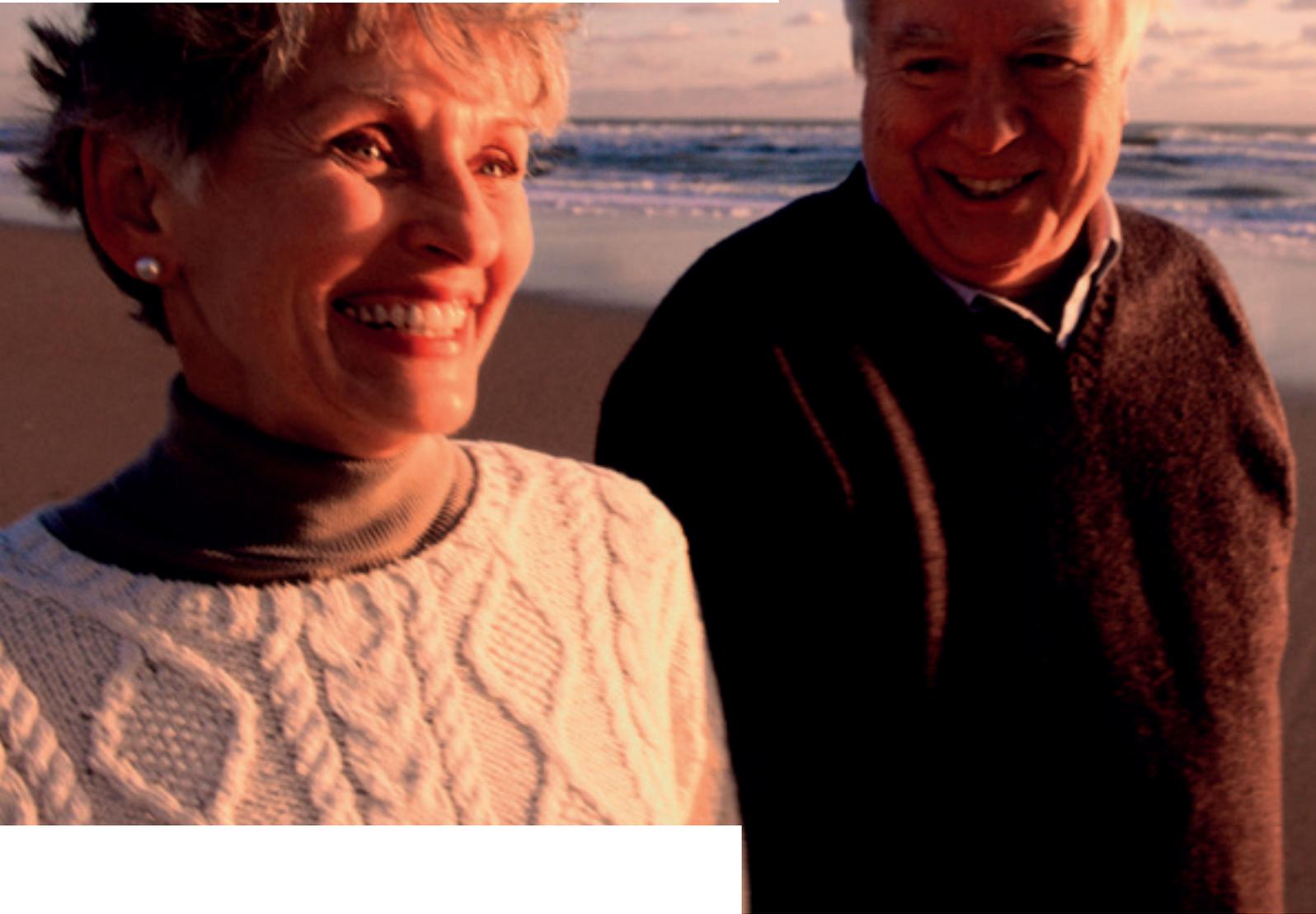




COCKBURN LUCAS
INDEPENDENT FINANCIAL CONSULTING



PLANNING FOR RETIREMENT

Back in 2006, something known as ‘A-Day’ was supposed to be the moment 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 – successive governments have continued to tinker with the regulations and it is therefore quite understandable you might feel a little overwhelmed by the complexities.

Nevertheless, despite all the changes, pensions still represent one of the most tax-efficient ways for most people to save for retirement. The aim of this guide, therefore, is to help you understand the available options.

WHAT IS A PENSION?

At its most basic, a pension is simply a savings scheme that offers very attractive tax benefits if you agree not to touch the proceeds until you are older. In other words, you hand over your money, 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, under the current rules, you are restricted in terms of what you can do with the proceeds once you reach that age.



THE DIFFERENT TYPES OF PENSION

THE STATE PENSION

The Basic State Pension officially came into being as part of the National Insurance Act of 1946 and is designed to provide a minimum amount of income during retirement. This year (2014/15), the weekly payment for each pensioner who has met the minimum National Insurance (NI) contributions is £113.10. For a married couple where one partner has not met the minimum NI contributions, the amount is £180.90.

On top of this, if you contributed to the State Earnings-Related Pensions Scheme (SERPS) – or, more recently, to the State Second Pension (S2P) – you may also receive an earnings-related top-up to the state pension. The amount you receive depends on how much you earned and how much you contributed.

However, these payments alone will not facilitate a luxurious retirement. For this reason – and because the UK's increasingly ageing population means 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.

OCCUPATIONAL PENSIONS

An occupational pension is a scheme set up and run for company employees, into which your employer may make some or all of the contributions on your behalf. These could be 'defined benefit' schemes (also known as 'final salary' schemes) in which the amount you receive depends on the number of years' service you gave to the company.

