LIVING WELL LATER

Retirement income isn't something you should only think about on the day you're handed a carriage clock. *Business & Management* looks at the personal wealth planning themes FDs should consider to ensure a comfortable post-career life

Are you on track for a comfortable and secure retirement? It's a deceptively simple question, and it's especially easy to put off answering it. There is no bad time to dust off your pension policies and investment plans to see whether you will be able to enjoy the Riviera lifestyle or be eating cold baked beans in a tent in your later years. When you're enjoying your evening or weekend, glass of wine in hand, it's tempting to believe you're automatically going to have the former rather than the latter because of your finance experience and the funds you've put aside to date.

But retirement planning was never straightforward, and it's a process that should be engaged with in an active rather than a passive context. In today's world of very low annuity rates and restrictions on the tax efficient amount that you can invest annually, planning for a secure retirement has become more challenging, and worse, the government could make changes to pensions regulations at any time which will affect your position in the years to come.

There are pivotal questions that all need to be properly considered: how much money do I need to live a comfortable life? Should I buy an annuity or use a pension drawdown plan? Is my pension performing as well as I had thought it would, and if not how do I minimise my taxes?

In anticipation of you beginning to answer these questions for yourselves, Nigel Hutchinson from Mazars, Adam Tavener of Clifton Asset Management, and ICAEW's John Gaskell share their expertise on the broader themes you should be aware of around personal wealth planning.

WHAT'S IN THE POT?

Nigel Hutchinson, financial planning partner, Mazars Financial Planning

When it comes to creating retirement income, there are very few defined benefit (DB) pension schemes still around, the state pension will only form part of most people's planning (see *The state we're in* box on page 15), cash returns are low and there is a less generous tax environment for buy-to-let. The situation doesn't seem promising.

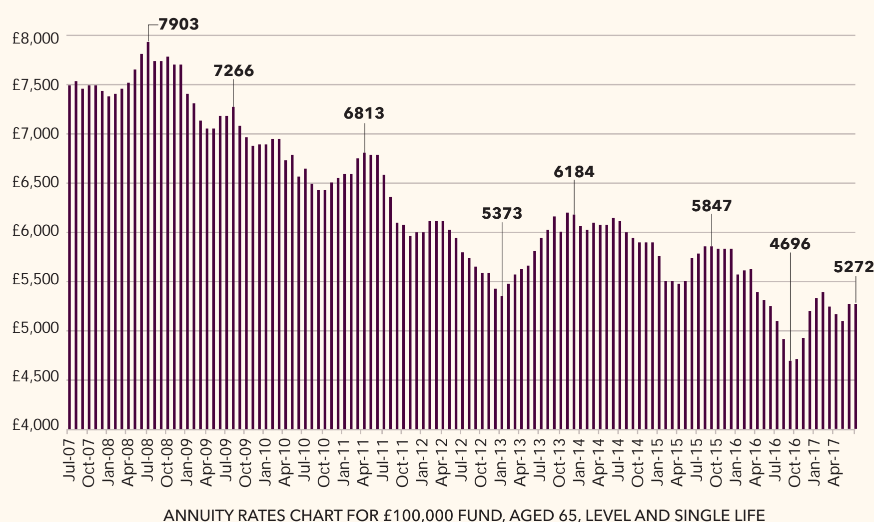
The key starting point then, is knowing how much you need to accumulate in order to fund your desired lifestyle in retirement. Advisers can assist with this by using financial modelling to help identify the level of savings and/or investment returns required to meet your retirement aspirations. Some advisers call this "knowing your number".

Individuals should be aiming to create a diverse pot of assets and use these to create a tax efficient, sustainable income stream once in retirement, while also considering issues such as long-term care costs, inheritance tax (IHT) planning and passing on wealth to future generations.

Defined contribution (DC) pension funds should be the first port of call for saving towards retirement but the government is reducing the amount high earners can contribute via the tapered annual allowance and the total that can be accumulated within pension funds via the lifetime allowance (reduced from £1.25m to £1m in the 2016/17 tax year). Individuals therefore need to use a variety of vehicles to accumulate a retirement pot to draw upon.

Once at retirement, the traditional route to providing retirement income has been to use pension funds to purchase an annuity, but low annuity rates may make this unattractive to some retirees. The introduction of pension freedoms has enabled people to consider options other than using pension funds to provide an income. Individuals should devise a strategy to utilise all of their personal taxation allowances. This would enable them to create a tax-efficient income stream from their pensions, ISAs, investment portfolios and rental income. In fact, because of the favourable Death Tax position of pension funds (since 2015 the 55% Death Tax on pension funds has been removed), it may make sense to defer using pension funds for as long as possible, so as to pass them on outside one's estate to future generations.

