PERMANENT

WEALTH PARTNERS

Haven’t reviewed your pension recently?

Here’s what you need to know

Pensions have long been complex and changes in the latest Budget build on a long line of tinkering by politicians, rendering them incomprehensible at times for non-experts.

The risks in your pension policy are essentially embedded in three areas:

1. Risks associated with the pension provider;
2. Risks associated with the specific policy details; and
3. Risks associated with how the pension is invested.

What’s to understand?

The pension industry is constantly undergoing mergers and acquisitions. It is not uncommon for your pension provider to change if your employer finds a better deal. It is also possible that a provider may have “sold its book” to another firm, so knowing who is administering your policy is the first step.

What are they charging?

Despite regulatory focus on fee transparency across financial services over the last two decades, it is not always clear what you are paying. Worse still, it is not often clear what you are getting. So how are you supposed to know that you are getting value for money?

Aren’t the charges all pretty low and pretty similar?

NOT AT ALL. There is a wide dispersion of fees charged on corporate and personal pension schemes. There a number of potential charges: administration fees, fund management charges, fund charges, and transaction costs.

Do small differences in fees really matter?

YES – sometimes a lot. If you hold this policy into retirement it may be with you from your early twenties to your late nineties! If you have £100k in a pension compounding for 50 years, the difference between 2.5% and 3% growth is c. £98k, so nearly as much as your original investment!

What sort of policy is it?

The vast majority of pensions these days are “Defined Contribution” or “Money Purchase” schemes where the amount you contribute over time and the net investment returns that you generate determine the size of the pension pot you will have upon retirement and this hugely influences your lifestyle in your later years. There are also pensions called “Defined Benefit” or “Final Salary” which use similar inputs but your pension is based upon your salary level at retirement.

Has the policy kept up with all of the rule changes?

Taxation and Pensions are the play things of government policy makers, so changes will continue, sure as death itself!

Do I really need to worry about this though?

It depends, but likely - Yes. If your policy is relatively new it will have the flexible drawdown features introduced by former Chancellor George Osbourne. These are popular because the idea of having to purchase an Annuity was so unpopular.

Can I move or consolidate my pensions?

It depends. It may or may not be possible, and it may or may not be advisable even if possible. The only way to be sure is to conduct thorough research and analysis of individual policies.

How is it invested?

Many group schemes, like those offered at Barrister’s Chambers, offer some simple alternatives. The problem is that many of these by design will result in poor outcomes for the policy holder. How so? Well they are usually categorised into industry standard jargonistic options like “Balanced Fund”, “Cautious Fund” or worse “Lifestyle” or “Target Date” funds.

If (a big if) you are actually asked about or assessed for your attitude to risk, this will inevitably lead to the majority of people (68% due to the normal distribution of outcomes) selecting the middle or balanced option. In the vast majority of cases, this will be an extremely expensive miscalculation. Why? You will be giving up expected returns over a long period of time that will compound so that your eventual pension pot could be substantially less than it could have been.

These funds are everywhere - what is the problem?

This whole concept is derived from a paternal and entirely wrong-headed idea of risk (I humbly submit). In the days when you were compelled to buy an annuity with your pension it made sense not to expose your policy to the volatility of investment markets in the leadup to crystallising the fund and making an Annuity purchase.

The defined contribution and flexible drawdown era, coupled with increasing life expectancy means that many people will need to fund retirement for decades. To have reduced the volatility of your investment portfolio at the price of greater exposure to the twin evils of inflation risk and longevity risk is NOT a good idea.

Isn't Volatility Risk?

No. Generically risk is the probability (high or low) of a given outcome (good or bad), occurring at some point in the future (near or far) and the impact of the outcome (large or small). Volatility is the mathematical measure of how much a series of observations are dispersed around the mean.

In English, volatility is a measure of the ups and downs that an investment has historically experienced. It is often used as a proxy for how risky an investment is. When you are properly planning your finances the risks that you are worried about are:

1. Longevity Risk – Will I run out of money before I die?; and
2. Inflation Risk – Will inflation reduce the spending power of my money over time such that I cannot afford my lifestyle in retirement?

That your investments go up and down (daily, weekly, monthly, yearly etc) can be an emotional cost, but if you are buying and owning the right investments it will not be a financial cost, it will be your saviour.

What is the answer?

Seek professional advice. You are briefed on matters due to your deep technical knowledge and problem-solving expertise. Your pension is likely to be your biggest asset after your home. You will spend you entire career making contributions and investing that pension to pay for your life in retirement.

To help you get started, we are offering a free no-obligation pension review, exclusively for barristers, if you would like to discuss your options.