Cantab
ASSET MANAGEMENT

Retirement Planning

When can I retire? How much do I need?

This note aims to cover the key aspects of retirement planning. As clients' circumstances and objectives are different, the details covered are not exhaustive and we recommend speaking to a Cantab adviser for a tailored recommendation.

'You reap what you sow'

There are two distinct and equally important phases of retirement planning, namely, the accumulation phase and the decumulation phase.

Pre-retirement, in the accumulation phase, clients are encouraged to maximise their contributions to pensions to benefit from the tax relief and to increase the size of their pot. Workplace pension schemes may benefit from employer matched contributions and salary exchange.

With the annual allowances limiting contributions, funds may be invested into other investments and savings vehicles, or "wrappers", such as Individual Savings Accounts (ISAs), General Investment Accounts (GIAs) and investment bonds, and, for some, Venture Capital Trusts (VCTs) and Enterprise Investment Schemes (EIS). Clients sometimes make direct property investments for their 'retirement' portfolios (see separate note on 'Buy to let: Points to Consider'). A multi-wrapper approach can provide greater tax efficiency because each vehicle is taxed differently (figure 1).

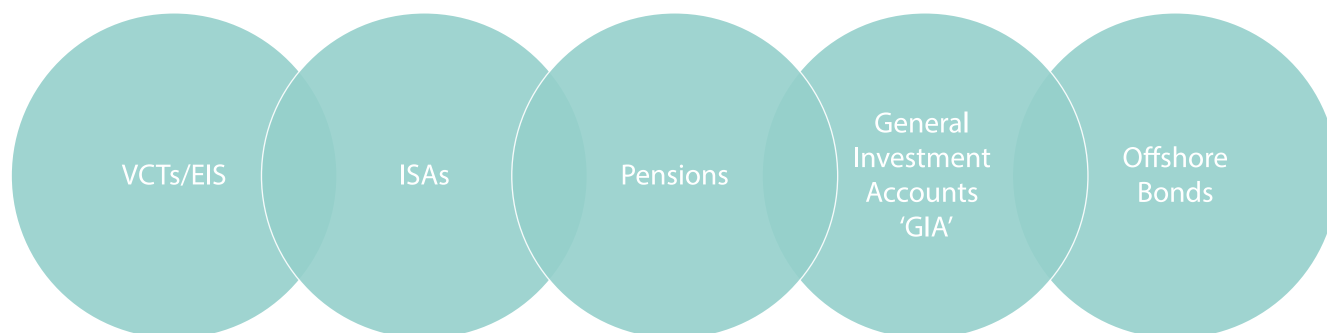

Figure 1. A Multi-Wrapper Approach

To grow funds and to maximise retirement income, we recommend starting early, maximising contributions to pensions, investing excess income into non-pension wrappers, and aligning investment portfolios with aims and appetite for risk.

In retirement, the decumulation phase involves drawing on assets to provide a sustainable income. Sequencing, the order in which investments are drawn, is important for asset longevity and tax planning. Preserving the pension by drawing on it later, or not at all, can be beneficial for estate planning.

Following the pension freedoms introduced by the coalition government in April 2015, from age 55 (rising to 57), individuals can draw as much or as little from their personal pensions as they like, subject to prevailing income tax rates in the year of encashment. Before this date, it was much more common to use pension savings to purchase an annuity, whereas now most clients will take income drawdown and keep their pension fully invested; this increases the investment timescale beyond retirement age, so that the portfolio should reflect the client's attitude to investment risk.

Cash flow analysis, using a series of assumptions to project the future, can help to determine the level of income that might be generated by assets. These projections can be useful to provide a degree of comfort or indeed encouragement to save further or retire later.

Pension specifics

A pension is a tax-efficient vehicle for building funds for retirement and generating an income in retirement. Pension contributions can attract tax relief at an individual's highest marginal rate, and, inside the pension, investments can grow free of income and capital gains taxes. The member can receive part of their benefits as a tax-free lump sum.

The amount of tax relief on contributions is limited by the lower of an individual's pensionable earnings and their annual allowance. Someone with no pensionable earnings can still receive a small amount of tax relief. High earners may be subject to a tapered annual allowance. It is possible to carry forward unused annual allowances from the previous three tax years, starting with the earliest year.

A "defined benefit" (DB) pension promises to pay the employee a defined amount each year in retirement for their lifetime, normally based on their final salary or career average earnings, and length of service. This is different to a "defined contribution" (DC) pension where a defined amount is contributed to build the pot to provide retirement income, via withdrawals or by purchasing an annuity. The income from a DC scheme is dependent on several factors, including, the amount of contributions, the investment performance, and the choices in retirement, such as the quantum and timing of withdrawals.

Owing to the costs to employers and the associated administration, the number of active DB schemes is reducing, particularly in the private sector, and most pension accumulation is now via contributions to DC schemes and group personal, stakeholder and self-invested personal pensions (SIPPs). Group personal and stakeholder schemes tend to provide lower cost options but with more limited investment choices, whereas SIPPs can be more expensive but invariably provide greater choice of investments, and some schemes permit direct commercial property investments.

It is important to understand the terms and conditions of each scheme. Some schemes provide a protected pension age and others may provide protected tax-free cash (more than the standard 25%) or an enhanced annuity rate. These benefits could be lost on transfer.

The lifetime allowance (LTA) is a limit on the value of benefits with tax concessions that can be drawn from pensions, excluding State Pensions. The standard LTA is set at £1,073,100 until April 2026; pensions may grow in value above the LTA but may be subject to a LTA tax charge. Since being introduced in April 2006 ("A-day"), there have been several transitional protections, to protect those with benefits in excess of the LTA (see table 1).

Year	2006	2012	2014	2016
Lifetime Allowance	Introduced at £1.5m	Reduced from £1.8m to £1.5m	Reduced from £1.5m to £1.25m	Reduced from £1.25m to £1m
Protection Available	Primary Protection Enhanced Protection	Fixed Protection 2012	Fixed Protection 2014 Individual Protection 2014	Fixed Protection 2016 Individual Protection 2016

Table 1. Lifetime Allowance – Transitional Protections

- Primary Protection, Enhanced Protection, FP12, FP14, IP14 are no longer available and can be lost in certain circumstances
- FP16 and IP16 are still available, subject to meeting conditions

On death, Personal Pensions may be passed on free of inheritance tax (IHT), and, because of this, pensions are also important estate planning tools.

Conclusion

In summary, retirement planning is not limited to pensions, but encompasses non-pension assets and other sources of income. Pension rules are complex and need careful consideration. Please speak to one of our Chartered Financial Planners to develop a plan to suit your situation and aims.

Risk Warnings This document has been prepared based on our understanding of current UK law and HM Revenue and Customs practice as at 1 January 2023, both of which may be the subject of change in the future. The opinions expressed herein are those of Cantab Asset Management Ltd and should not be construed as investment advice. Cantab Asset Management Ltd is authorised and regulated by the Financial Conduct Authority. As with all equity-based and bond-based investments, the value and the income therefrom can fall as well as rise and you may not get back all the money that you invested. The value of overseas securities will be influenced by the exchange rate used to convert these to sterling. Investments in stocks and shares should therefore be viewed as a medium to long-term investment. Past performance is not a guide to the future. Tax treatment depends on your individual circumstances and may be subject to change in the future.

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