ANNUITY RATES: THE DOWNWARD TREND



ANNUITY RATES CHART FOR £100,000 FUND, AGED 65, LEVEL AND SINGLE LIFE

SOURCE: WWW.SHARINGPENSIONS.CO.UK

Another key issue is risk and investment management both pre- and post-retirement. Prior to retirement, volatility can be your friend, due to the effects of cost averaging when you are making contributions to retirement savings. Post-retirement, once drawing upon your assets, volatility can be your enemy (drawing on pension funds when market value is low has a detrimental effect on the pension fund in the long term) so close monitoring of asset allocation, fund performance and withdrawals is necessary.

Individuals who are lucky enough to have final salary pensions may be attracted by the guaranteed stream of income throughout retirement. However, current high transfer values and the added flexibility offered by drawdown pensions, plus the scope for generational planning in order to benefit from the favourable IHT rules on drawdown, makes it essential to take advice on whether to stay within the DB environment or transfer out.

It is vital to choose a financial adviser who can look at your case as a whole, providing a multi-dimensional approach to retirement planning, including the use of sophisticated cash flow modelling.

They should be able to provide an ongoing review service to ensure that you remain on track to achieve your financial goals.

In the meantime, calculators from the likes of the Money Advice Service (moneyadviceservice.org.uk) can give individuals some cold comfort or a wake-up call…

FREEDOM OF CHOICE?

Adam Tavener, chairman of Alternative Business Funding (ABF) and Clifton Asset Management

Over the summer the Financial Conduct Authority issued warnings based on its research that suggested taking money early from pension pots was the 'new normal', however in the vast majority of cases this was being done without the benefit of advice, and thus the real financial consequences of this decision would only be felt at a later date.

Nowadays anyone over the age of 55 can access their DC pension pot (and, depending on the scheme rules, their DB pension as well, by means of a transfer out). Pensions are often significant pots of cash and thus can represent a temptation. Sometimes accessing these funds is done for the most banal of reasons; a holiday, say, or paying down credit card debt. Frequently the decision is more strategic and involves parlaying some of an individual's pension savings into a start-up capital fund for a new venture. In both cases it pays to be wary and take appropriate advice, even if you are a seasoned and qualified financial professional.

In the first instance, accessing cash for essentially domestic reasons, the first stage landscape is fairly benign. Accessing up to 25% of the total pot has no adverse consequences (beyond the inevitable reduction in value later on) and comes tax free.

Go just £1 over this limit however, and the world is suddenly a very different place. Two things immediately occur. The first is that all withdrawals over the 25% limit are treated as taxable income in the year that they occur, potentially delivering a sizeable increase in your ultimate tax bill (and yes, the published figures do show an HMRC 'windfall' of taxes paid by the unwary withdrawing pension monies which has already run into the billions of pounds). The second is that you will now be subject to the Money Purchase Annual Allowance (MPAA) that effectively reduces the amount of future pension savings that qualify for tax relief from (typically) £40,000 down to £4,000.

For those who have a wish to continue working after this point, and might wish to enjoy further employer contributions, or offset their own earnings, this is a pretty savage reduction and renders future saving marginal at best. Combined, these two considerations make for a pension freedoms landscape that is far from free, and a thoroughly delighted HMRC.

The second scenario – if you are either not yet due or not yet inclined to retire – may be to use your pension

MORE PLANNING POINTERS

Long-term care costs
No one knows if or when they will need assistance, but it pays to have an idea in advance of the cost of assisted living or residential accommodation. As well as financial advisers who specialise in costing care, for an initial ballpark estimate there are calculators available like the one provided by UK Care Guide. For example, someone going into a care home in Greater London in 2021, and living there for 10 years, may spend around £400,600. For the same duration and location, care at home for 20 hours a week could be approximately £171,600. An adviser will be able to inform you of the cost and tax implications of becoming an employer if you hire someone to work for you directly in your own home.

Investment portfolio
Whether investors are fans of the DIY approach or prefer the assistance of a broker, assessing a stock portfolio and the income derived from it when approaching retirement may require a different tack than in the midst of your working years. How long should you hold assets? How to decide what ones to sell? What is the best use of the proceeds?

