Summary
• Although workplace pensions may be seen as the best option for saving for retirement, there are alternatives that could suit some workers.
• Individual Savings Accounts (Isa), Lifetime Isas, Venture Capital Trusts and Enterprise Investment Schemes are valid saving options.
• However, most agree that these kinds of vehicles should be used in addition to a workplace pension, rather than instead of them.

A little something extra

Jack Gray investigates which type of saver would be best suited to which saving vehicles, and whether these products should compete with, or complement, a pension

When saving for retirement, it is hard to argue that a pension is not the best way to go. It can be the safest and most cost-effective way to do so, with tax relief on the money you pay in and the first 25 per cent of withdrawals being tax free. However, they do not provide much flexibility, and some may prefer to have the option to withdraw funds when unexpected or large costs come up.

Tried and trusted

Auto-enrolment has helped get more than 10 million additional people saving for their retirement, with many seeing it as the best way to fund a comfortable life in old age. It provides tax relief as the contributions from a worker's pay are not taxed, through either a relief at source or net pay arrangement. Savings are invested and grow throughout a career, with the decision making being made by experts, which, in theory, should result in better outcomes than if a saver with little financial knowledge was making the investment decisions.

Furthermore, employer top-ups in workplace schemes add 'free' money into people's retirement savings and the first 25 per cent withdrawn is done so tax-free.

Hargreaves Lansdown personal finance analyst, Sarah Coles, explains the advantages of pension saving, but concedes that additional vehicles can be useful: "If you have a defined contribution pension, you have more flexibility over taking lump sums, but it's incredibly useful to have a pot of tax-free savings too, so you don't face tax implications when withdrawing larger lump sums.

"The trump card for pensions is that if you're saving into a workplace pension, under the auto-enrolment rules, you'll get contributions from your employer. In many cases, when you pay in extra to these schemes your employer will match any extra you pay in too."

AJ Bell senior analyst, Tom Selby, adds: "Automatic enrolment means workplace pensions now come with a matched contribution of at least 3 per cent – effectively free money from your employer.

"While pensions remain the retirement savings vehicle of choice for most people, there are alternative vehicles it's worth considering."

One of the perceived shortcomings with pensions is the lack of flexibility when it comes to accessing the savings. Pension pots are not accessible until the saver is at least 55, which means that any unexpected or emergency costs that arise before then must be paid for through other means.

However, this could also be seen as a positive characteristic of pension schemes, as those who may be tempted to withdraw money when they do not really need it, such as for a holiday or other luxuries, will not be able to without incurring substantial tax bills.

Additional not replacement

It seems as if most experts believe that, although a pension is the best way to save for retirement, it may be savvy for savers to consider an additional savings vehicle to fund them in later life.

"The most obvious and popular is the Individual Savings Accounts (Isa)", says Selby. "Isas enjoy the same investment tax benefits – namely tax-free growth – as pensions, but you can also access your money without paying tax at any point in time. This flexibility is appealing to many investors who don't want to lock their money up until age 55, as you do with a pension."

Coles explains that, although someone may have a "generous and reliable income" if they have a defined benefit pension scheme, "it's not going to

be so useful when the boiler breaks down or the car gives up the ghost."

Research from Hargreaves Lansdown finds that 23 per cent of savers are planning to use Isas to help provide income for their retirement.

Coles continues: "The major advantage of an Isa is that not only is all growth tax free, but the income is tax free too. It's also much more flexible, so there's no age limit on when you can withdraw the cash. You're limited to contributions of £20,000 a year, but this still leaves enormous potential for retirement saving alongside a pension."

Despite the potential benefits of an Isa, Selby believes that a pension is still the most attractive retirement savings option.

He explains: "In return for locking away your money pensions offer generous tax benefits. You get tax relief on the money you pay in, while Isa contributions are made out of taxed income, and once you reach age 55 you can get 25 per cent tax-free through a pension, with the remaining 75 per cent taxed in the same way as income.

"This means that, end-to-end and provided you manage your withdrawals in retirement sensibly, a pension should give you a bigger bang for your buck than an Isa. You can also save twice as much each year in a pension (£40,000 in a pension vs £20,000 in an Isa)."

Self-employed

Saving into a pension may be the best option for most workers, but the self-employed could be better suited to using alternative saving vehicles. Isas and investment schemes can present a more flexible options that would better suit their income and lifestyle.

Now Pensions director of policy, Adrian Boulding, says that some self-employed workers may be better off saving into an alternative vehicle.

He adds: "Although it is really important to save for later life, pensions may not be the best way for some self-employed people to do this and other savings vehicles could be better suited. Some self-employed people's incomes are not very stable and so they can need more flexibility with their savings, which other saving options can provide.

"For example, if they have a big outlay with their job, such as hiring employees or needing equipment, they may need to access their savings to fund expenses. Self-employed workers' income can be irregular, which does not always suit pension saving.

"However, more traditional pensions are suited for the self-employed who do have a regular income such as fixed-term contractors who might choose to pay into a pension on an annual basis."

Age can also be a factor in determining who may be best suited to alternative savings vehicles. Columbia Threadneedle Investments head of pensions and investment education, Chris Wagstaff, says that the flexibility that the alternatives facilitates can be "good for the Sandwich Generation".

He continues: "The Sandwich Generation is people that are sandwiched between caring for elderly parents or relatives and providing financial assistance to their children.

"Alternative saving options can help this generation meet those needs as they are more flexible."

Riskier alternatives

Another option for savers is a Lifetime Isa (Lisa). This, as Coles describes, "combines the advantages of a tax-free income with the government top up". The government will pay a 25 per cent bonus on top of whatever savers put in each year. However, it does offer less flexibility than a standard Isa. Individuals must be over 18 but under 40 to open a Lisa and there are maximum annual contributions of £4,000. Additionally, if the money is withdrawn when the saver is either not buying their first home, not aged 60 or over, nor are terminally ill with less than 12 months to live, the saver will pay a 25 per cent charge.

Coles, however, adds that this can still be more flexible than a pension. She says: "While being less flexible than an Isa, a Lisa is more flexible than a pension. If you don't want to use your money for a property purchase, and you don't want to wait to access it at 60, you can get hold of money in your Lisa. You'll have to pay a penalty of 25 per cent, but that's far less than the penalty for accessing your pension early."

Selby states: "Lisas are worth considering if you're looking to buy a home, have used up all your annual or pensions lifetime allowance, or are a basic-rate taxpayer. However, for most people an auto-enrolment pension with a matched contribution is hard to beat."

There are other saving options, including investment schemes such as Enterprise Investment Schemes and Venture Capital Trusts. Selby continues: "Away from these mainstream vehicles, some investors have also turned to Enterprise Investment Schemes and Venture Capital Trusts, which offer tax benefits in return for investing in start-up companies. These investments tend to be particularly popular among people who have maxed out their pensions lifetime allowance.

"Anyone going down this route needs to be aware that the investments tend to be high risk and so there is a chance you will lose a substantial amount, or all, of your money."

It seems as if there might be riskier but potentially more rewarding saving options, but mostly for those that are more financially educated and experienced.

Despite the alternatives, most experts agree that other saving vehicles should be used by the average saver in conjunction with, rather than in place of, a pension.

Written by Jack Gray