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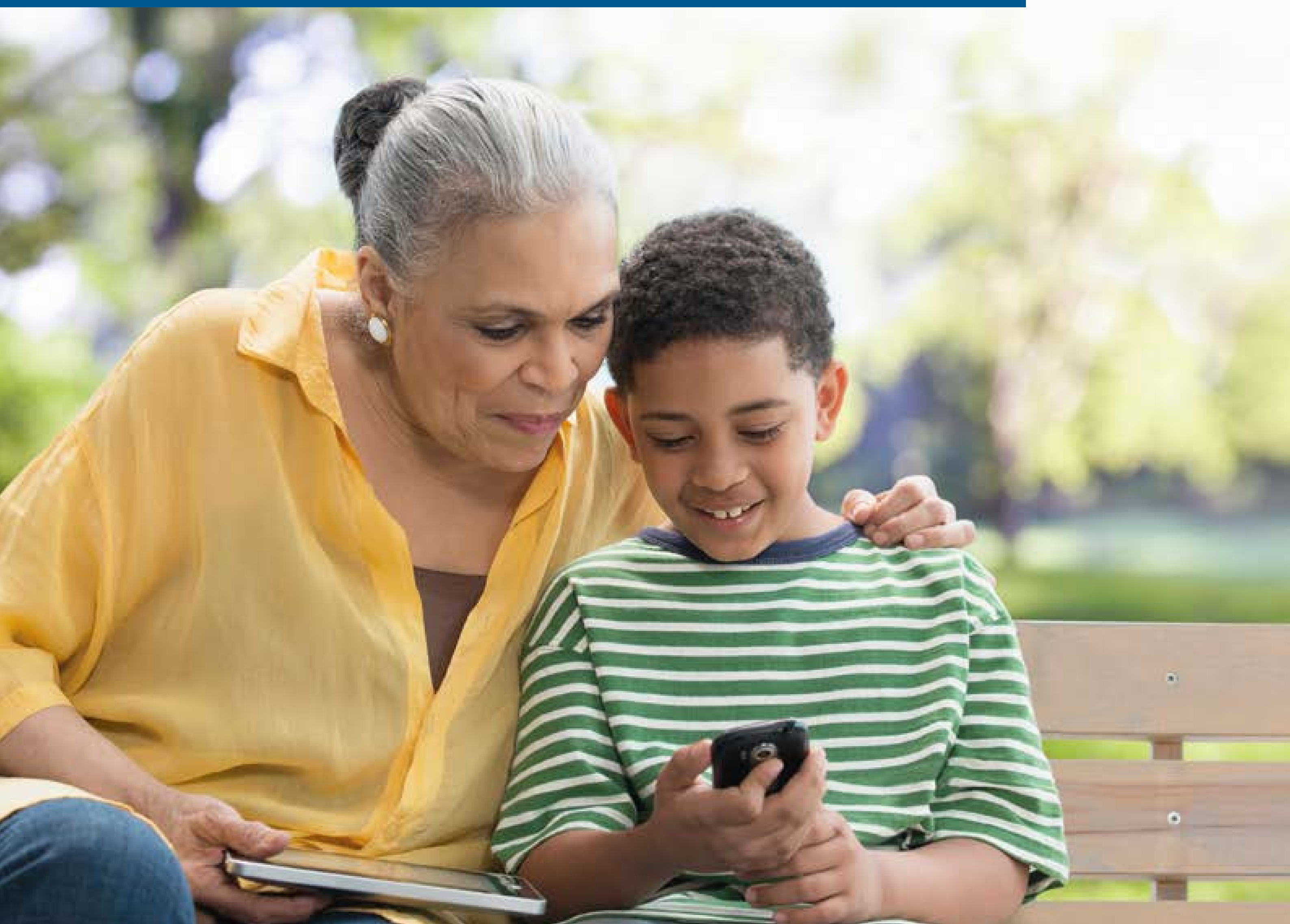
The changing face of retirement

