

Is a pension a luxury?

Yes.....provided you don't want to retire!

For those of us who do wish to retire at some point, a pension is a necessity, not a luxury. Saving for retirement should rank close to housing costs, fuel bills, food and insurance – priority expenditure, not just an add-on.

The State Pension Age is increasing to 66 in 2026, 67 in 2036 and 68 in 2046. Research shows the majority of people in the UK not only want to retire, but want to retire early. However, what we say and what we do are very different. State benefits are likely to provide for a very basic existence covering essential everyday living costs. Most of us are saving nowhere near enough for a comfortable retirement, never mind early retirement, and huge numbers are not saving at all. What are they going to retire on?

If you are reading this article it's likely you have pension savings in a scheme administered by The Pensions Trust. You might think this is preaching to the converted. But a new trend – the 'contribution holiday' – seems to be emerging, so please read on.

Last year household budgets were stretched as mortgages, gas, electricity, petrol, diesel and the weekly food shopping all shot up in price. Some of these price rises have now started to reverse, but as the recession bites many people have lost their jobs and others have lost overtime or had their working hours – and pay – reduced. When money is tight, it may be tempting to

suspend pension contributions until finances improve. There have been reports about this in the media, and The Pensions Trust has had enquiries about 'contribution holidays'.

However, taking a break from pension contributions could turn out to be a very costly short-term fix.

The first thing to note is, unless you have less than two years of 'qualifying service' you cannot have your contributions refunded

– so, if it's a lump sum you need, the pension scheme isn't going to provide it.

Another point that many overlook is the effect of tax relief. Stopping your contributions doesn't mean your take-home pay goes up by the equivalent amount. And, if your pension scheme is 'contracted-out' of the State Second Pension, you will pay higher National Insurance contributions if you leave the scheme.



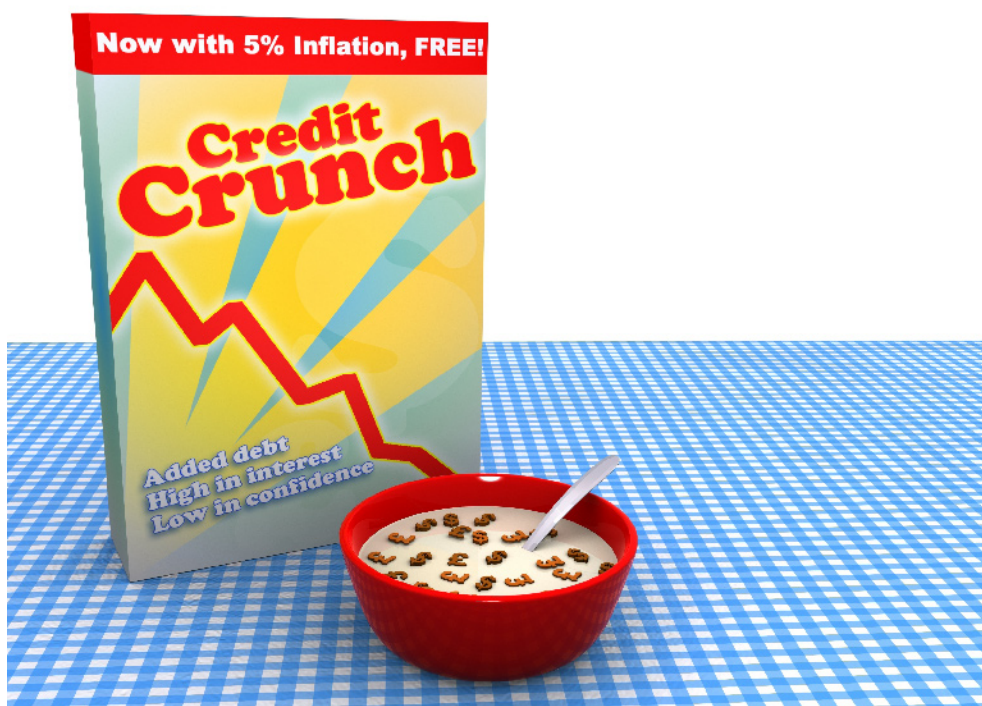
You also need to consider that, during a ‘contribution holiday’, you are giving up the money your employer pays into the scheme for you. You are turning down extra pay.

You may not be allowed to rejoin the scheme later – for example, the scheme may have closed to new members during your break, or you may have become ill and will fail the medical requirements for rejoining.

If these drawbacks aren’t enough to convince you that a ‘contribution holiday’ maybe isn’t the answer, then there’s more to think about.

Is your pension scheme a ‘defined contribution’ or ‘money purchase’ scheme? If it is, your pension is linked to the size of your fund at retirement. A break in contributions of just one year could reduce your fund by thousands of pounds. Less money will be paid in – but more importantly you will lose the investment returns on those contributions. The further away you are from retirement, the greater the impact on your pension fund – unless the shortfall (including the employer contribution) is made up very quickly after the break.

Recent poor investment returns aren’t necessarily a good reason to stop our pension contributions. What goes up comes down – and the reverse is true. Perversely, now may be a good time to invest. Unit prices are at their lowest levels in recent years, so each contribution will buy more units



than it would when prices are higher.

Members of ‘defined benefit’ schemes should also beware of the ‘quick fix’.

If you leave temporarily to save on contribution payments, you may find you can’t rejoin the scheme you left. Defined benefit schemes are becoming more expensive to run as people generally are living longer. Many employers have closed their schemes to new members in the last ten years, and others have made changes – for example, reducing the benefits for new members – to keep the scheme viable. The cost of the break could amount to hundreds/ thousands of pounds a year in retirement income.

Even if you can rejoin the scheme on the same terms as before, the break may still cost you dear.

You are unlikely to be allowed to link together the two periods of pensionable service, so the benefits from the first period of service will not be linked to your future salary rises.

If short-term financial difficulties are making life uncomfortable, try to imagine living like this for 10, 20, maybe 30 years or more in retirement.

Taking a break from pension contributions may seem to be an easy way to increase your income, but please consider this only as a very last resort. If a comfortable retirement, free from money worries, is important to you, then pension contributions are anything but a luxury.