

## Article

# Securing that gold-plated pension

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The cost to the taxpayer of public sector pensions is set to soar from £4 billion to £9 billion in the next four years, the office for Budget Responsibility (ODR) said last week.

The amount now paid to 2.5m public sector pensioners is about £20 billion a year, with employee contributions of about £4 billion and employer contributions of around £12 billion, leaving £4 billion to be picked up by the Treasury. This is likely to increase to £9 billion by 2014.

Nick Clegg, the deputy prime minister, promised action over these “unfair and unaffordable” gold-plated schemes, as prospects for those in private sector and personal pensions become more dismal.

While MPs and public sector workers can enjoy retirement safe in the knowledge that their guaranteed pensions will be paid, most private sector employees must shoulder the investment risk themselves.

Some 96 of the 100 largest listed companies in Britain have now closed the door to so-called “final salary” schemes (also called defined benefit schemes) for new employees, replacing them with “defined contribution” schemes. These do not guarantee any level of income and are based on stock market performance.

Aon Consulting, the actuarial consultancy, said stock market volatility in the past six weeks had shaved some £1,000 a year off the projected pension of an average 60-year-old employee in a defined contribution scheme, assuming they earned £25,000 and contributed 10% of salary.

Unions claimed the government is wrong to target public sector pensions because the average payout is small - but the cost of buying even a small guaranteed pension in the open market can be much higher than expected.

The average annual pension income for an NHS worker is just £6,931, but you would need a fund of £221,155 to buy that income in the annuity market, assuming it rises with inflation and pays a widow's pension, according to research for The Sunday Times carried out by Hargreaves Lansdown. The average private sector pension pot is just £30,000.

Teachers, who retire on average incomes of £9,358 a year, would need a £298,596 pension pot to buy the equivalent income in the private sector. In all these examples, which are based on a 60-year-old man, women would need to save more.

To make up the difference between a private and public sector pension, a private sector worker would need to commit about 30% of salary to a pension from their mid-twenties. However, most people only save about 10%.

A private sector worker aged 25, on average earnings of just over £25,000, would need to save £642 a month to retire on a pension of two-thirds final salary. Most only save £214, leaving a shortfall of more than £400 a month. This leaps to £830 a month for someone who earns £50,000 a year.

Pension providers say parents are increasingly giving children a leg up on the pensions ladder rather than the property ladder. Pension group Aviva's Pension Ladder research found that more than a third of people said they would use spare cash to start their children's pensions and 60% expected their children would have to continue working well past retirement age.

Here we look at pension planning through the ages.

### **START YOUNG**

Parents who start pensions for their children will be amazed at what the power of compounding can do. Our case study, Jonathan Rowe, recently invested £2,800 into a pension for his baby son. As non-taxpayers receive tax relief on contributions, this is automatically bumped up to £3,500.

According to A J Bell, which provides self invested personal pensions, if Rowe keeps up this level of saving until his son is 18, then leaves the fund invested until he is 65, his overall investment of £50,400 could grow to as much as £1.6m. This assumes investment growth of 7% a year and takes account of a 0.5% initial charge on contributions, and 1% annual management charge.

Billy Mackay at A J Bell said: "The effects of cumulative growth naturally have a very powerful effect on pensions bought for children. We have had a culture in the UK of underproviding for the future and not saving, but that has to change."

Figures from Aviva show that sales of pensions for the under-18s in 2010 will have almost doubled compared with 2009.

### **IN YOUR 20s AND 30s**

The cost of delaying pension savings can be high. Laith Khalaf at Hargreaves Lansdown, the adviser, said that someone earning £50,000 who wanted to retire at 65 on half their salary would need to save £322 a month if they started saving when they were 25, rising to £543 a month if they did not start until the age of 35.

Khalaf said: "Where there is an employer's pension contribution on offer, opting out is still basically turning away free money. It is probably therefore still worth making the minimum required contribution to attract a contribution from your employer."

If you do not want to tie up your money for so long, you could consider saving in an Isa instead, then transferring to a pension later, You run the risk of pension contribution tax relief being reduced in the meantime, however, and potentially missing out on employer contributions.

With such a long time to go until retirement, you can afford to take some risk with investments. Ben Yearsley at Hargreaves Lansdown suggests Melchior Asian Opportunities, First State Global Emerging Markets Leaders or Jupiter China.

Some experts say you should only hold the proportion of your retirement fund equivalent to your age outside equities. So if you are 25, you should have 75% invested in stocks and shares as you can afford to take more risk for the longer term.

If you are not comfortable managing your own investment choices for your pension, Philippa Gee of Philippa Gee Wealth Management said personal pension plans from Fidelity Funds Network or Standard Life are a good place to start.

### **IN YOUR 40s AND 50s**

This is when you should be shovelling everything you can into your retirement fund. You have 20-plus years until retirement so you can afford to take some risk. Check' what investment options your workplace scheme offers, but do not take on more risk than you are comfortable with. Khalaf said if you have accumulated several pension pots from different employers, it might make sense to consolidate them. If you haven't already you should get a state pension forecast. You can obtain one from [direct.gov.uk](http://direct.gov.uk).

Once you get to about 10 years before retirement, Khalaf said: "Start moving out of equities and into safer assets such as bonds, gilts and cash. The closer you get to retirement the less risky your pension portfolio should be."

Hargreaves recommends M&G Optimal Income and Artemis Strategic Assets.

**END**

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**Please note this document is intended for trade and national press individuals.**

#### **Notes for Editors**

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