Penguin Bitesize Guides to Better Money Management

Guide #2

Seven Common Mistakes People Make with their Pensions or ISAs

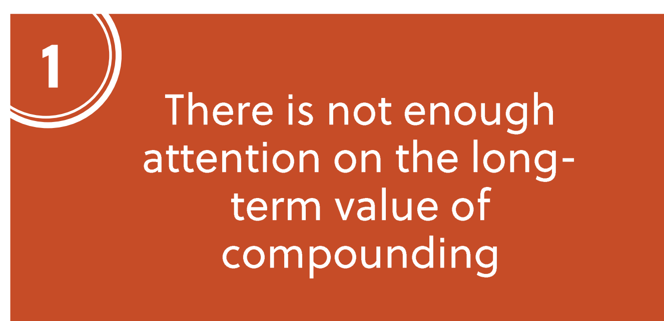
Pensions and Individual Savings Accounts (ISAs) are the most widely used Investment and Savings vehicles in the UK.

They will help you to build wealth and to meet your financial goals.

How well they do this will in large part be dependent on how they are managed over time.

Mistakes in this management process can derail the best laid plans or create shortfalls against the goals set.

In this guide we outline some of the common mistakes you should aim to avoid.



This simple concept, when explained well, always galvanises people to act.

Basically, find any savings calculator available to you, put in £100 per month and assume a 3.5% annual return, then look at the resulting sum after 10 years.

Then, do the same, except change the annual return to 7.0%. Now look at the resulting sum after 10 years.

Repeat the same exercise over 20 years.

Here's what you will find:

£100 per month/3.5% per year return/10 years	£14,343.25
£100 per month/7.0% per year return/10 years	£17,308.48

£100 per month/3.5% per year return/20 years	£34,686.93
£100 per month/7.0% per year return/20 years	£52,092.67

That higher return produces a bigger sum.

Relating this to pensions and ISAs, which are normally used as long-term vehicles for **generating a return**, too many people tend to ignore how well they are performing.

There is not enough attention paid to the strategy of how they are managed. Few people can say, when asked, how well their Pension/ISA is performing or how this compares to other options.

Extra growth, if it can be found, always adds up to more money in the pot, which is for your future.

Put simply, not making the effort to manage the money within a Pension or ISA to ***strive for*** better performance, is depriving no-one else other than your future self!

Managing the money within a pension or ISA to find the best returns, given your circumstances, goals and risk profile is highly important and not paying enough attention to this is a common mistake.

Penguin's advice:

Review all your existing pensions and ISAs and ensure you are invested in funds that can optimise the growth for your given level of risk.

2 The risk/reward relationship is not properly evaluated

Striving to get the best return is a case of developing a strategy, backed by a process.

This should include targeting the best possible rewards for the risks that you can take.

A common mistake would be to dampen the rewards - for example by using a cash ISA paying very little interest, when greater risk could be taken.

Or to not appreciate the long-term nature of a Pension Plan where higher risks can be contemplated on the invested money, due to the duration of the investing period.

In the other direction, some people may invest with too much risk taken unnecessarily, when their situations favour preserving or protecting what they have. For example, in retirement some people may have enough wealth accumulated to pay for the rest of their lifetime expenses, but still take risks on their invested money.

Penguin's advice:

Undertake a comprehensive risk profiling or objective based assessment if you haven't done so before.

3 Too much money is paid in tax or charges

With pensions and ISAs there will be charges and costs – which will drag down any return the investments make.

It is accurate to say that any money paid in costs is money that is not available for your future, as it will lower the returns.

Some old pensions, for example, have very high charges and these reduce significantly the amounts being built up.

Likewise, tax plays the same role, any money paid in tax from the returns generated reduces what is available to you. Whilst Pensions and ISAs are generally tax-efficient, there can still be tax payable (for example if you exceed the Lifetime Allowance with your Pensions, or your ISAs become subject to Inheritance Tax).

