Media Q&A

Consumer Question:

I'm 49, single and generally a pretty good saver. I've €40,000 on deposit, which would see me right for 6 months plus if I was to lose my job. I also save into a pension but a friend of mine suggested that I stop saving into my deposit account altogether and just save into my pension. I have €150,000 in my pension already so I'm reluctant – what are your thoughts?

Answer from Mark Reilly, Pension Propositions Lead, Royal London

In answering your question I'm going to make a few assumptions; that you earn little or nothing on your deposit account; that you earn an average of 5% after charges on your pension fund; that you pay tax at the higher rate of 40%; that your total pension savings won't exceed Revenue limits; and that the tax rules surrounding pensions won't change in the near future.

Those that are better off may typically have more in their pension fund than on deposit when they get to retirement.

When we are saving personal funds into a deposit account we do so using 'after tax' income, as in we have paid income tax, Universal Social Charge (USC) and Pay Related Social Insurance (PRSI) on the money we save, and hence, in this scenario nearly half of what the funds were when they were Gross Income. The money you save into a pension fund effectively comes out of your 'before tax' income, subject to certain limits.

Currently, the money on deposit is not likely to grow as it's probably not attracting any interest, although, it is safe and is readily accessible. The money in a pension fund is usually invested in a mixture of shares, bonds and cash, and past experience indicates that it should grow at a reasonable rate when invested in this way. It is important to note that your pension savings growth is not guaranteed – it could fail to grow or could even reduce in value. In addition, you cannot access the pension fund in the same way that you could access the deposit account. You need to retire it before accessing any of the funds in it.

So, let's take a simple example. You decide to save €100 out of your gross income. If you put it into a pension fund and it grows at 5% per annum for 18 years until you are 67, it should be worth about €240. If you want to put the same money into you deposit account, you first have to pay tax, PRSI and USC on it, leaving you with €48. If you get no interest, it will still be worth €48 in 18 years' time. And don't forget that inflation may have reduced the real value of your money on deposit.

After 18 years you are free to spend the €48 on deposit as you wish, while drawing down the €240 in your pension fund is a little more complex. One quarter of it (€60) can be withdrawn as tax free cash and the balance can either be left to support an ongoing income (subject to income tax) or fully withdrawn, subject to 20% tax and some upper limits. So, you end up with €60 plus (€180 less 20% tax = €144) giving you a total of €204, which seems far

better than the €48 you will get from the deposit account. The amount of tax you pay will depend on your own personal circumstances and the value of your pension fund when you retire.

So, which should you go for? The answer is probably both. Most advisors suggest that you retain a rainy-day fund of about 6-months net income in a deposit account and put the rest into a pension. As you already have that much on deposit, you should probably save everything else into a pension fund going forward.

We recommend you talk through your options with your Financial Broker before you make any decision.

ENDS

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