribute it will be more difficult to grow your pot in a personal pension. Therefore if your employer offers a defined contribution scheme – and all employers are being forced to introduce these for employees – you may want to consider putting your contributions towards that instead.

SIPP

A SIPP, or self-invested personal pension, is a special type of pension that gives you greater control over what you invest in. While a more garden-variety pension would allow you a limited choice between a selection of funds, a SIPP allows you to invest in anything from commercial property to individual stocks and shares. This can be attractive for people who own their own business, because they can use their own contributions as a source of capital for the company. However, SIPPs are exceedingly complex and their charges will depend on what kind of assets you invest in. This is partly owing to the fact that SIPP operating companies must hold a certain amount of capital in reserve, which varies depending on the liquidity and riskiness of the underlying assets. Unless you are extremely confident in your own investment prowess you should speak to an independent financial adviser if you are considering opening a SIPP.

3.3 State pensions

STATE PENSION

When you reach state pension age (which is between 61-68 depending on gender and when you were born), you will start to receive money from the government in the form of a state pension. This is typically tied to the amount of National Insurance you have paid over the years and for years there was also a second state pension that you could use to increase your savings. The government is, however, about to introduce a new single-tier state pension that will pay everyone equally. Although it's nice to know you will be getting at least a trickle of income regardless of your other financial circumstances, the government has a habit of tinkering with the state pension so if you are planning very far in advance it might be a good idea not to take it for granted.

NEW STATE PENSION

Under new plans for a single-tier state pension, a retiree will get no less than about £140 a week, if they have spent at least 35 years contributing to National Insurance. You will likely need to have a qualifying number of years contributing to NI in order to get anything at all (potentially seven to 10), and if you have contributed to NI for fewer than 35 years you will receive a pro rata amount.

4 What happens when I retire?

When you finally retire you will need to make some decisions with regard to your pension fund – and how to make it generate the income you need. Depending on your age, the type of pension you have (or can transfer into) and the amount you've saved, the decisions will be different. Decisions you make about what to do with your pension pot when you retire will also affect how much tax you will need to pay both immediately and in the future.

Lump Sum vs Income

If you have been saving for a pension you may be asked how much of your pension you will want to take as a tax-free lump sum, and how much you want to leave invested to continue providing income for you in the years ahead. You might want to spend or give away the lump sum, or perhaps use it for a different type of investment than is available through your pension. Buy to Let property is currently popular with many retired people. Making the right decision on this could have large effects on tax and future prosperity so advice is usually advisable.

Retirement Income

There are options with regard to receiving ongoing income through life after you retire. Two you might encounter are **Annuities** and **Income Drawdown.**

An **Annuity** is a financial contract whereby, in exchange for some of your pension pot, an annuity provider agrees to pay you a certain amount, usually for the rest of your life. If you die early you might not get your capital back, but if you live a long time you might be glad you bought an annuity instead of spending your savings, which are finite.

As good as it sounds, how much you get per year depends on the annuity rate offered by the provider. The annuity rate is a percentage of how much is paid for the annuity, and although they give the security of an income for life, the amount they will pay you is often meagre. So to retire on an income of £25,000 a year you currently would need to have saved a pot of around £285,000 to top up your state pension.

Income drawdown is another way of generating income by receiving capital from your pension savings while relying on capital growth to maintain or grow your pension pot. Drawdown is only available if your pension is (or is transferred into) a personal pension and as with annuities the details are very important.

You can consult an Independent Financial Adviser for more details of whether Annuities or Drawdown are possible or advisable in your particular circumstances.

5 Pension freedoms

The most earth-shattering change to the pensions landscape in recent years was announced by Chancellor George Osborne in last year's Budget. Shockwaves rippled through the pensions world when he revealed that from April 2015 retirees will be able to take as much or as little of their pot in cash as they want.

Currently, you can take up to 25 per cent of your pot as a tax-free lump sum, but will be charged a penalising tax of 55 per cent if you take it all. Once you've got your lump sum there are four things you can do with the rest: if you're over 60 and your pot is less than £30,000 you can take it all in one lump sum. If you can prove that you will have guaranteed income of at least £12,000 per year, you can draw as much from your pot as you want at your marginal rate of tax. Finally, if you prefer 'capped drawdown', you can take income from your pot equal to 150 per cent of what you'd get from an annuity purchased with your pot's full amount.

However, most people just buy an annuity and take that guaranteed – if somewhat measly – income for the rest of their lives.

Under the new rules, from April 2015, those aged 55 or over will be able to take as much as they want from their pot. After they've taken their 25 per cent lump sum any other withdrawals will be taxed at their marginal rate.

A 20 per cent income tax charge will be levied on pension withdrawals up to £31,785, minus the personal allowance. A further 40 per cent tax will be levied between £31,785 and £150,000. Tax planning is crucial here as there are many side effects from withdrawals. For example, basic rate taxpayers still working could be pushed into the higher rate bracket if they make a withdrawal.

However, this is opening up a huge number of options for people at retirement and presents a vast array of choices.

To help deal with this The Chancellor, George Osbourne, has promised every retiree will have access to guidance. While this guidance will be free of charge, it won't provide advice on what's best for you in your particular circumstance. So if you want to be sure that the recommendation you receive is the best for your circumstances you might want to consider finding an IFA.

When it comes to investing your pension there are many different routes to take that you might not think of yourself. Pension firms are cooking up lots of new investment products that are aimed at helping people turn their savings into an income under the new pension freedoms. A professional adviser will be able to sift through them and make recommendations tailored to your requirements.

In September 2014 George Osborne also announced plans to end the 55 per cent tax on cash held in pension pots upon the death of the account holder. This plan would mean pension pots are much more attractive as a place to leave money well into retirement, rather than, for example, using the funds to purchase an annuity or withdrawing them as a lump sum.

