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Your guide to pension saving

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A main financial planning aim for many people is reaching ‘financial independence’ – the point at which they can use their savings and investments to maintain the lifestyle they want without necessarily having to continue working. After a property, pension savings are the most valuable asset most people have, and this makes them central to achieving financial independence.

However, pensions have a reputation for being complicated, with years of regulatory rule changes and various allowances to navigate meaning some people avoid engaging with their pension.

At Holden & Partners, we aim to simplify pensions and work collaboratively to help you make the most of your pension both while you are saving, but also crucially at the time when your fund is used to create income. We frame your pension savings within a wider financial plan that incorporates other types of investments – such as ISAs, general accounts and offshore or onshore bonds – to make sure you meet your objectives.

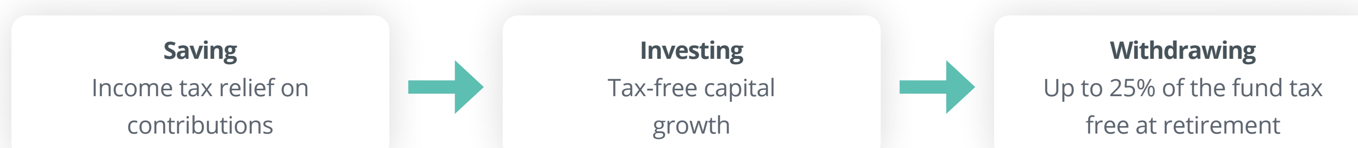
This guide covers what you need to know about saving the most common type of pension, sometimes called a money-purchase pension. This differs from a defined benefit pension scheme, which are now relatively rare outside of public sector employers.

What are the advantages of pension saving?

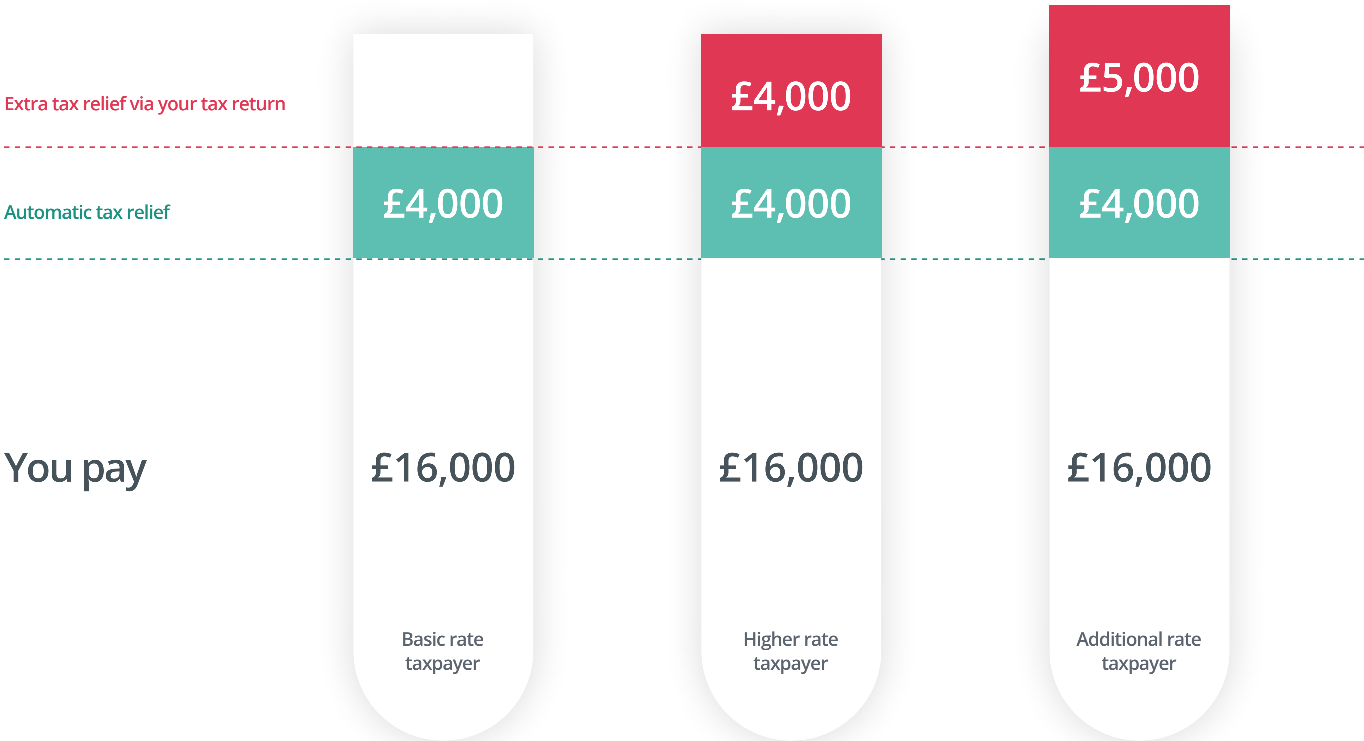
The tax benefits of pensions

Saving into a pension is one of the most tax-efficient ways to build up a fund for retirement, and prudently making use of the incentives offered to encourage saving can significantly improve the lifestyle you can look forward to in later life.