Property portfolio
The entry costs into the buy-to-let (BTL) market may have jumped due to a recent increase in stamp duty, but according to several experts a property portfolio can still be lucrative when compared with other asset and savings return on investments. At present interest rates are still low, although investors should heed the warnings of a rise aimed at the BTL market in the near future – can you cover the cost through rent and still come away with a strong yield? Again, how large to grow a property empire, and how long to live on the rental income or sell the portfolio will need periodic review.

GETTY, TAYLOR CALLERY/IKON

pot to start your own business. This scenario is far more nuanced. One could argue that successfully launching a business using pension monies is the best investment a person could make - a position that I would support, with some obvious qualifications. The merits of the decision itself notwithstanding, there are still pitfalls and advantages to look out for.

The 25% part of the process still stands. Thereafter the choices might be to withdraw a single lump (take the tax hit all in one year, probably the most expensive), multiple smaller lumps to spread the tax payments out over succeeding years, or just 'little and often' as required. In all cases, however, the tax and MPAA positions are as described above.

So this is where the need for good advice really kicks in. Under the current and very longstanding regime there are a number of ways that a pension can fund a start-up (or inject into a more mature business, for that matter) without all the nasty consequences. Built around the SIPP and SSAS pension capabilities, and broadly described as pension-led funding, a pension can provide capital in a number of ways. Loans are a common way of doing this, or share purchase. The purchase of certain types of asset on a leaseback basis often works well too.

This type of transaction is usually more complex and thus involves paying some professional fees, but to avoid significant taxation of pension savings and being subjected to the MPAA, it could be worth checking out.

Other resources: Links related to managing your income ahead of retirement

Inheritance tax: tinyurl.com/GOV-InTax

Pensions lifetime allowance: tinyurl.com/GOV-LifeAll

Buy to let tax relief: tinyurl.com/GOV-BTL

Check your state pension age: tinyurl.com/GOV-AgeCheck

The new state pension: tinyurl.com/GOV-NewPen

The money purchase annual allowance explained: tinyurl.com/GOV-MonPur

The 2017/18 limit for annual deposit into one of four types of individual savings account (ISA) is £20,000. tinyurl.com/GOV-DepLimit

AGE IS MORE THAN A NUMBER

John Gaskell, head of personal financial planning, ICAEW

If you are going to have that secure retirement, you and your family need a joined-up personal financial plan that is properly co-ordinated and regularly reviewed. Moreover, that plan needs to consist of more than just putting together a personal wealth balance sheet and running some projections around investment returns, longevity and lifetime cash flows: that's the relatively easy bit. The starting point in your planning, which is arguably the most difficult part of the entire process, is to get to grips with how you (and your partner/spouse if applicable) want to spend your later years. Be honest with yourself so that you understand what is really important to you and your nearest and dearest and allocate your retirement resources accordingly. Your planning also needs to include provision for what will happen financially if and when you need care, not just provision for the good times.

Do not make the mistake of underestimating how long you are likely to live, and therefore how long your funds will need to last. Statistically speaking, UK life expectancy for a 65-year-old man today is 84, and for a woman is 86. This increases to 91 for a man who is presently 85, and 92 for a woman. At the age of 95, life expectancy for both sexes has increased to around 98 years of age, with a reasonable likelihood of a congratulatory note from the Palace to follow soon after. Whether your 100th card is postmarked to the Riviera, or to that tent where you're eating baked beans in a forest, is in your own hands. ●

THE STATE WE'RE IN: HOW PENSIONS ARE CHANGING

State pension calculations are not the same for all, and people need to pay close attention to the sums, particularly if drawing the money will take them over the various thresholds for income tax when combined with personal pensions and other income.

However, in line with rising life expectancy, the government has started raising the minimum age at which a state pension can be drawn. For men born on or after 6 April 1951, and women born on or after 6 April 1953, the new state pension age – currently 65 – applies. This increases over the next decade or so to 66 by 2020, to 67 by 2028, and to 68 by 2039. The Pensions Act NI (2015) made provision for regular reviews, meaning that 68 is unlikely to be the fixed end point for long. For details of when you will be able to draw your state pension from, see tinyurl.com/BAM-age

Citizens are eligible for the state pension if they have made at least 10 qualifying years of (non-consecutive) NI contributions. However, anyone commencing their national insurance (NI) record from 6 April 2016 will need 35 qualifying years of contributions. For those who have spent time living or working abroad or those who have paid married women's or widow's NI rates different rules may apply. See tinyurl.com/GOV-calc for a detailed explanation of what you will be entitled to.