Planning for retirement



Fidelity INTERNATIONAL

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Introduction

Retirement has undergone a revolution during the 21st Century. There is no longer a default retirement age and employees can request flexible working. Final salary pensions, where pension benefits are based on salary and service, have mostly given way to defined contribution schemes, where employer and employee contributions are invested to provide a retirement pot. What's more, average life expectancy has increased over this period (notwithstanding a fall post COVID)[1]. Finally, since the introduction of 'pension freedoms' in 2015, income drawdown has replaced the traditional option of a lifetime annuity as the product of choice for most people[2].

These changes have led to a more fluid, progressive concept of retirement. Increasingly, people no longer stop work abruptly one day and retire the next. The lack of a fixed retirement date and the right to request flexible working has catalysed a new approach to retirement. People now have much greater control over how and when they leave the workplace and they can access their retirement savings without retiring from age 55. This is due to rise to 57 on 6 April 2028.

Companies increasingly recognise the skills, experience and maturity that older employees can bring to the workplace. Research suggests that over three-quarters of employers feel it's important to retain over 50s employees, while four out of five employers 'have policies and practices in place to support and retain their older workers'. The research also revealed that 84% of employers consider it important to invest in training to help retain older workers for longer[3].

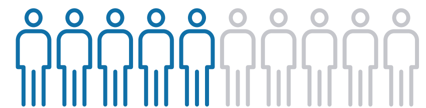
In 'The changing face of retirement' we consider the implications of this seminal change and what it means in practice for employers and their employees, as people transition gradually towards their life after work.

1. Source: Office for National Statistics, January 2024 – National life tables – life expectancy in the UK: 2020 to 2022.
2. Source: Financial Conduct Authority, September 2024 – Retirement income market data 2023/24.
3. Source: Aviva, September 2024, Working for the future.

These days retirement is a nebulous concept. It's not always obvious where work ends and retirement begins. Yet there is usually a signal. It may start with a reduction in working hours or a move to a less stressful role. It could be a switch from employment to self-employment (or even starting a new company). Nevertheless, there is generally some change in the pattern of work that denotes a new phase that will eventually lead to outright retirement.

Age UK estimates the number of self-employed people aged 65 and over has more than doubled in the five year period between 2017 and 2022[4]. Office for National Statistics data shows that from April to June 2022, the number of people aged 65 years and over in employment increased by a record 173,000 on the quarter to 1.468 million, which was also a record level. This increase was driven primarily by a rise in part-time work[5].

A 2019 poll of 2,400 people in the UK, found that while most workers planned to retire from their primary job at age 66, 52% expected they would continue to work at least part time in their retirement. The survey also found 45% expected to work past the age of 70, and nearly one in 10 (9%) planned to keep working into their 80s[6].



52% expect to continue working at least part time in their retirement

4. Source: Age UK, September 2022 – Be your own boss.
5. Source: Office for National Statistics, September 2022 – People aged 65 years and over in employment, UK: January to March 2022 to April to June 2022.
6. Source: People Management, Jessica Brown, November 2019.

How do people retire? Let me count the ways

This new flexible approach to retirement can take various forms:

- Working full time beyond State Pension age.
- Moving to part time work or a less well-paid role.
- Leaving full time employment to become self-employed.
- Setting up a company.
- Retiring outright, then returning to the workplace.

It could be argued that people starting a business or becoming self-employed haven't retired or even begun the transition to retirement. They may still be working long hours. But when someone chooses this route later in life, it's often a sign. A change made possible because they can access pension savings, if necessary, and often have fewer financial commitments. In other words, they can take control.

This degree of financial independence creates the opportunity to make the break and to do something they may have always wanted to do. In this sense, it signals the end of an era. An era where the burden of work to earn money and discharge responsibilities dominated. Instead, it heralds the beginning of a new journey characterised by self-fulfilment, a better work/life balance and greater control of one's destiny. Ultimately, this will usually lead to outright retirement at some point, so it is reasonable to define this as the beginning of a transition towards retirement.