Alternatively – and these days more likely – they will be 'defined contribution' schemes, in which you and/or your employer will make a fixed level of contribution and the final value will depend on how well (or badly) the underlying investments have performed. Thanks to volatile stockmarkets and additional regulation, the days of final salary pension schemes are generally considered to

be all but over – apart from some lucky souls in the public sector or those with unchangeable employment contracts in the private sector.

AUTO-ENROLMENT AND THE ADVENT OF 'NEST'

Until recently, whether your employer offered a pension scheme – and, if they did, how much they contributed on your behalf – was entirely voluntary. However, from October 2012, all employers became obliged to automatically enrol employees in a qualifying in-house pension scheme or in the National Employment Savings Trust (NEST). Moreover, employers will also have to start making a minimum contribution, rising to at least 3% of your salary by 2018. In exchange, you will have to make contributions that will rise to 4% by 2018 and the Government, by way of tax relief, will contribute another 1%.

For individuals employed in smaller companies, this might represent their first opportunity to get involved in formal occupational pension planning. For larger companies, however, these minimum requirements might already have been exceeded. Indeed, if you decide to contribute more than the minimum, you might find your employer will match that higher amount. It is therefore worth checking your employers' pension provision and what they have done about auto-enrolment.

PERSONAL PENSIONS

Personal pensions are schemes organised by the individual for the benefit of the individual. It does not matter who you work for, how long you work for them or how much you earn – you decide how much to contribute (subject to an annual contribution limit) 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 perform, the higher that value will be.

“BECAUSE THE UK'S INCREASINGLY AGEING POPULATION MEANS THE GOVERNMENT IS FINDING IT HARDER AND HARDER TO MEET ITS STATE PENSION OBLIGATIONS, WE ARE BEING ENCOURAGED TO MAKE ADDITIONAL INVESTMENTS TOWARDS OUR OWN RETIREMENT.”



There are three basic types of personal pension:

Stakeholder pensions: The simplest pensions, these are designed to encourage lower earners to save for their future. As they are subject to restrictions on charging, 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 that will suit most people's basic needs.

Individual personal pensions: These pensions offer access to a range of different funds. They may have additional benefits that will make them easier for you to manage if you are looking for something beyond a basic managed or tracker fund, or to switch around different types of investment. They are not subject to the same charging restrictions as stakeholder pensions, so the fund choice can be wider. They should 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 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 more complex investments as well. They therefore allow you to build a portfolio specifically tailored to your needs and to make adjustments to that portfolio whenever and however you like.

As a result, compared with the other choices mentioned above, SIPPs have proved relatively expensive. In some cases, however, charges have reduced and a new generation of 'low-cost' SIPPs have emerged. These offer the same switching and management flexibility but do not offer quite the same level of access to the more esoteric investments.

However, as with any product in any industry, you pay for the bells and whistles. So, if you do not need them or do not have the time or

experience to take proper advantage of them, you might be wasting your money by paying for such a product. As ever, if you are in doubt about anything, you should seek professional advice.

BUILDING A PORTFOLIO

Choosing a type of pension is important but the greatest impact on your long-term wealth will be the contributions you make and the underlying investments you choose. The choice of investments available within pensions has evolved since the days of 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.

THE RULES OF PENSION INVESTMENT

TAX BENEFITS

It may feel as if the rules on pensions can change with the seasons but some basic elements have remained constant in recent years. Investors receive income tax relief on their contributions into a pension scheme (up to certain limits) and the income and gains made by that fund accumulate free of additional tax while the money remains invested.

Under the current rules, anyone who withdraws all the money from their pension pot will have to pay tax of 55%. However, up to 25% of a person's pension pot can be taken without having to pay any tax while, with regard to the remainder, there are four options:

- You could choose to purchase some form of annuity in order to secure a fixed, regular level of income.
- 'Capped drawdown' allows a person to draw income from their pension, subject to a maximum annual allowance of 150% of an equivalent annuity.
- 'Flexible drawdown' allows unlimited withdrawal of cash from a pension pot but the person must also be able to show they have what is known as a 'secure income' of more than £12,000 a year.
- Those aged 60 and over with total pension savings of less than £30,000 can take the entire amount as one lump sum – a process known as 'trivial commutation'. Any pension pot worth less than £10,000, meanwhile, is regarded as a 'small pot' and up to three of these can be taken as a lump sum, regardless of a person's total pension wealth.

However, the rules are changing. From April 2015, anyone aged 55 or over can take their defined contribution pension pot in whatever

way they wish – regardless of its size – subject to their marginal tax rate and to the pension provider's rules. 25% of the pot can be taken as a tax-free lump sum. Those who wish to buy an annuity will be able to do so but others might opt to keep their pension invested and take an income from it.

ANNUAL CONTRIBUTION LIMITS

During the current tax year (2014/15), the maximum amount you can invest into your pension (personal or occupational) is 100% of your income or £40,000 - whichever is the lower. You will receive tax relief on the entire investment up to that limit. However, if you try to invest more than £40,000, 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.

LIFETIME ALLOWANCE

The lifetime allowance applies to the total value of all private and workplace pensions (not state pensions) that you build up over your lifetime, including the investment growth that you have achieved. For 2014/15, the lifetime allowance is valued at £1.25m. If your pension fund grows above this value, you will be liable to tax charges on the excess. 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.

Therefore, if you already have a large pension fund – even if it has not yet reached the limit



The value of investments and the income from them may fall as well as rise and you may not get back the full amount you invested.

set by the lifetime allowance – you have to consider whether there might still be some investment growth to come. As an example, if your pension fund is valued at more than £1m and you have 10 years still to go before you plan to retire, it might be time to stop contributing and find another home for your savings.



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