Wealth Design Ltd's Retirement Guide

One of the biggest changes to pensions in recent years has been the introduction of pension freedoms, which has changed the way we can access our pensions. This guide brings together different sources to create a thought-provoking and insightful look at how the landscape for retirement has changed, and the implications on financial planning in the run-up to and throughout retirement.

A complete guide, it looks back at how retirement has changed over the years and forward to the trends of the future. Topics covered include the history of pensions, how retirement and those retiring have changed, spending in retirement, investment risk, accessing your pension, and leaving a legacy through your pension.

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Section One: Retirement – the Big Picture

Where are we now? The UK's working population

The Changing Landscape of Work in the UK[1]

The population in the UK is growing and people are living longer, which is changing the landscape of work and retirement. This puts more financial pressure on the government to provide pensions for an increasing number of pensioners who are also drawing pensions for longer than their predecessors did.

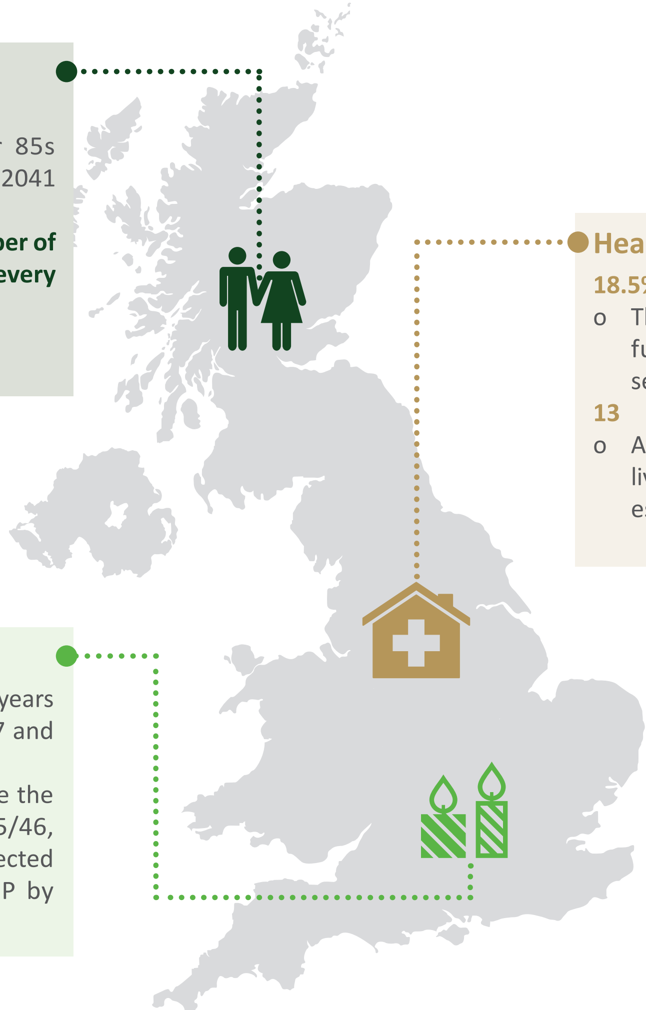
UK Population

3.2 Million

- Predicted number of over 85s between mid-2016 and mid 2041 (double what it is now)

Old age dependency ratio (number of people of pensionable age for every 1,000 people)

- Mid-2016: 305
- Mid-2041: 370



Healthcare

18.5%

- The total percentage of government funding spent on the healthcare sector in 2017/18

13

- Average number of years people are living longer than when the NHS was established in 1948

State Pension Age

- Pension age to increase to 68 years old, phased in between 2037 and 2039
- The move is designed to save the taxpayer £74 billion by 2045/46, with state pension costs expected to account for 6.1% of GDP by 2039/40.

These population projections have profound implications for national income and public expenditure, with public receipts likely to be blunted, while the need for spending across health, pensions, welfare and wider social protection will increase significantly. The management of this trend therefore represents a significant challenge for the government over the coming decades.

This growth stresses the significance of the UK pension age, and the need to increase this in line with life expectancy to reduce dependency and limit the possible damage represented by the ageing population. Without changes to the pension system, public expenditure will rise without a correlating rise in contributions, establishing and widening a deficit between these trajectories.

Beyond changes to pensions, immigration has also previously boosted public receipts, with migrants currently central to national income and the working age population. Meanwhile, the government continues in its attempt to boost productivity across the UK, which could potentially not only increase income tax, but also VAT income.

[1] Public Expenditure, Key Insights, August 2018. Published by Mintel Group Ltd, www.mintel.com email: info@mintel.com

A Short History of Pensions

First introduced in the late 1800s, pensions have seen many changes over the years. The following diagram[2] depicts some of the most significant changes:

The late 1800s

Final Salary Pensions were born. The railway companies were first, and Cadbury followed not long after.

1908

Old age pension introduced. It paid 5 shillings a week (£14 today) to men aged over 70. Life expectancy was 47 years.

1948

Modern State Pension launched.

1967

8m+ private company employees enjoy final salary pensions, along with four million state workers.

1985

Frozen Pensions abolished, these are pensions which have remained at a fixed value. Increased regulation became inevitable. Companies were forced to inflation-proof the pensions of leavers.

1990

Robert Maxwell scandal - he had stolen £400m from the Mirror Group pension scheme. The public demanded increased protection of their pension savings.

2004

Pension Protection Fund established to bail out collapsing funds.

2015

Pension Freedoms introduced. This is further explained in the next section.

[2]Based on "A turbulent history of the British pensions, since 1874" in Telegraph Money.

Pension Freedoms

The 2015 pension reforms provided more choice in how people can use their pension savings in retirement. With the pension freedoms you can currently access cash as early as 55, which may help you pay off a mortgage or help a child buy their first property. You have control as to how much you take from your pension account. So, for example, you could take out money to spend on a once in a lifetime holiday or a sports car, rather than being restricted by an annual income through an annuity.

The Chancellor, George Osborne, started a pension revolution in 2015 when he announced the introduction of the new pension freedoms. The rule changes shone a spotlight on annuities as the traditional way to generate income in retirement, leading to a dramatic impact on annuity sales. Individuals could now take income withdrawals from any money purchase pension arrangement, provided the scheme rules permit such a benefit to be taken. This was achieved by a change in the tax rules, which allows greater access to pensions. Since 6 April 2015 withdrawals have been available through “flexi-access drawdown”, where there is no limit on yearly income withdrawals. However, the first ‘taxable’ withdrawal from flexi-access drawdown will trigger the Money Purchase Annual Allowance (MPAA).

