Long-term savings, short-term problems

Jonathan Watts-Lay asks whether pensions are a good option to fulfil a short-term cash need

Last year there were many scheme members who accessed their pension for the first time than perhaps would have in normal times.

In fact, HMRC figures indicated a surge in early pension withdrawals in the over 55s, which is thought to be due to pressure on household income caused by the pandemic.

Despite promises the ongoing vaccination programme may bring, it will take some time for the economy to recover. It is thought that redundancies are likely to continue and many will still be on furlough or facing reduced hours, increasing the pressure on household income and potentially resulting in more members accessing pensions early. Jonathan Watts-Lay highlights some key considerations for those who may want to access their pension early:

Tax implications

There are a number of tax considerations. Firstly, up to 25 per cent of a pension pot can be received as tax-free cash, however anything beyond this is potentially taxable at 20 per cent, 40 per cent or even 45 per cent.

Also, when someone draws money from their pension beyond their tax-free cash entitlement, in most cases a money purchase annual allowance is introduced. This means an annual contribution limit of £4,000 rather than £40,000, if a tax charge is to be avoided for those who wish to work again.

For many, other savings and investments may be a better source of short-term cash than pensions. Not only may this help avoid unnecessary tax but it will also allow the pension to grow in a tax-free environment.

Underestimating how long retirement savings may need to last

Research has found that most people live longer than they expect, and so members could easily underestimate how long they think their savings will need to last. For example, The Institute for Fiscal Studies found that those in their 50s and 60s underestimate their chances of survival to age 75 by around 20 per cent, and to 85 by around 5-10 per cent. Before accessing their pensions, members will need to think about if they will have enough money to last the duration of their retirement.

Falling for a scam

A recent report by Action Fraud found that pension scams had become one of the most common types of fraud to occur last year and that £30.8 million has been lost to pension scams over the past three years.

In addition to this, The Pensions Regulator (TPR) revealed it was investigating over £54 million worth of lost pension savings, in cases that have affected 18,000 savers. However, the FCA warned that this number is in fact likely to be much higher.

TPR has advised trustees to urge members 'not to rush decisions and provide them with clear, relevant and timely information so they can make informed decisions'. They also instruct trustees to follow the Pension Scams Industry Group (PSIG) code of good practice, based on three key principles which include: raising awareness of pension scams for members and beneficiaries; having robust processes for assessing whether a scheme may be operating as part of a scam; and being aware of the known current scam strategies.

DB pension transfers

XPS Pension Group, suggests some pension schemes are seeing an increase in defined benefit (DB) transfer requests in the wake of Covid-19. Ensuring access to appropriate advice is key and many trustees now facilitate access to reputable advisory firms having gone through a due diligence exercise.

What can employers and trustees do?

Employers and trustees play a key role in ensuring members make informed choices concerning their pensions. Providing financial education and guidance to members can help them to understand their options and the generic risks and pitfalls of certain actions. It can also help members to decide if they would like further support such as regulated financial advice, although this of course is a requirement for anyone looking to transfer a DB scheme over the value of £30,000.

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