Benefits of retiring in instalments

This transitional approach may be motivated by a need to boost savings, but could be symptomatic of other issues. It might be to maintain the social benefits that work brings and stave off loneliness. It may be a desire to stay active mentally or physically. Perhaps it's to continue to enjoy the status and self-esteem work often confers.

Whatever the physiological benefits, there are financial benefits too:

- More time to save.
- More time for savings to grow (though, of course, the value of investments can fall as well as rise).
- Option to defer the State Pension, if working beyond State Pension age.
- Better annuity rates or higher withdrawal rates from drawdown (because the pension pot doesn't have to last so long).

Mind the gap

Often the transition from full time employment leads to a reduction in earnings, which may trigger a need to supplement income. National Insurance contributions are not payable over State Pension age and some costs, commuting perhaps, could reduce, so the actual financial gap may be less than the difference in earnings.

Moving to part time work or a less well-paid role

If a gap does exist there are several ways to deal with this:

State Pension

Someone who has reached State Pension age could take their State Pension. However, it's not possible to take part of the State Pension, which means the extra income could push someone into a higher tax bracket. At best, it may provide more income than the client needs (though any excess could be used to fund further pension contributions under the right circumstances).

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Top up from private pensions

It could make sense to top up any shortfall from private pensions. If so, the following should be borne in mind:

- Leaving aside the tax-free cash element, generally up to 25% can be taken tax-free, income from private pensions is taxable, so this approach could push someone into a higher tax bracket.
- The Standard Annual Allowance, currently £60,000, governs the pension contributions that can be paid each year before tax is payable, and includes both employee and employer contributions. Taking income could trigger the Money Purchase Annual Allowance (MPAA). The MPAA increased from £4,000 to £10,000 in April 2023.
- Using the tax-free cash sum to top up income would not trigger the MPAA or lead to an increase in tax payable. Also, less income would need to be withdrawn because of the tax-free status.
- Income from a lifetime annuity or any defined benefit income would not trigger the MPAA, but would be taxable and can't be varied (though it may increase each year). Also, if the retirement journey begins at a young age, annuity rates might be less attractive and defined benefit pensions often apply an actuarial reduction.

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Other savings and investments

An alternative source of income to top up any shortfall could be other savings and investments, particularly those which are tax advantaged like ISAs or the tax deferred status of investment bonds. In the case of investment bonds, up to 5% income can be taken each year tax-free. There is no further tax due if someone is paying basic rate Income Tax when the bond matures or is cashed in (higher rate taxpayers may have a tax liability when the bond matures or is encashed).

Utilising the Capital Gains Tax allowance, dividend allowance and personal savings allowance may also create additional income tax-free, though these allowances have been squeezed lately. The CGT allowance is now £3,000 (2024/25), while the dividend allowance has been reduced to £500 (2024/25). More radical solutions to fund any shortfall could include downsizing or equity release, though these are unlikely to be the first port of call for most people.

Whenever a tax-free solution is used, the amount required will be less than if it's drawn from a taxable source. Making up any shortfall from sources other than pensions also preserves the favourable tax status on death of funds held in pensions before age 75.

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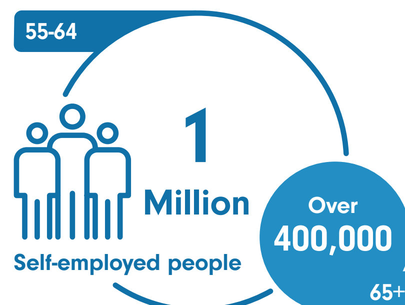
Working for yourself

Reducing working hours or taking on a less demanding role aren't the only options. In some cases, people see this transitional period as an opportunity to continue working, but to become their own boss. There are almost 1 million self-employed people between 55-64 and more than 400,000 people over 65 who are self-employed[7].