Flexi-access Drawdown - The Basics

Currently from age 55, or earlier in the case of ill health or a protected pension age, a member can choose to designate all or part of the funds under his/her arrangement to provide income withdrawals through flexi-access drawdown. Those who already have a capped drawdown arrangement may be able to designate further funds to it. At each designation, 25% of the value can be taken as tax-free pension commencement lump sum (PCLS) as long as there is sufficient lifetime allowance remaining.

Any benefits crystallised to provide income withdrawals are kept separate from any other uncrystallised benefits under the member’s arrangement. Where the member has any uncrystallised benefits remaining in an arrangement, further contributions may be paid to that arrangement.

There is no need to take an income each year if the member does not wish to do so.

Greater Choice in Retirement

Following on from the introduction of Pension Freedoms, there are a number of options available. These include:

- Continue to leave the pension invested without withdrawing any funds
- Purchasing an annuity
- Taking a flexible income (flexi-access drawdown)
- Taking up to 25% tax-free Pension Commencement Lump Sum (PCLS) and no income
- Cashing in the whole pension in one go (Uncrystallised Funds Pension Lump Sum), in which case 25% of the value can be taken as tax-free pension commencement lump sum (PCLS) as long as there is sufficient lifetime allowance remaining.
- Taking cash lump sums over and above the 25% tax-free PCLS as Uncrystallised Funds Pension Lump Sum.
- Mixing any of the options above

The role of annuities in pension planning

Prior to the introduction of pension freedoms, retirement was often funded by purchasing an annuity. Annuities have become something of a poor relation in retirement planning in recent years. There are many reasons for this, including sharp falls in annuity rates as interest rates declined and life expectancy increased, and suspicion that insurance companies were offering poor terms, particularly to those who did not shop around for the best rates. Since the 2014 Budget, annuity sales have plummeted.

With rising life expectancies and uncertain investment markets, annuities still have their place. An annuity is guaranteed to pay an income for life. Many people crave the peace of mind this brings, especially if they don't have other sources of secure income when work stops.

A conventional annuity is the tried and tested method of providing an income in retirement. Normally, after any tax-free cash is taken, the balance of an individual's retirement fund will be used to purchase an annuity at the then available rates.

The advantages of a conventional annuity include:

- A secure and certain income once the annuity has been purchased. The annuity is effectively an insurance against the annuitant living too long and running out of funds.
- Simplicity. Once the basis of the annuity has been selected the annuitant no longer has to make any further decisions about what to do with his/her retirement income.
- Mortality effect. If an annuitant is in good health and anticipates living longer than average for someone of his/her age he/she will benefit by purchasing an annuity.
- Suitability. Where the available annuity purchase price is very low, an annuity may be the only alternative to taking the whole fund as a lump sum at retirement.

The disadvantages of a conventional annuity include:

- Inflexibility. Once the annuity has been secured its terms cannot subsequently be changed even if the annuitant's circumstances have.
- Unattractive death benefit. The death benefit is often considered unattractive where an annuitant dies shortly after an annuity has been purchased. This is, however, now less true for those who opt for annuity protection.

The Changing Shape of Pensions

There are two main types of pension scheme:

Defined Benefit scheme

A Defined Benefit scheme pays out a secure income for life which increases each year. They usually pay your spouse, civil partner or dependents a pension income when you die. It is otherwise referred to as a 'final salary' or 'career average' pension. It's a defined benefit pension that's nearly always a work-based pension arranged by your employer. This type of pension scheme is declining in popularity with a number of employers offering employees the chance to transfer out.

The size of pension you receive when you retire depends on the amount you earn, the length of time you have been paying in the scheme, and the terms of the individual pension scheme. It guarantees a certain amount for you to receive each year when you retire, as the organisation buys an annuity on your behalf.

Defined Contribution scheme

A Defined Contribution scheme is where you build a pot of money to provide an income in retirement, rather than being guaranteed a secure income. Income depends on the amount you pay in, the fund's investment performance and the choices you make at retirement with the accumulated fund. When you retire you can access and use your pension pot as you wish, taking out money as and when you wish. Defined contribution pensions currently can be accessed flexibly from age 55 (57 years from 2028).

Employee Workplace Pensions in the UK

The Office for National Statistics (ONS) reports on Employee Workplace Pensions in the UK (2018 provisional and 2017 revised results)[3]:

- Over three-quarters (76%) of UK employees were members of a workplace pension scheme in 2018, up from 73% in 2017.
- The number of employees with defined contribution (pension wealth dependent upon factors such as investment performance) workplace pensions has increased considerably in recent years; in 2018 the proportion of employees with workplace pensions of this type (34%) almost equalled that of defined benefit (which guarantee a specific retirement income, 36%).
- The vast majority (85%) of defined benefit pension members received employer contributions equivalent to 12% or more of their earnings in 2018, while just 8% of defined contribution members received employer contributions of this size: this reflects the legal requirement on employers to ensure defined benefit schemes are funded sufficiently to pay future pensions.

[3] Employee workplace pensions in the UK: 2018 provisional and 2017 revised results, Office for National Statistics, 12 April 2019: https://www.ons.gov.uk/employmentandlabourmarket/peopleinwork/workplacepensions/bulletinsannualsurveyofhoursandearningspensiontables/2018provisionaland2017revisedresults

Section Two: The Changing Face of Retirement

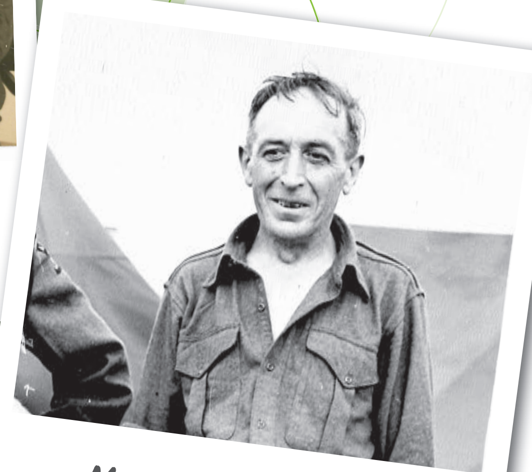
What does “old” mean?

David Philips, Director & Financial Planner at Wealth Design, has been reflecting on how much things have changed since the times of his grandparents.

The images below show how much visibly older his grandfathers looked than people in their 50s and 60s today. George lived until the age of 69 and Frank died at 63. In contrast, David’s great grandparents lived until what we consider to be a typical life expectancy for today—82 (James) and 80 (Elizabeth).

