PK | EMPLOYEE BENEFITS

Pensions – Answering the big questions

How much do I need to live on?

Amazingly, most people don't know how much income they need when they stop work. Aegon, one of the leading pension providers, have recently identified that being able to visualise your retirement usually means that you plan better. So, having better retirement outcomes is often more down to whether you can imagine what you want to do in retirement early rather than how much money you earn.

Two ways you can work out what income you need:

1. Look at your existing household expenditure and take away the things that you won't be spending money on when you stop work such as mortgages, children and commuting.

   Don't forget to add on the cost of things you'll do in retirement that you don't do now…and we don't just mean the incontinence pads!

2. Look at some surveys of retirement living standards for a few tips. This is one of the most comprehensive: https://www.retirementlivingstandards.org.uk/
   This is what level of annual income they think you need if you were a couple retiring today:

Minimum	£17,000
Moderate	£31,000
Comfortable	£50,000

How big a pot do I need?

There are a few ways to answer this. As a broad-brush rule of thumb, you probably don't want to take more than 4% to 4.5% a year (as a percentage of your pot value) out of any invested pot if you want to make that income sustainable for the long term.

And you probably do want that pot to last for the long term – you're likely to have a 50% chance of living another 20 years or so after you retire.

Don't forget inflation – if you're not going to retire for some time, you'll need a bigger pot to get the same buying power as you have now, and inflation will also mean you'll probably want your income to increase during your retirement.

So, that pot of money we're going to live off after we stop work is facing quite a few challenges…and there's one more: **Risk**

Simply put – the lower level of risk you are likely to take with your investments, the lower the 'safe' withdrawal rate, otherwise you may run out of money before you die.

Sounds complicated? Yes, it really is so we've put together what we think is a simple(ish) calculator designed to help you model how much you might need to get a certain level of income in the future.

https://pension.pkengage.co.uk/forecast/

Please bear in mind that this is just a forecast based on assumptions about the future. Nobody really knows what the future holds in store for us so you should always review any plans regularly to ensure that you stay on track.

What's the best way to make that pot?

For most people, the answer's simple – it's your pension.

The reason is tax – pensions benefit from a unique set of tax privileges that give them an inbuilt advantage over other investments.

You get tax relief at your highest rate on what you pay in, your money grows free of tax and, when you withdraw money, at least 25% of your withdrawals are tax-free, sometimes more. (Please note – this assumes that you haven't exceeded either the Annual* or Lifetime** Allowances).

Whatever's in your pot when you die can be passed onto your beneficiaries, usually free of Inheritance Tax and completely tax-free if you die before age 75.

Quick example – let's say I invest £100 – thanks to tax relief, the net cost to me is

Basic Rate taxpayer:	£80
Higher rate taxpayer:	£60
Additional rate taxpayer:	£55

(if my employer allows 'Salary Sacrifice' I can also save National Insurance on my contribution, leading to an extra saving of between 3.25% and 13.25%)

How much do I get back at retirement?

If I'm a Basic Rate taxpayer in retirement – which most people are, even if they pay the Higher Rate while they were working – I'll pay 20% tax but only on 75% of what I withdraw so on that £100, I'll only pay £15 in tax.

It gets even better – in retirement, you still have a Tax-Free Personal Allowance, just like when you're working. For 22/23 that's £12,570, so you only pay tax on total income above that level.

So, a combination of an individual's tax-free Personal Allowance and the fact that 25% of withdrawals are tax-free means that the effective rate of tax on pension income could end up quite a bit less than 15%.

The result of all of this is that it's pretty hard not to make a tax gain out of pensions, even before you've had any investment growth, because you tend to get more tax relief on what you pay in than you pay in tax on what you take out.

Of course, there are other viable ways to invest for your future: ISAs, Buy to Lets, Investment Trusts to name just a few. In the right circumstances all sorts of options may have a place but do make sure that you understand how any alternative options is taxed – we're not saying pensions are unbeatable in all cases, but we think they will be in most.

Please understand though that, as with any investment, nothing's guaranteed and investments can fall as well as rise in value so do keep an eye on what's happening to your pot.

OK, so pensions are a tax-efficient investment, what else do I need to know?

If your employer's pension is managed by PK Employee Benefits then we'll have a factsheet that shows you all the main features but here we'll list some of the common features of a typical workplace pension.

- **Investments** – when you're enrolled in a workplace pension, your money's invested in a default investment fund. This will be well diversified (not all your eggs in one basket) and have a risk reduction process built in that aims to reduce volatility on the run up to retirement.
  You will also have a choice of other investments if you want to exercise some choices. Often this will give you a surprisingly large choice with many pensions offering hundreds of options.

- **Death benefits** – as we've said, usually paid tax-free, but it's important that your pension company knows where to pay the money. All pensions will have a process, either online via their portal or app, or paper-based so you can tell them who you want to benefit

- **Change your contributions** – pensions with an invested pot are pretty straight forward – the more you pay in, the more you'll get out. Contributions at outset are set by your employer's rules but you can increase your own investment to improve your outcome.
  Also – make sure that you understand your employer's rules. Some will match contributions above the basic amount – if there's extra money on the table, don't miss out!

- **Charges** – all pension companies will deduct a charge to cover the costs of running your plan. If you have multiple pensions, it might be worthwhile understanding the charges on all of your pensions in case there's an efficiency to be gained by moving money from your more expensive to your least expensive ones.

  This, on its own, won't guarantee you a better outcome at retirement but it will help…and do remember to check other factors such as penalties, guarantees etc in case there are any other issues to consider.

  if your employer uses PK Employee Benefits, we can help you understand how your pensions compare.

- **Options at retirement** – all pensions will allow you to buy an annuity at retirement. Very broadly, this is a fixed income for life, but you can also go into 'Flexible Access Drawdown' as another option when you retire.

  Drawdown is very much what it sounds like – in general terms you leave your pot invested and take out what you need for today with the rest remaining invested for future drawings.

  Not all pensions offer drawdown so, as you approach retirement, it's worth understanding what options your pensions will allow.

Different options will be right for different circumstances and there’s loads of detail we can’t go into in a very general document like this so please make sure you understand all your options in detail before making any decisions.

*see here for more information on the Annual Allowance
**see here for more information on the Lifetime Allowance

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