Penguin's advice:

Get any existing plans and funds you have evaluated to ensure you are not paying or incurring unnecessary charges or costs.

4

Tax Relief is not maximised

The tax treatment of Pensions and ISAs is very favourable, however some of the tax benefits need to be maximised and if they are not, this is an error.

A classic example of this is not claiming the full amount of tax relief available against a pension contribution.

Tax Relief	Pension Contribution
20%	25%
40%	66%

Higher rate tax relief needs to be claimed separately and sometimes this can be missed or neglected.

Likewise, there are generous yearly allowances of what can be contributed to these tax-efficient areas, but these are not always available to be 'made up' if previous years are missed.

Penguin's advice:

Get help in checking you are not missing any valuable tax reliefs you are entitled to.

5

Pension Savers use "Default Funds"

In many pension schemes, especially workplace schemes, an option is offered to savers called the Default Fund. This is an easy tick box which allows savers to simply allow the pension company to look after and invest the money in the best way they consider works.

These funds often have a track record of producing lower returns than comparable options and are most definitely not chosen because they are suitable for the saver's risk profile.

The Default Fund option is well-named because it is the fund of choice when there has been no discernible thought given to which funds are most suitable for that saver.

Penguin's advice:

If you are using a Default Fund, then consider what other options are available to you and how you should be pursuing a more structured approach.

6 Regular reviews are not made

The long-term nature of investing and saving suggests most ISAs and Pensions will be held for many years, and in most cases – decades.

Over time things change. The economic backdrop, investment markets and expectations, interest rates, tax levels and rules, inflation and even your own situation are likely to change.

The amounts you contribute, the funds that you use, the strategy you pursue should be fluid. Sticking with your investment strategy, your contribution amounts and, even, your plan providers may not always make sense.

Whether changes are required or desirable will be determined by making regular reviews.

So often, problems arise because what someone put in place in the past becomes out of kilter or doesn't work in the present.

Failing to regularly review one's plans and approach is a mistake.

Penguin's advice:

Make sure you undertake structured reviews and rebalance your portfolios on a regular basis.

7

The Lifetime Allowance (LTA) is ignored

Pensions rules and regulations need to be carefully considered.

With respect to the LTA, which is a cap on the amount that can be accumulated within pensions. The LTA is the collective total that an individual can hold in pensions before a tax charge is applied to the excess amount.

It is easy to breach this figure, which is currently frozen (until 2026) as at tax year 2022/2023 at an amount of £1,073,000.

This may look a large figure by historic standards. However, as time progresses and the cost of retirement increases, this sort of total figure is within many people's targeted sums to meet their retirement income goal.

In addition, where there are pensions that are based on a 'final salary' arrangement, the value of the pension must be calculated based on a formula which multiplies up the annual pension and this multiplier effect can be significant.

If the LTA is exceeded, the tax charge is 25% of any income or 55% of any lump sum on the excess sums. The LTA applies to all pensions combined, not per pension plan or fund.

Ignoring how one's savings into pensions could be impacted by the LTA could prove very expensive later down the line.

Penguin's advice:

Get help and advice on how the LTA affects your plans.

About Penguin Wealth

We are a Cardiff-based Financial Planning firm formed in 2010 by a group of Financial Planners who share the same vision and love for what we do. Our processes, support team and the accreditation we have achieved all reflect our principles and prove that we are best placed to help you live the life you deserve with peace of mind.

Our Mission Statement

Helping People Live their Best Lives, by Making Smarter Financial Decisions.

Core Values

- At Penguin we Commit to our Words, Actions and Results
- Clients' Needs 1st – Always
- Communication is key
- Have Penguin Positivity

Providing the highest standard of advice is at the heart of what we do, and we are always extremely excited to see what we can help you to achieve in the future!

Contact Us

Penguin House, 2 Raleigh Walk, Brigantine Place, Cardiff CF10 4LN

T: 02920 450143
E: info@penguinwealth.com
W: penguinwealth.com