

What is a pension?

The doom mongers keep repeating that an impoverished retirement lies ahead for us all unless we get saving now. But how many of us really understand what a pension is and what we need to do?

A pension is a long-term savings plan and its sole purpose is to provide a secure income in retirement. Essentially, a little money goes in each month throughout your working life - then by retirement, it should have built into a tidy sum. This sum is then commonly used to purchase an annuity, which will pay a regular fixed amount, usually each month and thereby supports you in your dotage.

To encourage you to start saving, the Government provides tax breaks on contributions. For example, basic rate tax payers take home £80 for every £100 earned. However, if that £80 is then placed in a pension, the Government refunds the other £20 to give £100 invested. Higher rate taxpayers get £100 invested for laying out only £60 of their take home pay.

There are two basic types of pension - a personal pension, started by an individual, and an occupational scheme, organised by an employer. The latter then breaks down further to 'defined contribution', where a set amount goes into the scheme and the payout depends on the growth of assets, and 'defined benefit' (now increasingly rare), where contributions vary but the amount the scheme pays out is agreed in advance.

Little and often

In the world of investment, timing is everything. But, despite claims to the contrary, no one can second-guess the market.

However, by saving regularly, investors can benefit from what is called 'pound cost averaging'. Regular savings mitigates the risk of buying all your investment at a single price. Instead, smaller sums are invested at a variety of prices. In a rising market, regular savings would underperform a lump sum as the later investments would miss out on the early growth. However, in a variable or falling market, later investments would buy in at lower or alternating prices and thereby offer more growth as the market returns to higher levels.