My grandafather George holding me

My great grandparents



My grandfather Frank in his 50s

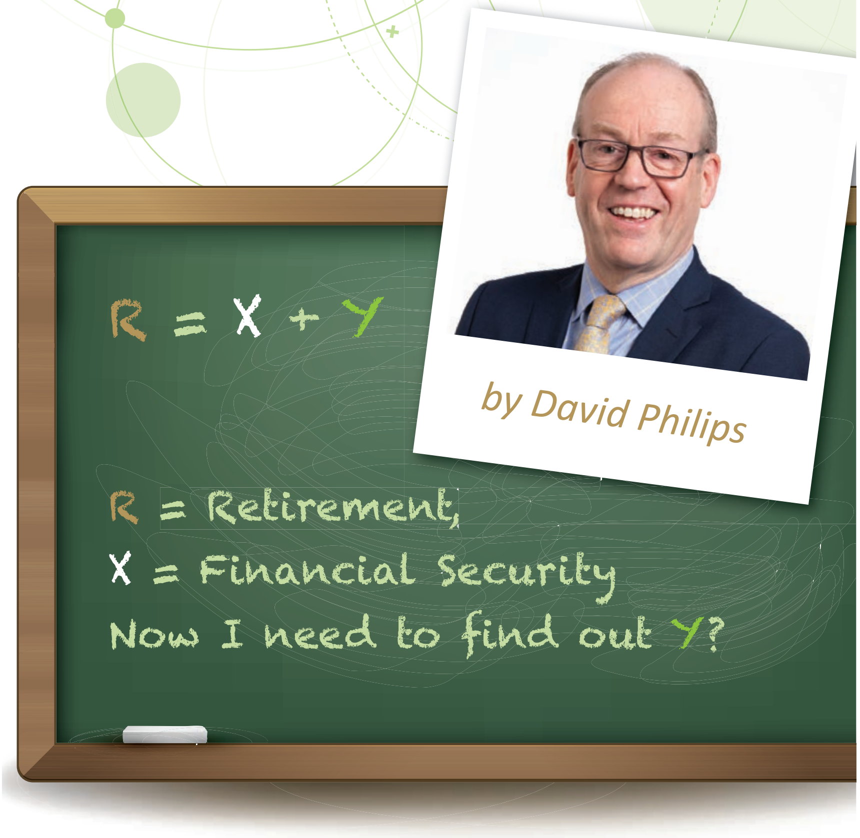
The photographs illustrate how those entering retirement have changed over the generations. David’s observations are further supported by a report from Prudential, where they state:

> **"The nature of retirement has changed from a few years at the end of life, often in poverty, to a period of twenty plus years, which for many (though not all) is increasingly characterised by relative financial security. Older consumers are now a large and growing part of our economy."[4]**

[4] Understanding Retirement journeys: Expectations vs Reality, Published by Prudential, November 2015

The Retirement Formula - 'R = X+Y'

Director & Chartered Financial Planner, David Philips, considers why so many of his discussions with clients and prospects are not about finance, but about them and their future.



Finding out 'y' (or should that be 'why'?) is a factor that I've spent some time thinking about lately.

I've figured out that it is about having empathy with people around the wider topic of 'retirement' and what it means. It's about testing perceptions and helping people open up to their emotions and the practicalities of living longer.

I remember that the classic view of retirement was that work colleagues gathered in the canteen or Boardroom (where a glass of sherry was quaffed as you struggled to figure out the contents of that vol-au-vent). The Works Manager waxed lyrically about how much you'd done and how much you'd be missed, culminating in a Presentation Decanter and four glasses, with a bouquet for your dear wife. You were done, you were 'retired'; you'd made it!

I can't recall that story being played out anymore. So what is the 'R' factor, the 'Retirement Factor'? It appears to be an evolving scenario of not finishing altogether, a world of slowing down and not stopping, a world of realising that finishing work at 60 means an average 25 years of doing what?

There's a list of jobs, of course, a holiday or two to have, some decorating at the kids new house, more golf to play, but is it enough to keep you engaged and stimulated for the next 25 years?

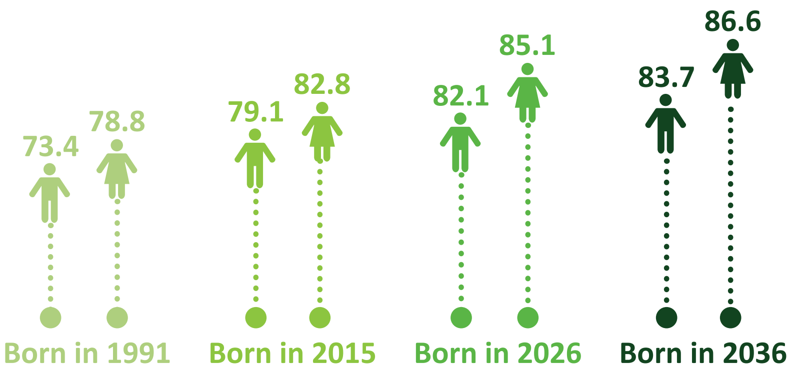
My experience is that everyone speaks of a cold, dark, wet October morning where the curtains are opened and the question is asked: 'What am I going to do today?' Physical and mental stimulation is part of being in the workplace. Being at work is a social activity, having a laugh, sharing a concern, doing your bit, and feeling fulfilled!

More and more I'm finding that people are not asking themselves the question of 'What will I do today?' I am passionate that it's an important consideration and so my approach is to help clients face their future. It is being remarked on as a reason why people are coming to me for advice.

'The numbers are the numbers' and financial security is a huge consideration, but don't forget the broader picture and open yourself up to a discussion about 'what am I going to do today?' in your world of retirement and what it might mean for you.

