

Saving for retirement

The biscuit tin approach

Saving for retirement is no different from old-fashioned saving for Christmas – you set aside money bit by bit when you can through the year and then, come the big day, you use it for you and your loved ones to have a good time. Except...

Except that with retirement you're hoping it's going to be Christmas every day – for twenty years or more.

Quite rightly the issues surrounding retirement and pensions are attracting massive amounts of attention at the moment – the issues themselves are massive. Hardly a day goes by without another report or debate or survey or prediction concerning the plight of pensioners - either current ones or those in the future. The inadequacy of the state pension, public sector versus private sector pensions, the demise of defined benefit schemes, under-funded schemes, government bailouts, insufficient private savings – the list goes on and on.

And with it come all kinds of exhortations from banks, insurance companies, pension funds, equity release providers and personal financial advisers trying to convince us that their way is better and probably more tax efficient.

Understanding the real issues

What chance has any individual to make sense of this, particularly at a time when most of us are trying to hang on to our jobs, meet our bills, bring up families and perhaps enjoy life a little as well?

We make our National Insurance contributions towards our state pension as does our employer; we possibly put something into our work pension scheme or our own private pension; and we tuck some away in an ISA – isn't this enough? Don't expect me to understand how it all works – it's too complicated and besides – retirement? It's years away.

If these sentiments are familiar you are not alone – but don't take any comfort from that. We are presently going through a complete sea change in

terms of retirement and providing for it – no one is immune. Yet despite all the exhortations in the media and the workplace about "improved retirement planning", nobody actually explains to us what that really means in terms of what we must do, or what will happen to us, certainly not in words of one syllable and without a product to sell on the back of their explanation.

In the general climate of suspicion and even some hostility which now surrounds the financial services and banking industries in the light of recent gross mismanagement it's difficult to know who to trust and where to turn to for advice. After all, if you don't even know what questions to ask, how can you evaluate the answers?

Common problem but individual responsibility

Consequently we need a common overview of the situation on which to base our own individual decisions. After all, it is down to us to take responsibility for our own financial futures, as we keep being told. Of course, there are plenty of books out there which might help, but let's be realistic - if it was such a fascinating topic wouldn't we have read them already?

Our aim here then is to provide a brief summary of the reality of pensions and retirement in simple terms so that you can understand.

Let's start with the fundamentals. The most significant of which is why is there suddenly so much fuss about the whole subject?

The main driving force for all the change in the pensions field is our longer life expectancy. Instead of a few twilight years of retirement after a lifetime of slog, even with increased retirement ages (by and large you can forget early retirement) we still have, male or female, some 20 to 25 years of life to look forward to and finance post-retirement, together with accompanying ill-health and/or potential care home costs. And not only are our own circumstances important, depending on our family circumstances, we may have elderly relatives to consider or children still to support.

Working out the figures

That's why we need our biscuit tin – our “pension pot” – although straightforward pensions, and certainly state pensions, are only one part of what we need to think about.

At its most basic the arithmetic is very simple. There are only three things we have to consider.

First, how long are we going to live in retirement? Let's say 20 years.

Second, what lifestyle do we aspire to and what are our financial commitments? And so how much cash do we need each year? Let's say £15,000 a year would be nice. This is obviously plucked out of the air here and depends on a whole host of things. However, it will do for the moment.

We need to think “cash”, that is after tax, on the one hand because it's cash that we actually spend, not gross income, and on the other our cash may come from different sources with different tax implications, perhaps none at all if it's our own capital.

And so, the third question is how much do we need in our biscuit tin? Well, we need 20 years times £15,000, that is £300,000.

“But what about the income on our savings?” you say. “You've ignored that!”

Yes – and for several reasons. First, the income may be unpredictable or like now, very low. Second, the income will do little more than cover inflation, if that, and so keep our standard of living up in the future. And third, and most important, the number £300,000 is only an order of magnitude estimate.

The whole crux of the issue is that people may be putting away pension pots of £10,000, £20,000, £50,000 or whatever and these may seem like large sums of money looked at in isolation, which indeed they are. But when these sums are spread over 20 or 25 years of “non-work” they are not going to go very far.

Facing up to reality

So what do we glean from this?

One major conclusion is that a great number of people need to carry out a reality check on their finances and their aspirations, whatever age they may currently be, and start thinking in these terms.

The state pension, if eligible for it, will make up some part of that £15,000 above but relying on it and not much else (even with pension credits) will not lead to a very satisfying standard of living, in

fact for most of those used to a comfortable lifestyle it is, practically speaking, close to poverty.

Deciding what action to take

On the basis of our simple analysis above, the issues now can be looked at very objectively.

There are all kinds of ways of filling a “retirement biscuit tin” but increasingly we will see that we can't have it both ways – having both a comfortable retirement and leaving a sizeable inheritance. If those times did indeed exist they will soon be fading away.

We must understand that we have come into the world with nothing and we will leave with nothing and we must manage that financial process over the whole of our lifetimes. Pensions will undoubtedly be a core part of our retirement savings but so will other forms of saving like property - but we must be prepared to downsize or release some of the equity when the time comes.

If we cannot find the way to build up an adequate store of wealth in our tin then we must look at the other side of the equation.

Either we must reconsider our aspirations for retirement and rein in a bit to live within our means and so reduce that fictional £15,000 to something we can afford, or we must come to terms with the fact that we may have to work for longer and so not have to fund ourselves for as long as 20 years.

What we need to see is much more opportunity for part time and flexible working at the time of the transition from work to non-work so that all the necessary adjustments can be made gradually and sensibly.

Thinking outside the box

Of course, the account we have given is simplistic and we make no apology for that. The hope is that, if you understand the simple foundation of retirement and pensions savings, then you, as a creative and resourceful individual, will be able to take appropriate action to suit your own aspirations and circumstances.

Today with divorce, re-marriages, extended families, and the increasingly flexible work patterns of both men and women over the length of their careers, much needs to be taken into account. The only sure thing is that, unless death intervenes, we will all age and, at some stage, will need to retire.

*For further information contact:
Richard Ciechan: Richard@inmyprime.co.uk*