Retirement planning

A guide for clients

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Introduction

An introduction to using your resources to ensure you get the retirement you want.

What do you want your life to be like when you pass retirement age? Are you looking forward to the end of your working life as a time to take on new projects or to simply relax after 40 plus years of work?

The kind of retirement you have will be determined by the decisions you make today about how you organise your money. This is the central idea driving retirement planning: how are you going to ensure that you get the retirement you want?

The answer does not simply involve relying on your employer or the government to provide for you in your old age. Rather, it involves bridging any gaps between what you want, what you have and what you are going to need.

Do you have enough to retire?

Retirement planning begins with an awareness of two basic parts of the equation. The retirement age is based on when you were born and signifies when a person is able to retire. Through the scrapping of the default retirement age, you can now legally work past your retirement age.

So, the question is whether you want to bow out of employment as soon as you are able or you think you will continue working in some capacity (perhaps with reduced hours)? In other words, are you going to need a retirement income to be fully in place or will you still have a regular salary coming in?

The new state pension is a maximum of £155.65 a week (as from 6 April 2016). The new pension rate will apply to those men born on or after 6 April 1951 and women born on or after 6 April 1953. The new state pension will be based on your national insurance record, and an individual will need 10 qualifying years to be eligible.

What do you need?

You now have a timescale and a base income as a starting point for the rest of your plans. Auto-enrolment means you are also likely to have a work pension scheme to make use of. Is this going to be enough to give you the life you want? For many, trying to live solely off of the state pension and a work pension will represent a fall in monthly income compared to working.

Another factor is any debts such as a mortgage and other obligations like energy bills that may eat further into your regular income. Any savings and investments you have will be an important counter-balance.

You may now see a gap opening up between what you want and what you currently have. Retirement planning is about closing the gap between expectation and reality.

The days of relying on a state pension to cover the costs of your retirement are long gone. Consumer watchdog Which? calculates the average person currently needs an annual income of £26,000 to fund a comfortable retirement, which is why the earlier you start saving the more financially stable you will be later in life.

Financial planning and bridging the gap

The retirement planning strategy you should adopt will depend on how close you are to retirement. Someone in their 50s, with retirement looming on the horizon, should generally be looking to minimise risk and thinking about their current lifestyle. Someone in their 20s, with a myriad of other financial concerns, may simply decide to try to remain as debt free as possible and begin saving.

In your 20s

If you're in your 20s, saving for your retirement is unlikely to be high on your list of priorities. But people in this age band have the best chance to prepare for retirement, and chipping away at a student debt can free up more resources to boost your savings.

Avoid temptation to opt out of automatic enrolment if you are in employment. It would be short-sighted to cancel the 1% deduction from your monthly pay packet when your employer is matching that – and with the minimum employer contribution to rise to 3% in 2019.

You will probably already be paying into your state pension through national insurance contributions (NICs). If circumstances allow and you harbour ambitions of boosting your pension pot outside of your state or workplace pensions, the Lifetime ISA enables over-18s to put in up to £4,000 a year with the state paying an annual bonus of 25% – or up to £1,000 a year.

For example, if you were to open a Lifetime ISA at the age of 18, and pay the maximum of £4,000 a year into it until the age of 50, you will earn a government bonus of £32,000 on top of the £128,000 you've saved (£150,000 total plus interest).

If you are self-employed or caring for children or relatives, opening a personal pension should be an essential move. While you will not benefit from an employer contribution, taxpayers will get tax relief at their marginal rate.

Those who begin saving at the age of 20 need to contribute the least (£131 per month over 48 years) to achieve the target income of £26,000 by the average retirement age of 68.

In your 30s

It's fair to say most people begin to change their priorities in their 30s, whether that's taking their first steps on the property ladder, getting married or perhaps starting a family. Even though you may be feeling the squeeze on your finances, it is important to put away as much as possible for retirement as any saving at this stage will be worthwhile later on.

As your career progresses so should your earnings. You can choose to increase your workplace pension contributions – and now would be a good time to do this. However much you choose to put in on top of your default contribution, your employer and the government will also contribute.

In your 40s

With around 20 years left until you retire (if you're lucky), your finances should be on a fairly even keel. Hopefully your earning power will have increased, while sizeable outgoings such as mortgage repayments and childcare costs will be either under control or possibly even behind you.

If you have a partner, consider their provision to give you a good idea of where you are and what you need to do. If you're at or near your earnings peak in your 40s, now would be a good time to assess the size of your pension pot and how it is invested. You should be able to take a higher level of risk with your investments after building up a solid base and these should pay off in the long run.

However, if you haven't already started planning your retirement, it's crucial to act now before it's too late. According to 'Which?' the average retired couple needs an annual income of £18,000 to cover household essentials, such as energy bills, food and transport. With inflation climbing to a four-year high of 2.7% in May 2017, it looks certain you will need more than this when your time comes to retire.