Life Expectancy and the UK Population

Life Expectancy from Birth[5]

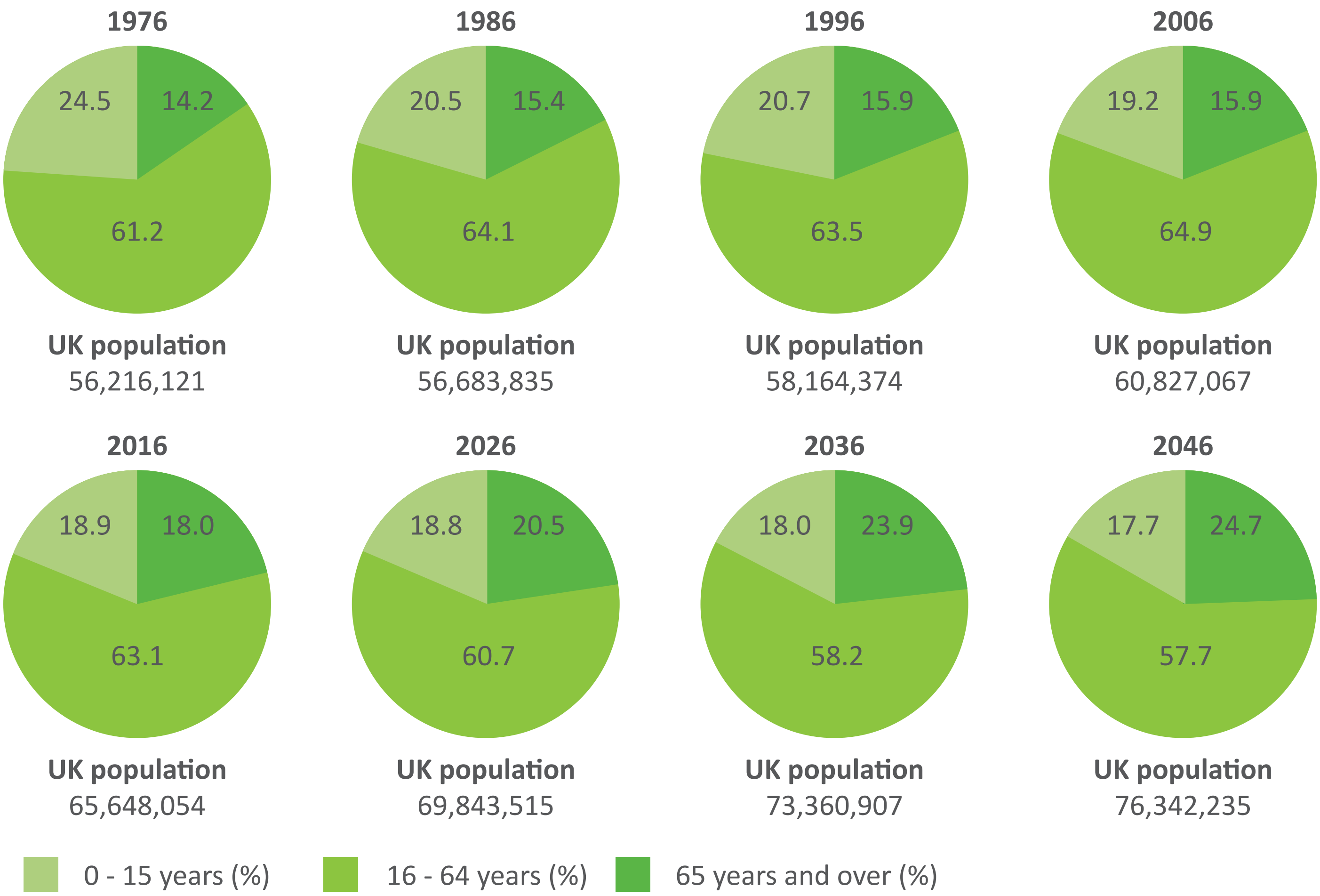


Life Expectancy from Age 65[6]

The older you live, statistically the longer your life expectancy.

A Growing Proportion of People Retired

Age distribution of the UK population, 1976 to 2046 (projected)



Source: Office for National Statistics (2014)

The age distribution of the UK population is changing. ONS reported in 2017 that "The population in the UK is getting older with 18% aged 65 and over and 2.4% aged 85 and over."[8] It is projected that by 2046 almost 25% of the UK population will be age 65 and over.

[5] ONS -Office for National Statistics (2014)

[6] Source for diagram: The Institute and Faculty of Actuaries https://www.theguardian.com/society/2019/mar/07/life-expectancy-slumps-by-five-months

[7] Overview of the UK population: July 2017, Office of National Statistics, 21 July 2017: https://www.ons.gov.uk/peoplepopulationandcommunity/populationandmigration/populationestimates/articles/overviewoftheukpopulation/july2017

How are retirees changing?

The spending power of over-50s has never been greater. They make up a third of the UK's population but hold 80% of the wealth and their consumer spending has grown on average 4.4% annually for the past decade, compared with 1.2% for under-50s.[8]

In this section we will look at how retirees have changed from a social, physical and psychological perspective.

Social

Retirement has traditionally been viewed as the winding down period in life. However, it seems that this attitude is shifting. A survey of 50,000 people by over-50s insurance company SunLife recently uncovered that "over-50s feel younger than they are, they're enjoying life more than ever, are busier than ever and care less about what other people think.

They love adventurous travel, sport and being active, and are starting more businesses. Many are single and on the dating scene. "A lot of them are getting tattoos for the first time, or adding to their collection of tattoos," SunLife chief executive Dean Lamble says. "This is a very colourful time of life. They're not conforming.""[9]

Having positive self-perceptions of ageing can have positive effects. In *That Age Old Question: How attitudes to ageing affect our health and wellbeing*[10], it is reported that: "...those with more positive self-perceptions of ageing live on average 7.5 years longer than those with less positive self-perceptions of ageing. Since then, the research base on the impact of age stereotyping on length of life has grown considerably."

Physical

Retirees today are more likely to be in better health than those from previous generations. A collaborative study by several research institutions in Germany, including the Humboldt-Universit, found that "people aged 75 are more likely to be fitter today than those who were 75 twenty years ago. The research was conducted in Berlin, where more than 700 older people over the age of 60 were tested for their cognitive functioning and rated for personal well-being"[11]

However, a person's health can also depend on factors such as class, what job they have retired from, and how healthy they were before they retired. Dr Martin Hyde, an associate professor of gerontology at the Centre for Innovative Ageing in Swansea found in a review of longitudinal studies (in 2013) that "There is no health dividend in retiring for people with good jobs. "They are in pretty good health before retirement and pretty good health after retirement. There's no effect."[12]

[8] 'The 50+ age group is still a grey area for brands' in Campaign, April 05, 2017:
https://www.campaignlive.co.uk/article/50+-age-group-grey-area-brands/1429270

[9] 'The 50+ age group is still a grey area for brands' in Campaign, April 05, 2017:
https://www.campaignlive.co.uk/article/50+-age-group-grey-area-brands/1429270

[10] *That Age Old Question: How attitudes to ageing affect our health and wellbeing*, Published by Royal Society for Public Health, www.rsph.org.uk

[11] 'Research suggests that older people are fitter today than in the past', 23rd April 2015, Age UK,
https://www.ageukmobility.co.uk/mobility-news/article/research-suggests-that-older-people-are-fitter-today-than-in-the-past

[12] 'Can retirement lead to an early death? Why quitting work could kill us' in The Times, July 25 2019,
https://www.thetimes.co.uk/article/can-retirement-lead-to-an-early-death-why-quitting-work-could-kill-us-7tdqtzfdp

Psychological

Retirees entering retirement are healthier, feel younger and are leading busier lives. However, as retirement goes on, there is a shift in how people spend their time.