The key risk is a shortfall in income but, in contrast to employees who reduce their working hours or take less well-paid roles, income is likely to be variable. Supplementing any shortfall with a fixed or increasing income like an annuity, defined benefit pension or the State Pension may not be suitable.

Other people may choose to do their own thing by starting a limited company rather than becoming self-employed. This introduces additional considerations. In particular, the interplay between income and dividends. The right mix of income will depend on individual circumstances, but does add a further layer of complexity, particularly in respect of taxation regulations.



7. Source: Statista, 2024 – Number of self-employed workers in the UK 2019-2022 by age group.

The ‘unretired’

The word ‘unretired’ has recently entered the financial services lexicon. It’s used to describe people who’ve left the workplace to retire and subsequently return to work. They may have chosen to take a few years out, akin to an extended sabbatical or they may be disillusioned with retirement – doing nothing can seem desirable, but boredom can set in. For some people, the main reason is the obvious reason: the realisation that they don’t have enough money to enjoy a satisfying retirement. There are a number of issues to consider:

Auto-enrolment

Anyone returning to the workplace who is below the State Pension age and earning above £10,000 should automatically be enrolled into a workplace pension scheme. People over State Pension age won’t automatically be enrolled, but should be given the option of joining a workplace pension scheme.

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State Pension

Even if the State Pension is already being paid, it can be stopped if someone returns to the workplace. This will boost their State Pension when it is reinstated. This can only be done once and it is necessary to contact the Department for Work and Pensions. The date to stop payment cannot be a date in the past or more than four weeks into the future. Someone returning to work under State Pension age can choose to defer payment of their State Pension age when it becomes due.

Private pensions

Someone returning to the workplace may want to reduce or stop any income they receive from their private pensions. This should allow them to take a higher income when they eventually retire outright. Of course, they may not have this option. Benefits received from a defined benefit scheme can’t usually be stopped nor can the income from a lifetime annuity.

Helping your employees retire gradually

There are actions you can take to help your employees transition towards retirement and also support the organisation's manpower planning:

Understand the impact

Hold open discussions with employees to understand who may be approaching retirement in the next five years. There is no longer a default retirement age, but more people retire around or near to the State Retirement age than at any other age[8]. Understanding how many employees are likely to retire and which roles will be affected can help the company plan for the future.

Boost employee confidence with education programmes that support retirement planning and outline the options people have these days as they move towards their life after work

Encourage openness

Employees may be reluctant to open up about their future plans for fear of being overlooked for promotion or given reduced responsibility or less interesting work. Allay these fears and create an environment where employees aren't backward in coming forward with their retirement plans.

Assessing benefits

Evaluate the benefits package for employees approaching retirement. Do these benefits help the transition to retirement? If not, how could the organisation better equip employees who want to retire gradually? Does the company encourage or support employees who choose to reduce their working hours or responsibilities as they near retirement?

Educating employees

Boost employee confidence with education programmes that support retirement planning and outline the options people have these days as they move towards their life after work. At Fidelity, we offer a webinar programme which can support this education and enhance the financial wellbeing and confidence of your employees. Explain how the company can support them in achieving their objectives after they leave the workplace.

8. Source: Office for National Statistics, April 2024 – Milestones: journeying through modern life.

Summary

This trend towards a more flexible approach to retirement has significant implications for employers. Resource planning becomes much more difficult if companies can't accurately forecast when employees will leave the workplace. This becomes even more complicated if employees choose to retire over a period, gradually reducing their hours of work or the nature of their employment.

For a gradual transition to retirement, employees need to consider how they can organise their finances if there is a shortfall in income. Advice and/or guidance may be required on how best to supplement income from their pension savings or other savings and investments.

