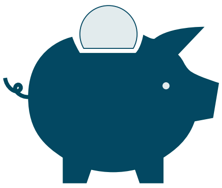
THE FOUR POTS OF RETIREMENT

Ever wondered where to begin when it comes to planning for retirement? You're not alone.

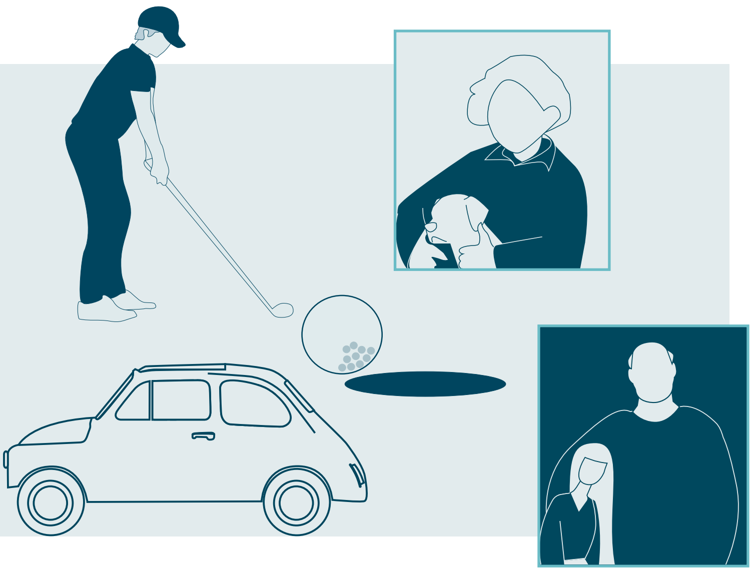


That's why our consumer editor, Ruth Strachan sat down with head of retirement, Richard Parkin to pick his brain on how people may begin to prepare for life beyond work.

Here, Richard details the four savings pots you could consider when financially planning for your retirement.

KEY TAKEAWAYS

- Planning for retirement can be daunting, so it can help to consider your finances across four pots.
- The four pots include active years, later years, rainy day fund and legacy planning.
- There is not a one-size-fits-all approach when it comes to retirement. Therefore, it can be helpful to talk through your plans with a financial adviser.



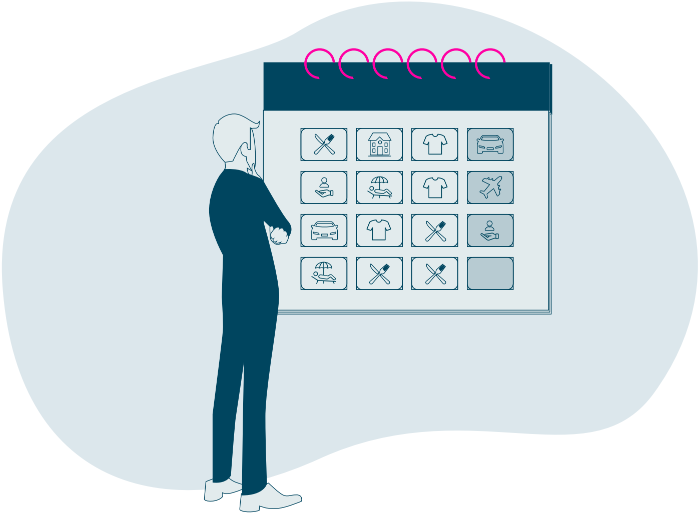
Facing retirement can be really overwhelming for many, because there's just so much to think about, right?

Absolutely. While retirement is seen by many as a chance to enjoy the fruits of many years' hard work, it is usually a fundamental upheaval of the life you've been used to and that can raise a lot of issues and take a lot of thinking about. Even if you have pretty clear plans of what you'd like to do with all your free time, the transition from full-time work can often bring up some emotional and practical challenges as well as the inevitable concerns of how it's all going to be paid for. While it's a very important part of retirement planning, financial planning is just part of the story.

But planning for retirement isn't simply accessing your pension, is it?

I'm sure we all wish it was that simple, but for many it's likely to be more complex. So for example, many people these days will have money in ISAs as well as pensions. They may also have other assets such as property that they're going to have to rely on to support them in retirement. Working out when and how to use these assets to support retirement is rarely straightforward, and it's going to be a good idea to get some expert advice if you're unsure.

If we just stick with pensions for a moment, (even this is more complex) people may have multiple pensions from different employments. Some of these may provide a guaranteed income but, increasingly, people will have pensions that just give them a pot of money to use as they see fit at retirement. That could be taking their savings as



a lump sum, maybe using them to generate an income or just keeping them invested for the future. Sometimes, you might want to do a combination of all three of those.

But loads of people have more than one pension right?

That's right Ruth, and it can make sense to bring these together into one place to make them easier to manage. Whether this is right for you depends on a range of factors and you should look to get expert help (like talking to a financial adviser) before taking any action.

Beyond this, you need to start thinking how you want to use your pension pot. How much will you need to spend in retirement? What other costs might you be faced with? As well as thinking about these you'll also need to consider how your pension and other assets are invested to support your retirement plans. It's likely the investment approach you followed when saving for retirement is not necessarily the right one for you when you start taking money from your retirement savings.

Just checking I'm understanding correctly - there's a huge shift in perspective when it comes to investing for retirement…

Your understanding is spot on, Ruth. So, when we're saving for retirement, we're probably most focused on maximising our wealth. Without taking unnecessary risks, we usually want to grow our retirement pot to be as big as possible to give us the best chance of having enough money to support the standard of living we want in retirement. Once we're in retirement, the attention turns to making our retirement savings last as long as we need them to. We still want our savings to grow but we're likely to be more focused on avoiding or at least limiting losses so that our savings don't run out too quickly or we find we can't support the level of income we want.