"In contrast to the expectations of a leisure-filled retirement, with a boom in holidays and cruises, the reality appears to be quite different. Retirement does not appear to result in more holidays, while time spent on leisure activities falls with age. And perhaps the most startling trend is time spent at home alone. Between the ages of 70-90 time spent alone rises from an average of 3.5 hours to 9 hours per day."[13]

Health in later life: can it be a restrictor on achieving retirement aspirations?

Many people in later life do consider health to interfere with what they would like to do. Just over half (50.5%) of those aged 70-74 often or sometimes agree that their health stops them doing things they want to, and this proportion steadily increases with each age group to reach 84.5% of those 90+. Many older people do feel a positive degree of self-determination, though this falls with age.[14]

It has also been found that negative perceptions of ageing can have an impact. "The starkest example of the power of negative self-perceptions comes from a study which found that those with more positive self-perceptions of ageing live on average 7.5 years longer than those with less positive self-perceptions of ageing. Since then, the research base on the impact of age stereotyping on length of life has grown considerably."[15]

How do retirees feel about stopping work?

In a poll carried out by the Department of Work and Pensions, when asked to reflect on their working life, just over one in five (22 per cent) of those retired said that they missed work, while approximately three quarters (74 per cent) said they did not miss it. Also, while 23 per cent said they wish they had worked a bit longer before retiring, 72 per cent stated they do not.[16]

In the same poll, 62% of those questioned said no changes to their work situation, such as increased flexibility, reduced stress or the offer of a part time role, would have stopped them from retiring when they did.[17]

[13] *Understanding Retirement journeys: Expectations vs Reality*, Published by Prudential, November 2015
[14] *Understanding Retirement journeys: Expectations vs Reality*, Published by Prudential, November 2015
[15] *That Age Old Question: How attitudes to ageing affect our health and wellbeing*, Published by Royal Society for Public Health, www.rsph.org.uk
[16] *Attitudes of the over 50s to Fuller Working Lives*, Department for Work & Pensions, January 2015
[17] *Attitudes of the over 50s to Fuller Working Lives*, Department for Work & Pensions, January 2015
[18] *Attitudes of the over 50s to Fuller Working Lives*, Department for Work & Pensions, January 2015
[19] *That Age Old Question: How attitudes to ageing affect our health and wellbeing*, Published by Royal Society for Public Health, www.rsph.org.uk

What does retirement look like now?

Several factors have contributed towards key shifts which give people more flexibility around when, how and what retirement looks like, giving retirement an entirely new shape. This is supported by findings in *Attitudes of the over 50s to Fuller Working Lives*, a report commissioned by the Department of Work and Pensions, which looks at the difference between those who have retired and those who are looking at retiring.[18]

Control and Choice

According to *That Age Old Question: How attitudes to ageing affect our health and wellbeing*[19] "both younger and older groups thought independently that, compared to other stages of life, they were the ones with more freedom and independence in their lives. The key difference between the groups was that they conceived of that freedom in different ways.

Those in the younger group emphasised their freedom and ability to define themselves, and their years ahead to become the best they can be in whatever they choose. They felt free to make mistakes, change life course, and move geographically, all with relative ease. Those in the older group instead emphasised that at this point in their lives, many have fewer obligations to children, a mortgage, their job, and much more - pointing out that the young have all this ahead of them. When discussing as a mixed group, many participants conjectured that it is those at an interim life stage, or 'middle-age', who have the least independence and freedom. Many older participants felt strongly that a really important element to maintaining a positive attitude to ageing is having control over one's life."

Freedom

The introduction of Pension Freedoms was to allow individuals more say in how and when they access their pension income. Putting them in control of their pension pot and giving them more options when it comes to financing their retirement.

Pension reforms have given people flexibility in terms of how they use their defined contribution pension pots means that many will have to think about what shape of income they will need in retirement to meet their changing consumption needs. In this regard, many have argued that products that deliver a U shaped income - high initial income for leisure and holidays on entering retirement, low in the middle of retirement as preferences change and then high again at the end of life to fund long term care costs - might be most appropriate. However, hard empirical analyses about what consumption during retirement actually looks like, how this relates to people's daily activities, and whether people are happy with this are few and far between.[20]

"By far the leading reason for not retiring was 'needing' to earn money (31 per cent). Following this, 'I think I'm too young to stop' was the second most common response (13 per cent), while 'I enjoy the work I do' was third (9 per cent). The proportion of respondents who claimed the dominant reason for not being retired was enjoyment of work increased significantly with age; 5 per cent among those in their 50s, 15 per cent among those in their 60s and rising to 33 per cent of those aged 70 plus."[21]

[20] *Understanding Retirement journeys: Expectations vs Reality*, Published by Prudential, November 2015

[21] *Attitudes of the over 50s to Fuller Working Lives*, Department for Work & Pensions, January 2015

Flexibility and Ability to work

In the workplace people can now continue working for as long as they want (provided they can do their job well and their employer cannot justify asking them to leave). Workers have the right to ask their employer about working part-time or flexibly. In addition, this can prove more lucrative as they do not have to pay National Insurance after reaching State Pension age.

Attitudes of the over 50s to Fuller Working Lives states thirty nine percent of respondents not currently retired said that working part time or flexible hours before stopping work altogether would be the best way to retire. Seventeen per cent preferred a less demanding job before retiring altogether, while the same proportion said working full time and then stopping work altogether would be the best way to retire.

> **"About a third of those currently not retired said they had some interest in moving to self-employment (33 per cent) or starting a new career (36 per cent) and over half showed some interest in mentoring younger workers (54 per cent)."[22]**

Unretiring

Around one in four retirees in the UK return to work or 'unretire', mostly within five years of retiring, according to research by The University of Manchester and King's College London.[23]

> **"The researchers have found that while 'unretirement' is common, men are more likely to unretire than women, as are people in good health, those who are better educated and those still paying off a mortgage. People who report having financial problems before retiring are not more likely to unretire than those without, nor are those with lower incomes. After ten years, a retiree's chances of returning to paid work are low."**

The key findings include:

- Men were 26 per cent more likely to return to paid work following retirement than women
- Individuals in good health were around 25 per cent more likely to return to paid work than those reporting fair, poor or very poor health
- People whose partner worked were 31 per cent more likely to unretired
- Mortgage payers were 50 per cent more likely to return to work than those who own their homes outright
- Those with post-secondary qualifications were almost twice as likely to return to work than those with none

Entrepreneurs

According to a study of 2,000 small business owners by Sandler Training, the average age for an entrepreneur is 47 (46 for men; 48 for women).