At each stage of the pension lifecycle, there are generous tax benefits available to savers:



- Contributions, whether paid monthly or as a one-off sum, receive income tax relief based on the highest rate of tax you pay. For a higher rate taxpayer in England, for example, it is possible to save £24,000 via a pension at a cost of just £16,000 once you have claimed tax relief:



- You pay contributions net of basic rate income tax, your pension provider claims the relief from HMRC, with any higher/additional rate relief being claimed through your tax return.
- Investments in a pension scheme grow without incurring capital gains tax or income tax, which makes pensions a very powerful way to save over long, multi-decade periods.
- When you reach the point of taking money out of your pension, you can usually take up to 25% of the fund without any tax liability. This does not necessarily need to be taken as one lump sum so you could, for instance, spread the tax-free amount over several years to optimise your retirement income.

Your employer saves with you

In addition to these tax benefits, the introduction of auto enrolment means most employees also have pension contributions paid by their employer.

Generally speaking, if you are between age 22 and State pension age and earning over £10,000 per year, you can expect your employer to add a minimum of 3% of your earnings to your pension, so long as you are paying in at least 5%. As this is paid in addition to your salary, it is effectively additional earnings that have been deferred to the future. You could be missing out on extra pay from your employer, so it is always worth checking that you are getting the full 'matched' contributions on offer.

Freelancers and the self-employed can still benefit

If you are self-employed, however, there is of course no employer to add money to your pension alongside you. Despite this, the tax advantages of pensions mean they shouldn't be ignored. While employees have the convenience of their employer choosing a pension scheme and then adding money to it every month, freelancers and contractors can opt to set up their own personal pension. Many pension companies or an independent financial adviser can guide you towards a suitable investment fund. Then, once a direct debit has been set up, the plan can be left to 'set and forget' apart from a financial MOT once a year.

Furthermore, if you operate a limited company, your business could save into your pension on your behalf. If you do this, not only does the company save on National Insurance contributions it would normally pay on your income, the pension contribution is an allowable expense for corporation tax and you do not incur any income tax because the contribution has come from your company rather than you personally.

At Holden & Partners, we work with our clients' other advisers, such as accountants, to build a strategy that will maximise their current income while setting aside money to provide for later life.

> Making decisions that will have a positive impact on your future is hugely empowering and often not as daunting as many people think it will be.
>
> Stefani Williams, Financial Planner & Partner

How do I combine my pensions?

On average, workers in the UK change jobs every five years.[1] This means they are likely to accumulate pension savings in a number of schemes, perhaps provided by different pension and investment companies.

If you have a defined benefit (or 'final salary' pension), it is vital to get financial advice before considering whether to transfer your benefits. In fact, it is a statutory requirement to seek financial advice where benefits exceed a certain amount.

Here are some examples of where our clients have benefited from a consolidated pension pot:

- It's more straightforward to manage one pension plan rather than several. For example, if you move home you won't have to contact lots of different companies to tell them your new address.
- You can implement a coherent investment strategy so that you are invested appropriately depending on what stage of the savings journey you are at.
- Larger pension pots can sometimes get a discount on the pension provider's management fees.
- You can keep track of your plans so that one of them isn't forgotten about.
- A consolidated approach to death benefits.

Legislation is frequently changing and so it is very important to be cautious when transferring pensions – particularly with old pensions – as they may include valuable benefits that would be lost if transferred.

For instance, a scheme might have a protected pension age that allows somebody to access their pension at an early age, a guaranteed annuity rate that is more competitive than what is available in the open market or an entitlement to tax-free cash that exceeds the standard 25% available from most plans.

Consolidated pensions may not be suitable for everyone's situation, so it is worth asking a financial adviser to review your pensions and the options open to you.

1. https://www.bbc.co.uk/news/business-38828581

Case Study: Olivia

Situation
Olivia is 34 years old and has had four jobs since she graduated 12 years ago. As a result, she has four different pension plans with various amounts in them, all with different providers and invested in the standard fund chosen at outset.

Olivia's concerns
Olivia is unsure whether the funds meet her risk profile or sustainable objectives. She is unaware of any charges or whether she has beneficiaries associated with any of these plans. The plans have become administratively burdensome, particularly as the pension providers have changed names during this period. She does not have a clear projection of what she could expect to receive at retirement.

Olivia was unsure which of her plans would be the best one to combine her savings into, so asked a financial adviser for help.

Outcome
Her adviser carefully analysed her plans both to establish the most suitable one for Olivia, taking into account charges, functionality, fund choice, etc. but also to make sure she didn't accidentally lose an important benefit, such as preferential plan charges or enhanced tax-free cash.

As a result, Olivia now has a single, cost-effective pension to manage that contains all of her retirement savings, which she can be assured is properly invested to provide for her future.