Pensions are constantly being tinkered with. In 2012 the government began implementing a scheme called auto-enrolment, which requires all employers, no matter how large, to enrol their employees automatically into an approved pension scheme. In a nutshell this scheme involves the employer matching employees' contributions to a certain point. Unless the employee opts out, they will automatically pay a bit of their wage into the plan and the employer will do likewise.

Auto-enrolment hit the largest employers first and is gradually working its way down to the smallest companies.

The state pension age is moving all the time, and pension rules too. It’s a lot to keep up with, which is often where professional advice can help.

6 What charges do pensions attract?

Pensions minister Steve Webb has proposed a charge cap of 0.75 per cent for auto-enrolment pensions. However, in 2013 the National Association of Pension Funds found that the average charge savers pay in management fees is 0.46 per cent. The same survey of almost one million schemes found that charges ranged from 0.004 per cent all the way up to 1.2 per cent. Considering the effect charges will have on the growth of your investment over time, it is of utmost importance to be absolutely certain how much a pension is going to cost you.

Also, there are several different charges that might apply. A pension is simply a tax efficient 'wrapper'. It holds your money which is invested in a bundle of funds to which tax relief is applied. There are several layers of charges involved. Some pay for the operation of the pension, some go to whoever manages the underlying funds that will most likely be paid out of your investment. Your IFA will also levy a charge. All of these fees are often expressed as a percentage of how much is invested.

7 Does saving in a pension come with any risks?

As they say…there's no such thing as a free lunch and pensions are no different. In exchange for the generous tax relief given on contributions to your retirement pot, you have to adhere to some rules and run the risk of some side effects.

1/ Lack of access

As has been mentioned already most pensions do not allow you to access your investment pot until you reach your pension age which is usually 55 at the very earliest. This is probably for the best as it prevents people from dipping into the investment for one-offs like weddings, holidays, or perhaps clearing debt run up on a credit card. An investment left undisturbed will have more chance to grow than a similar investment that is chipped away, even if the underlying assets perform just as well. However, this also means that if you find yourself in a crisis you will not be able to use the money you'd put away even for an emergency.

2/ Investment risk

Investing money in the stock market offers opportunity for improved returns that are likely to exceed any interest rate a high street bank can offer. But the value of your savings can go down as well as up.

Introducing risk becomes less of an issue if you are investing over the longer term, however, and historically speaking, stock market gains far outweigh cash.

A good fund manager - who looks after your money - will spread the risk by investing across a number of companies. Despite this it must be pointed out that the value of a fund generally does fluctuate and you are not guaranteed positive returns or even to get back what you originally put in. A benefit of investing over the long term is the opportunity to ride out any stock market storms.

Plus, pensions are cleverly designed so that your investment is 'lifestyled'. This means it is invested in riskier assets, usually stocks and shares, while the saver is younger, and gradually shifts over to less risky assets, typically bonds, as they approach retirement age.

This brings us to another principle of investing: higher possible returns generally come with higher risks.

In reality, even cash is not without risk. In choosing the supposedly safer option of cash as a long term investment, it is almost certain your money will fall in value over time as it is slowly but surely eroded by inflation.

3/ Cost of an annuity

With annuities offering only £6,000 per year for a £100,000 pension pot you may feel other investments will provide a better return. After April purchasing an annuity will no longer be a necessity as we are being given complete freedom to spend our pension as we wish. However, for many people an annuity is likely to remain the right path. A good financial adviser could help you think through your options and find the best route for generating income.

If you decide to take an annuity you need to choose whether the payments you receive track inflation or not. If you decide to take a fixed amount that doesn't track inflation – let's say £6,000 a year – how much that amount can buy will decrease over time as inflation erodes the value of a pound. In brief terms, if inflation for a given year is 2 per cent, it means that a pound can only buy 98p worth of goods compared to the previous year.

Annuities that track inflation allow you to receive payments that increase with inflation but generally the starting amount you receive will be significantly lower.

8 Should I use an adviser?

Now that we've outlined the various types of pensions and things to consider when planning for retirement you can see there are quite a lot of choices to make. That's where an Independent Financial Adviser, or IFA, can help. The 'independent' title means they aren't limited to recommending products from a certain provider so they can and should consider the entire universe of available products before deciding which best suits your personal goals and circumstances.

An adviser will charge you a fee which may include a small percentage of the amount invested as an ongoing payment but what you get is the security of having a professional recommend the best path to take. If you choose a product or investment yourself, and it ends up not performing the way you feel it should, there may be nobody to blame but yourself.

On the other hand if you use an IFA there are consumer bodies that stand up for people who feel they have been put into the wrong investment or 'mis-sold'. These include The Pensions Regulator and the Financial Conduct Authority.

However, you can’t make a claim simply because your investment hasn’t performed as you had hoped.

Crucially, if you use an IFA your pension will be covered by the Financial Services Compensation Scheme (FSCS) which will compensate you if the organisation holding your savings goes bust. The FSCS will protect 90 per cent of the value of your pension pot, while it is still in a pension fund, with no upper limit.

If you have a complaint, begin by taking it to your IFA. If you feel that it hasn't been properly resolved you can go to the Financial Ombudsman who will scrutinise your case and in some cases award compensation.

In other words, although advice is not free it will ensure the best choice for your own needs and will also transfer some responsibility away from you in case things go wrong.

WHAT NOW?

To find a rated and reviewed IFA in your area, visit:

www.vouchedfor.co.uk

To find a rated and reviewed Independent Financial Adviser, Mortgage Broker or Solicitor in your area, please visit:

www.vouchedfor.co.uk

For more information on financial and legal topics, please visit:

answers.vouchedfor.co.uk

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