What's more, self-employment is becoming a more popular choice for older people in the UK, with the total number of self-employed people over age 65 increasing from 159,000 to 469,000 between 2001 and 2016.[24]

[22] *Attitudes of the over 50s to Fuller Working Lives*, Department for Work & Pensions, January 2015

[23] 'Unretirement - one in four Britons return to work', The University of Manchester, 1 November 2017, https://www.manchester.ac.uk/discover/news/unretirement/

[24] 'Rise of the "pensionpreneurs": how to start a business when you retire' in The Telegraph, 21 November 2018 https://www.telegraph.co.uk/money/smart-life-saving-for-the-future/starting-a-business-in-retirement/

Other factors which can impact financial planning in retirement

Age Gap relationships

"Across Western countries, about 8 per cent of all married heterosexual couples can be classified as having a large age gap (10 years or more). These generally involve older men partnered with younger women. About 1 per cent of age-gap couples involve an older woman partnered with a younger man."[25]

Implications for financial planning

Where there is a large age gap in a relationship, there is more flexibility around when each person in the relationship retires. For example, to enjoy more time together, one of the couple may retire in their 50s or work part time, making the accumulation stage shorter. Alternatively, the older spouse may unretire if their spouse continues to work full time, which will increase the amount accumulated.

Mortgage and car payments extending into retirement

"A fifth of the UK's homeowners will still be paying off their mortgage after they stop earning, according to startling new figures that reveal the legacy of interest-only loans and delayed first-time buying. Around 3 million people now expect to still be repaying their home loan after the current state retirement age of 65, research from online broker L&C Mortgages has found, in a break from the historic and often assumed norm."[26]

According to The Car Expert, there were 1,052,749 new car sales in 2019. "Just under 960,000 private new car buyers took out some form of car finance in 2018, usually a personal contract purchase (PCP), with a record total of almost £19.4 billion borrowed."[27] This means that 91% of cars are paid for with finance. Payments are typically paid back over a number of years, which, depending on the age of the person taking out the loan, can overlap with retiring.

Implications for financial planning

Ongoing financial commitments, such as mortgage and car repayments, increase the financial burden in retirement, meaning you may need more money throughout your retirement.

A Mars a Day – helps us work rest and play

With the Mars principal came the idea that our lives are segmented into thirds; a third of our time we spend working, a third we spend resting and a third we spend playing. In retirement, with the third spent working gone, how will we spend that extra time? Are we going to increase the amount of time resting, or are we going to increase the amount of time we spend playing? How will we fund the additional play time?

[25] 'Why couples with big age gaps are happier, despite the social disapproval', ABC, 20 Apr 2018, https://www.abc.net.au/news/2018-04-20/couple-with-a-larger-age-gap-happier/9680764

[26] 'Millions of homeowners will still be paying off mortgage after retirement, research warns', The Independent, 24 November 2018, https://www.independent.co.uk/money/spend-save/mortgage-pension-retirement-house-prices-property-interest-loans-a8647681.html

[27] Car finance report 2018: record debt for new and used cars, The Car Expert, 8 February 2019, https://www.thecarexpert.co.uk/car-finance-report-2018-record-debt-for-new-and-used-cars/

Financial Journey in Retirement

How we spend our time, and thereby our money, changes over the course of retirement. Prudential found that:

"The amount of money spent on non-essentials – primarily for the pursuit of pleasurable activities, such as recreation or going to restaurants and hotels – declines steadily with age. A closer look at the different categories of non-essential spending, reveals that people spend a relatively similar amount of money on recreational goods and services between the age of 50 and 65, and only then do they start spending progressively less. This seems to contradict the stereotypical image of retirees splurging in the immediate post-retirement phase of life, going on cruises and spending all their hard-earned cash on fun activities.

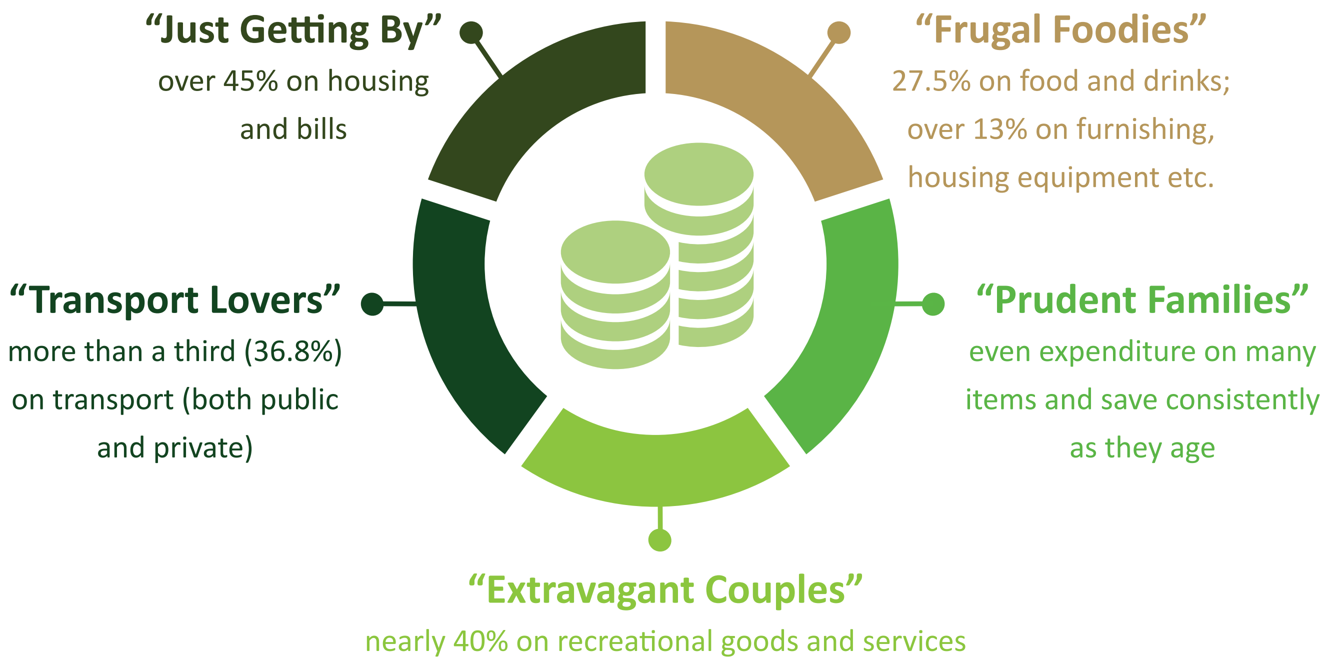
With respect to expenditure related to going out to restaurants and staying in hotels, the decline that occurs after the age of 65 is much steeper than that which occurs between 50 and 65. Again, it would appear that the post-retirement stereotype of extravagant dinners and nights away in hotels or on cruises (i.e. on holiday) is not reflected in the evidence based on average expenditure."[28]