Savings allowances

When you save into a pension, there are two important allowances to keep in mind:

annual allowance

The annual amount somebody can save into a pension and claim tax relief on

The annual allowance is currently **£60,000**

However, where somebody earns more than £260,000 in a year, their annual allowance is tapered

Additionally, anybody who has accessed their pension flexibly has a reduced annual allowance of £10,000

lifetime allowance

The lifetime allowance (LTA) is the maximum value you can accrue in your pension pots, without incurring a tax charge. This excludes your State pension.

The current LTA is **£1,073,100**. Following the Spring budget, the tax charge has been reduced to 0%, effective from the start of the 2023/24 tax year.

The allowance is set to be abolished in the 2024/25 tax year, and further guidance is due to released later this year.

Should your pensions exceed the LTA, your tax-free cash entitlement will be capped at £268,275 (25% of the current LTA). Members with a protected entitlement to a higher tax-free cash, will continue to be able to access this right.

These allowances represent potential pitfalls that, if caught out by, could lead to a tax bill. As a result, financial advice to fully consider your circumstances and the options you have for saving into pensions or other investments can be extremely beneficial. For example, some people's situation allows them to obtain a protected, higher lifetime allowance and the potential to 'carry forward' annual allowance from previous tax years could reduce or eliminate an annual allowance charge.

If you would like advice around pensions annual allowance or lifetime allowance issues, call one of our advisers on 020 7812 1460.

How do I access my pension?

Unless in serious ill health, you cannot access your pension savings before age 55. In 2028, however, the normal minimum pension age is increasing to age 57, which means anyone born after 6 April 1971 will have to wait an extra two years before they can start drawing their pension.

With modern pensions, investors have a lot of flexibility over how they use their pension fund to produce an income. Most people opt to take an income via 'flexi-access drawdown', which allows them to take lump sums and/or income as needed to suit their specific situation as it evolves during retirement. It is possible to vary the amount drawn each year, with any remaining fund on death passed on to beneficiaries, but in a drawdown arrangement the investor is responsible for managing their fund and making sure it lasts for as long as it is needed.

An alternative way of using a pension to provide an income is an annuity, where the pension saver swaps their pension fund for an annual income provided by an insurance company. Annuities used to be much more popular; although they provide a secure ongoing income, they are comparatively inflexible and as such are now used less often.

Despite this, there is sometimes still a place for annuities in financial planning. For instance, the guaranteed annuity income could be used to provide a secure income to cover somebody's essential expenditure, with the invested drawdown fund then used to meet leisure expenditure, such as holidays or trips with family.

What happens to my pension when I die?

Following rule changes made in 2015, pensions are now a very efficient tool for somebody to pass money on when they die either to family or causes that matter to them.

Importantly, pension funds are not included in somebody's estate when inheritance tax (IHT) is calculated, which potentially prevents a 40% reduction in their value on death. Then, depending on their age when the pension member died, there might not be any tax to pay by the recipient of the inherited pension fund:

- Where a pension scheme member died under age 75, withdrawals – whether as a drawdown income or annuity – will be paid tax free.
- If they were over age 75, however, the recipient of the funds will pay income tax at their own marginal rate on anything they withdraw from the pension fund.

This means, for those with substantial non-pension assets such as ISAs or collective investments, it is often sensible to fund a lifestyle in retirement with those so that the pension fund is preserved to be passed on tax efficiently. This is slightly counter-intuitive as many people view their pension as a way to fund their own retirement, but it goes to show the importance of taking a complete view of your financial arrangements.

What should I be doing with my pension?

Pensions are a focal point of many people's financial plans and building a fund to support you to in retirement can seem like a daunting prospect. We aim to strip away any complexity from pensions and help you build an actionable plan to set you on the path to a prosperous retirement.

One simple action that most people can take to improve their lifestyle in retirement is simply to start saving. The powerful combination of tax relief on contributions and tax-free compound growth means the sooner you start saving, the bigger the fund you can expect in retirement. These illustrative figures show the power of saving regularly for longer:

Start saving at...	Monthly contributions	Plus basic rate tax relief	Pension fund at age 68[1]
Age 30	£200	£50	£212,232
Age 40	£200	£50	£131,394
Age 50	£200	£50	£71,485

[1] Assuming real investment growth at 3% per year

For high earners, however, pensions have become increasingly complicated and need careful planning. In addition, the relatively recent change to the treatment of pension funds on death means it is increasingly important to take a holistic view of your financial arrangements to consider how pensions interact with other savings and investments to meet the needs of today while also meeting objectives to provide for family and other beneficiaries in the future.

Don't forget your State pension, which for most people is now payable from age 67. If you are approaching retirement, or have gaps in your employment, then it's worthwhile requesting a projection, so you can understand what you might receive when you reach State pension age. You can do this by going to https://www.gov.uk/check-state-pension

At Holden & Partners, we work with our clients to explore every option so that they can make informed decisions about when and how they would like to retire, and how to achieve this through investing in ethical investments and with a sustainable approach.

Please do get in touch to discuss your pension savings or any aspect of your financial planning.

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