The abandonment of a default retirement age and the right to apply for flexible working create an environment that encourages a move away from the traditional approach to retirement. Employers should embrace this transformation and develop policies and practices that accommodate the changing face of retirement. This will benefit the company and will help to attract and retain talent in the workplace. What's more, supporting retirement planning can become a powerful tool within a benefits package. Manpower planning will be smoother, if the company create an environment where employees feel confident to discuss their future plans.

Overview of different types of flexible retirement

State Pension	Private pensions	Savings and investments	Other considerations
Continuing to work beyond State Pension age			
■ Consider deferring State Pension assuming income unchanged or use it to fund further savings or pension contributions. ■ No National Insurance contributions (NICs) payable so net income increases anyway.	■ Membership should be unaffected. ■ Defined Benefit (DB) pensions may not continue to grow past State Pension Age.		■ Automatic enrolment doesn't apply to workers aged 75 or over and tax relief is no longer available. ■ Sustainable withdrawal rate and annuity rates should both improve if continuing to work.
Moving to part time work or a less well-paid role			
■ If eligible, State Pension can make up any shortfall, but 100% must be taken which could be more than required. ■ No NICs payable if beyond State Pension Age.	■ Any shortfall could be covered by pension income, but this could trigger the Money Purchase Annual Allowance (MPAA). ■ Tax-free cash could be used to avoid MPAA. ■ A lifetime annuity or any defined benefit income would also mean MPAA not triggered.	■ Tax-free savings and investments like ISAs could be used to gap fill. ■ Tax-free status means less income needed. ■ Maximises pension savings and favourable treatment on death before 75.	■ Increase in MPAA to £10,000 may mean fewer people affected. Carry forward provisions can't be used to fund more than the MPAA. ■ Taking benefits from a DB scheme before the selected retirement date will often result in an actuarial reduction being applied.
Becoming self-employed			
■ Income from self employment can be variable. If top up required State Pension may be too much or too little. ■ Class 2 NICs have been abolished for self employed individuals with profits over the small profit threshold. ■ Voluntary class 2 NICs can still be paid where profits are less than the small profits threshold up to State Pension Age.	■ Pensions savings could be used, but same considerations as per people working part time or in a lower paid role apply. ■ A lifetime annuity or DB income might not be ideal as income cannot be varied and an actuarial reduction may apply if DB benefits taken early.	■ Same considerations as per people working part time or in a lower paid role.	
Starting a company			
■ If State Pension Age reached, the State Pension can be set against the personal allowance or stopped if in payment. ■ If the State Pension isn't payable yet, it can be deferred when State Pension Age is reached. ■ No NICs payable after State Pension Age.	■ Treatment of dividend income requires careful tax planning. It may make sense to take income over personal allowance as dividend income if possible. ■ Tax-free cash could be used to top up any shortfall in income and would not trigger MPAA.	■ Tax-free savings and investments could be used to gap fill without reducing the advantageous treatment of dividend income. ■ Tax-free status means less income needed. ■ Maximises pension savings and favourable treatment on death before 75.	■ There is a dividend allowance of £500 (2024/25). Dividend payments in excess of this are treated as the top slice of income and taxed at 8.75% for basic rate taxpayers, 33.75% for people paying higher rate tax payer or 39.35% for anyone paying the additional rate tax payer.
Returning to work after retirement			
■ The State Pension can be stopped if someone returns to the workplace. This can only be done once. ■ Someone returning to the workplace under State Pension Age can defer payment of their State Pension when it is due.	■ Income received from private pensions can be reduced or stopped (this is not possible for income from DB scheme or lifetime annuity). ■ Anyone below State Pension Age earning above £10k should automatically be enrolled into a workplace pension. People over State Pension Age should be given the option of joining a workplace pension to age 74.	■ Tax-free savings and investments could be used, if required, to make up any shortfall in income if this is more advantageous.	■ If benefits have or are being taken the MPAA will apply, unless these are exempt. For example, tax-free lump sum, lifetime annuity, benefits from a defined benefit scheme.

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