Retirement does not lead to more holidays, while those at older ages spend more time alone.[29]

- Time at home alone increases by age, while time spent with family and friends falls. By age 90+, watching television and spending time at home alone are the most common daily activities.
- The age group 70-74 appears to be a tipping point. From this age, the average amount of time spent at home alone increases markedly, while the time spent with family and/or friends falls.
- With the exception of early retirement, retirement does not lead to more holidays or other leisure activities. Nor does retirement lead to a sudden splurge in eating out.

[28] *Understanding Retirement journeys: Expectations vs Reality*, Published by Prudential, November 2015 https://www.prudential.co.uk/~/media/Files/P/Prudential-V2/content-pdf/retirement-journeys.pdf

[29] Source for infographic: *Understanding Retirement journeys: Expectations vs Reality*, Published by Prudential, November 2015



[30] *Understanding Retirement journeys: Expectations vs Reality*, Published by Prudential, November 2015

Section Four - Investment Risk in Retirement

In this section we look at the implications of factors we have already seen when it comes to financial planning moving into and during retirement.

Investment Stage

In investment terms when nearing or post-retirement, you will be in the decumulation stage. Your focus at this point will most likely be on preserving your assets and securing an income, which changes the focus in your financial plan.

The investment decisions at this stage are critical as you will be living off the money that you have built during your lifetime, with no chance to rebuild it.

Interestingly, the report from Prudential says that even within retirement “Many older households continue saving throughout retirement. Indeed, we calculate that individuals aged 80 and over are saving, on average, around £5,870 per year.”[31]

What are the risks which affect investment in retirement?

Risk is an unavoidable part of the investment process. Here, we consider the main types of risk than can affect investments at the decumulation phase.

Financial markets go through a cycle of rising (peaks) and falling (troughs). Depending on the level of risk you take, this cycle usually takes 2.5 years, after which the markets will be back to the same point as when you started investing.

It is important to make sure that your money lasts through the peaks and troughs. In putting your plan together, our aim is to ensure that you always have funds in your investment from which you can continue to withdraw your income without depleting the main pot.

Therefore, the strategies we design will take into account the rising and falling of the market and ensure that you have three years of income before getting back to where you started.

Sequencing Risk

Sequencing risk is the risk created by the particular sequence in which portfolio returns are generated (i.e. weak or strong years for performance) and in which withdrawals are made from the portfolio. For example, if portfolio returns are weak and unsustainable high income is withdrawn, this can affect the long-term value of the portfolio and its ability to meet future withdrawal requirements.

This is a risk which particularly affects those who are relying on their portfolios for income and therefore, our approach is to make sure that you will have:

- Two years income in cash;
- One year of income invested in a portfolio which is one risk profile below your current one.

[31] Understanding Retirement journeys: Expectations vs Reality, Published by Prudential, November 2015

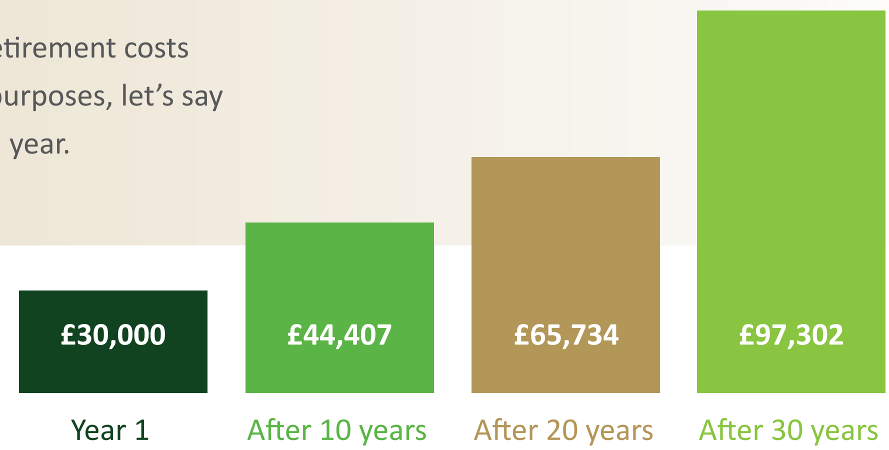
Inflation Risk

Inflation can be a risk to a successful retirement, especially when people outlive their money, which is more likely now that people are living longer. Most of our clients will be spending more time decumulating than accumulating and so inflation becomes a major consideration in the design of any investment plan.

To continue to receive an income throughout retirement, your investment will need to both cover inflation and grow higher than the inflation rate.

Example

Mr and Mrs Jones have all-in lifestyle retirement costs of £30,000 per annum. For illustrative purposes, let's say the Retail Price Inflation rate is 4% each year.
This is how their spending would look:



What is Cash Flow Modelling?

Cash flow modelling is a powerful tool that assesses your current wealth and what it could look like in the future. At Wealth Design we use it to help with financial planning and to visualise the impact of inflation (and other variables such as changes to the market). A cash flow graph shows clients the compounding effect of inflation over time, which is used to show how inflation impacts lifestyle costs and helps them to see the impact of longevity and inflation.

Our cash flow modelling software can help you to see what your financial future could look like. You will be able to look at the different scenarios which will show you how much you have to live on and what financial implications there are if you retire at different ages.

We use a personalised state pension prediction from HMRC to build in when you will get your state pension and we can change different variables to see how they could impact your financial situation over time.
The scenarios we build look at:

- What income you will receive based on different levels of inflation
- What happens to your income when the markets fall or rise?
- The implications if you want to withdraw money to fund a holiday of a lifetime, private health care or help a family member onto the property ladder

Using this information, we can work with you towards your goals, and plan for different scenarios both during retirement and in the run up to it.