In your 50s

As thoughts of retirement become clearer in your 50s, now is the time to start thinking about when you will actually call it a day. The first port of call should be to check your state pension age to find out when you can start claiming the state pension.

If your earnings allow, consider increasing contributions into your workplace pension as well as any personal pensions or ISAs you have been paying into. This can only build your pension pot when the time comes to retire or help you support grown-up children with rising living or education costs.

You can usually access any personal pensions from the age of 55, with options including annuities, income drawdown and taking either lump sums or the whole pot. The first 25% of your withdrawal will be tax-free, although the rest will be taxed as income.

If you've yet to start planning for your retirement, be aware that 50-year-olds would need to save the most (£633 per month over 17 years) to achieve the target annual income of £26,000 by the age of 67.

General strategies

At any stage in your working life, the following could help contribute to putting you in a better position when it comes to your retirement.

Clearing debts

Since it is likely that your income will decrease anyway, the impact of any debt carried into retirement will have a more pronounced impact.

An important first step is getting an accurate handle on how much you owe. You may have mortgage, credit card and other personal loans to factor into the equation. The interest rates on these debts are almost as important as the actual amount owed when planning on the best way reducing of them.

Freeing yourself of debts takes some of the pressure off in other areas of retirement planning.

Boosting your pension contributions

Increasing the amount you regularly pay into either your work or private pension will increase the amount available to you when you retire.

There is an annual allowance of £40,000 meaning you will be taxed if your savings for each year exceed this. You can, however, top up your allowance with any previously unused allowance from the previous 3 years.

Individuals who earn £150,000 or more will see their annual allowance reduced by £1 for every £2 above £150,000 down to a minimum of £10,000 from 6 April 2016. So those earning over £210,000 a year will only be able to contribute £10,000 a year into a pension.

Boost your state pension

If you do not have enough years of paying national insurance, it is possible to 'buy' additional years in order to qualify.

Your pension options

The introduction of the pension freedoms in Budget 2014 were hailed as the most seismic reforms to pensions in decades.

From April 2015, individuals were given the option of taking out their full pension pot in cash from the age of 55. This new option now sits alongside annuities and income drawdown plans as strategies for people to consider.

You can take 25% of your pension pot tax-free, with the rest being charged at your marginal rate of tax.

The importance of saving

It should be apparent that saving is an incredibly important part of the retirement planning process.

The Lifetime Allowance

The lifetime allowance (LTA) is the total amount of savings you can build up over your lifetime, in all registered pension plans you have without incurring a tax charge. The allowance includes payments into your plan from both you and your employer. The current LTA is £1m. Pension savings built up in excess of the LTA are subject to a tax charge when you come to take your benefits. The tax charge is 55% of any amount you take from your pension savings as a lump sum over the LTA and 25% of any amount you take as pension income. Your income will also be subject to income tax.

While pension funds are tax-efficient ways to fund your retirement, there are other options for those looking to maximise their savings.

ISAs

Cash ISAs do not charge tax on the interest earned from savings, allowing savers in the basic rate to avoid a 20% charge and higher rate taxpayers to avoid income tax at 40%. The current annual limit for ISAs is £15,240, increasing to £20,000 in April 2017.

New Lifetime ISA

The Government has announced the introduction of the new Lifetime ISA from April 2017. It can be opened by any adult under 40 and is designed to help people save for their first home or their retirement. Individuals will be able to invest up to £4,000 each year and they will receive a 25% bonus from the Government for every pound they put in. The Government's bonus will stop at the age of 50.

If individuals use the Lifetime ISA to buy their first home, they can withdraw their savings and the Government bonus at any time, tax free, once they have held it for 12 months. Their savings and the bonus can also be withdrawn from age 60, tax free, for use in retirement. To make this savings account as flexible as possible, the Government will allow individuals to withdraw their savings at any time for other purposes too. If they do this though, the bonus may be lost and a 5% charge imposed.

NS&I

NS&I is government-backed and offers tax-efficient long-term savings funds. Some of the products pay interest that is taxable while others are tax free.

Investing

Investing can be a way to get a bigger return than you would through the methods listed above, but investing carries a risk that you may not make a big return or lose your money. Investing is a complicated area and it is always wise to seek the advice of a professional before committing any of your money.

The decisions you make today will affect the life you are able to live in retirement. Our expert team can help you define your goals and create a workable strategy to achieve them. Contact Sue Stephens or John Elliott for more information.

FOR GENERAL INFORMATION ONLY

Please note that this guide is not intended to give specific technical advice and it should not be construed as doing so. It is designed to alert clients to some of the issues. It is not intended to give exhaustive coverage of the topic.

Professional advice should always be sought before action is either taken or refrained from as a result of information contained herein.

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