But if we're more focused on creating an income and stability in retirement – how can you even begin to organise that?

It can be helpful to think about your retirement needs using different pots. Let's start with the first pot, thinking about the income you'll need to support your day-to-day expenditure. There's a couple of ways of doing this and you could combine them. The first approach is to split your likely expenditure between essential expenses and (what we might call) more discretionary expenditure. By essential expenses we mean those costs that you need just to keep yourself alive; things like heating, eating and cost of accommodation, but there may be others.

Discretionary expenditure are things that you'd like to have, but that you could probably cut back on as needed. The reason we do this is because we want to be pretty certain we can meet our essential expenditures come what may.

We may look for more secure income sources to support these essential expenses. Whereas for discretionary expenditure, we can perhaps be more flexible with how we provide for that. Perhaps we'll be prepared to take more risk on the investments supporting that discretionary expenditure, knowing we can afford to reduce our spending if things don't work out quite as well as planned.

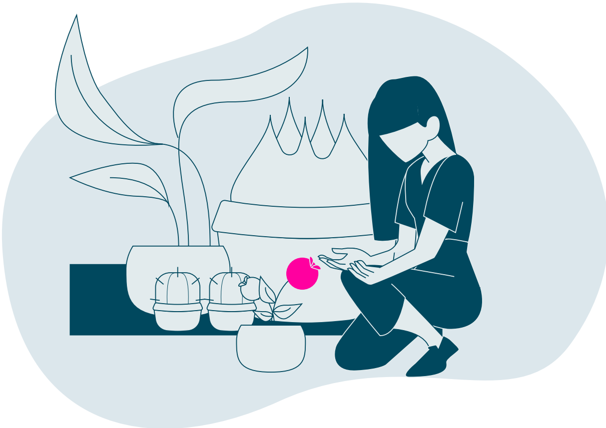
The other way of thinking about income needs is to consider what I need at different stages of retirement. The reality is that, as we get older, our spending needs change and we tend to spend less as we become less active. Of course, we may see a big increase in expenditure in later life if we need medical support or long-term care, but that won't apply for everybody.

That makes a lot of sense about having to make adjustments to these big changes. Actually my dad has taken up golf lessons in his retirement…

That's a great example, Ruth. So, under the first approach to thinking about income, your dad might want to think about whether those golf lessons are nice to have or essential expenditure. I think I know the answer, he'll almost certainly see them as essential expenditure.

Ha, probably!

Looking at it through the lens of different stages of retirement, he'll hopefully have many years of golfing ahead of him but there may come a time when perhaps he's not able to play golf quite as often and so may not need to spend quite as much on his hobby. Who knows, he could turn pro and never have to worry about money again!



Fingers crossed, dad! But I definitely don't see my dad wanting to give up his golf, but can you say a little bit more about how your retirement plans might change later in life?

Sure thing. As we've talked about already, spending needs may change as people get older with them usually spending less as they become less active. Retirement expenditure will likely be more focused on the essentials we talked about earlier, so people may look for a greater degree of certainty, perhaps looking to more secure forms of income such as annuities. (Annuities are where you give an insurance company a lump sum payment and, in return, you get a regular income for the rest of your life, however long that may be.)

Of course, people don't know how long they'll live or indeed if they'll need care in later life. While it makes sense to set some savings aside for later life, it is also worth thinking about other ways of funding this. So, for example, can your source the cost of that longer life or those care costs from other assets? For example, accessing the capital tied up in the family home is an option.

While most people would want to make sure they could fund these things if needed. You don't want to have to be having to scrimp and save all the way through retirement just because you might live longer than expected.

And what about for spending that isn't 'everyday'? What if you wanted your kitchen redone, a holiday or your car broke down?

It's probably helpful when thinking about your everyday income needs to factor in some of the known big expenses like doing ongoing work on the house or changing your car from time to time. But there will be expenses that are truly unexpected, and these can be handled using what we might call a rainy-day fund. This is another pot you can think of.

Quite how much you'll need in your rainy-day pot depends on your lifestyle and the extent to which you've factored unexpected expenses into your other income plans already. It might make sense to keep this money where its accessible at short notice and not exposed to investment market risk. Perhaps, some form of cash deposit would likely fit this need. Another potential option is to dip into your other retirement savings but that may affect other goals - especially if you have to sell investments when they're not performing well.

So, we've spoken about our active years, our later years and our rainy-day pots, but are there any other pots that we should perhaps consider in retirement?

Yes, so the fourth pot we might think about is called our legacy pot or what we want to pass on to others. This is usually money we want to leave to others when we die but there may be money we want to pass on to children or grandchildren to help them during our retirement. This is a complicated area not least because of the tax implications of passing on wealth. Also, people have very different ideas about how they want to invest this money. Some will take a view that it's not likely to be accessed until many years in the future and so they can pursue a potentially higher-risk, higher-reward approach. Other people will want to know the money will be there for their loved ones and so will likely prefer a more cautious investment approach.

So, with pensions, there's not really a 'one size fits all' but there is a rough ideology to follow?

There's certainly some key considerations to help those approaching retirement think about what they might need. Retirement is daunting for many and so thinking about retirement in those four pots with a financial adviser can be a good way to start your life beyond work.

Thank you, Richard.