Phased tax-free income throughout retirement

Pension drawdown is an option which allows a person to take an income from their pension savings throughout their retirement. The income is taken from a 'pot', which has been built up over some years, either from a pension plan which you set up yourself or a pension scheme run by your employer.

The idea of pension drawdown is to keep your pension savings invested while growing it further so that you can draw down an income without depleting the pot. However, returns are not guaranteed and so careful consideration, planning and investment are required.

How much can I take out?

While your main pot stays invested, you can decide how you prefer to draw your income. You can make regular withdrawals or you can take a one-off lump sum. You can also decide if you want it to be made up of the returns on your investment or if you want to take money from the main pot, reducing your 'pot' over time. How much you take and when will depend on how flexible your pension provider is. (In theory, you could withdraw the whole pot in one go if you wanted to.) However you decide to withdraw your money, you should always consider the tax implications.

Is the income taxable?

Pension drawdown payments are taxable and if you were to draw a large sum in one go it could put you into a higher tax bracket. However, even when you have already started drawing your pension you can continue to save into it. In this case you can earn a tax relief on your pension contributions of up to £10,000 per year.

Additionally, you usually have the option to take 25% of your pension savings as a tax-free lump sum. You can spend this money in any way you like.

Advantages

- Pension savings remain invested, giving you the potential to grow it
- Flexibility to adjust your income as needed
- You can continue to pay into your pension
- You have control over your pension savings
- You still have the option to buy an annuity
- Your money can be passed on to your family when you die (they may have to pay inheritance tax on this)

Disadvantages

- Income is not guaranteed, so money needs to be managed carefully to prevent it from running out
- Returns on investment will probably fluctuate
- Risk of pension investments falling in value due to poor investment performance
- Investments need to be monitored regularly – will you want to continue doing so as you get older?

Annual Allowance

The annual allowance is a limit on the amount you can save towards your pension each year and receive tax relief. This allowance is currently set at £40,000 and includes all of the pension schemes you belong to. Contributions above this amount will be subject to the annual allowance charge.

"If you have an income of over £150,000 in a tax year, then your annual allowance for that tax year will reduce on a tapered basis. For every £2 of adjusted income above £150,000, your annual allowance will reduce by £1. The maximum reduction is £30,000 so anyone with an income of £210,000 or more will have an annual allowance of £10,000."[32]

Money Purchase Annual Allowance

If you have already started to access your pension, the lower Money Purchase Allowance (MPAA) may apply. This is the amount you can pay into your pension every year and still get tax relief, currently set at £4,000. Introduced in April 2015, the MPAA rules were introduced to ensure that individuals do not use the pension freedoms to avoid tax on their current earnings. Without it an individual could divert their salary into their pension with tax relief, and then immediately withdraw it with 25% payable tax-free.

The MPAA applies to an individual who, on or after 6 April 2015:

- draws any income from a flexi-access drawdown fund;
- receives an uncrystallised funds pension lump sum;
- converts a capped drawdown fund to flexi-access drawdown and subsequently takes a drawdown income from that fund;
- takes more than the maximum allowable income from a capped drawdown fund;
- had a pre-5 April 2016 flexible drawdown plan;
- receives a stand-alone lump sum where they have primary protection and a protected lump sum right in excess of £375,000;
- receives a payment from an annuity that can decrease except in certain defined circumstances; or
- receives a payment of scheme pension other than through an annuity in a scheme with fewer than 12 members (i.e. a SSAS).

A money purchase annual allowance will not be triggered by any of the following payments:

- A pension commencement lump sum;
- A trivial commutation lump sum;
- A small pots triviality lump sum;
- A scheme pension (defined benefit or money purchase) except as described above;
- A lifetime annuity that does not decrease; or
- Income from a pre-6 April 2015 capped drawdown pension arrangement which is within the permitted maximum.

There is no carry forward between tax years for the money purchase annual allowance. Once the money purchase annual allowance has been triggered, it will continue to have effect every year.

[32] 'What's the annual allowance?', The People's Pension, https://thepeoplespension.co.uk/help/knowledgebase/allowance/

Death Nominations

It is possible to pass on your pension to your loved ones when you die. However, pensions do not become part of your estate and are therefore not automatically passed to your family when you die. To pass on your pension you will need to fill in what is called a Death Benefit Nomination.

A Death Benefit Nomination is a legal form that allows you to state who will receive your pension on the event of your death. Death benefits can be paid out either as a lump sum or in the form of a pension. Lump sums can be paid to anyone you choose, while pension payments can only be paid out to people who come under the definitions of ‘dependant’, ‘nominee’ or ‘successor’. Dependants are defined as:

- a spouse (including de facto, opposite and same-sex)
- children of any age (including adopted or ex-nuptial)
- any person(s) financially dependent on the member
- any person(s) in an interdependency relationship with the member

A nominee is a beneficiary who you nominate on a death benefit nomination, and a successor is a beneficiary who has been nominated by a dependant or nominee.

"Since the introduction of the pensions freedoms rules in April 2015, death benefits are largely free from tax if the client dies before age 75. However, they will usually be subject to tax at the beneficiary’s marginal rate if the client dies from 75 onwards.In some cases, it can be more tax-efficient for a beneficiary to receive a pension than a lump sum, and this is one reason why it’s important to review nominations, especially from age 75."[33]

[33] ‘The importance of keeping death benefit nominations up-to-date’ AJ Bell Investcentre, 23 November 2017, https://www.investcentre.co.uk/articles/importance-keeping-death-benefit-nominations-date

Planning for Retirement

The importance of making a retirement plan cannot be overstated. It's a savings plan that will grow into a fund that will see you through retirement. Contributions are held in a pension fund, and there is a range of types from which to choose, with varying degrees of risk. Therefore it's important to seek advice to ensure you're investing in a way that suits your age and attitude to risk.

There will be charges to consider, which may be in the form of a percentage of the contribution as an initial fee or a percentage of the fund value every year, to cover administration and fund management. You may wish to opt to top up your pension by making additional contributions, particularly as your income grows, so that your pension doesn't lag behind your earnings.

At Retirement

Your pension fund should now provide an income for your retirement years. This may be in the form of an annuity or by drawing down an income from the fund. You will be taxed on your pension income, although you may take the first 25% as a tax-free lump sum. You may have additional financial priorities, such as supporting your family, which you want to build into your plans.

Breadth of Knowledge

This guide illustrates the changing landscape, both from a demographic point of view and also in terms of how the government's policy changes impact the attractiveness of different retirement planning options.

At Wealth Design, we take pride in keeping abreast of the changes and their financial implications and listening to our clients to understand their priorities and needs to create a tailored financial plan through your retirement journey.

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