Shackleton

Britain's financial adviser

A GUIDE TO TAKING INCOME IN RETIREMENT

Introduction

This document is designed to help people with pensions consisting of invested funds. These are often called 'Money Purchase', or 'Defined Contribution' pensions and this category includes Group Personal Pensions.

You may have access to other types of pension such as 'Defined Benefit' or 'Final Salary' schemes and these are covered in outline towards the end of this Guide.

When you get to retirement, there are two main ways that you can draw income – via an **Annuity** or by **Flexi Access Drawdown.**

Annuities

Using an Annuity is the traditional method of taking income in retirement. Put simply, an Annuity is a guaranteed income, usually for life, although fixed term annuities also exist.

When you take an Annuity, you can normally take up to 25% of your pension fund as a Tax-Free lump sum (also known as a PCLS or Pension Commencement Lump Sum). The remainder of your fund buys an Annuity.

The rate of annual Annuity income that you receive from your pot value will depend upon your age and the options that you choose to include. The most common are:

- A pension for your spouse/partner if they live longer than you. This is often set at 50% of your own Annuity but could be more or less than this.
- A 'guaranteed period' – this ensures that the annuity will continue to be paid for a specified time even if you die during that period.
- Escalation – you can set a rate of annual increase to your Annuity income to help offset the effects of inflation

Depending upon your circumstances, Annuities may have advantages and disadvantages:

Advantages
- Guaranteed for life, no matter how long you live

Disadvantages
- Dies with you (or your spouse), subject to any guarantee period, so may offer perceived poor value if you die early.
- Inflexible – once set, you can't change the level of income or change your mind about how you take retirement benefits

Other types of Annuity

Fixed Term
This is very much what it sounds like – an Annuity that pays an income for a set number of years and then provides a sum at the end of the term. At this point you could buy another Annuity or go into Drawdown.

Enhanced or Impaired Annuity
If your health or lifestyle circumstances are such that you have a reduced life expectancy, you may apply for an individually assessed, higher than normal, level of annuity to reflect your lower life expectancy.

Investment linked Annuity
Works in a similar way to a conventional annuity, but the pension you receive will fluctuate depending on how the underlying investments perform.

Buying your Annuity
Different Annuity providers will offer different rates of Annuity for a given size of pension pot. As the choice of provider will have a direct effect on your level of income for the rest of your life, we recommend either shopping around thoroughly or employing an Independent Financial Adviser to help ensure that you're making the right choices.

Flexible Access Drawdown

In principle, this is very straightforward: you treat your pension pot very much like 'normal' money and make withdrawals as and when you need income, leaving the remainder to stay invested and grow to provide more income in the future.

In practice, this might be a little more complex than it appears on the surface. For instance, how do you know how much money you can safely take each year? You might need to consider:

- Your expected investment return and the risk you want to take with your investments
- How much you need to increase your income in the future to combat inflation
- Whether or not you want to exhaust some or all of the fund before you die

These can be fairly tricky calculations, especially when you consider that the most important factor in these is completely unknown to you – you don't know how long you're going to live!

It's worth mentioning at this point that a lot of people underestimate their own life expectancy – according to ONS, a 65 year old female in the UK has an average life expectancy of 89 and a 1 in 4 chance of reaching 96 ONS life expectancy calculator

Advantages

- Flexibility – you can vary the level of income that you take
- Not a 'one way street' – you can start taking benefits via Drawdown and then buy an Annuity later
- Doesn't die with you – any unspent fund after you die can be left to anyone that you want. Usually paid tax free if you die before age 75.

Disadvantages

- No guarantee as to how much income you can safely withdraw as your pot value will depend upon future investment performance which may even be negative
- Potentially your pot could run out

With Drawdown 25% of your money is still tax Free. However, unlike when you take an Annuity, you don't have to take this all upfront. You can just take some of it, leaving the rest to be invested and hopefully grow to provide more tax-free money in the future.

Alternative methods – UFPLS, 'Small Pots' etc

There are some other ways that you may flexibly access pension benefits:

UFPLS (Uncrystallised Funds Pension Lump Sum)

This option means that you leave the bulk of your pension money invested and take a series of lump sums from it. Each lump sum is comprised of 25% tax free money with the rest taxable

'Small Pots'

If you have pots valued at less than £10,000 then they may be taken as a whole lump sum. This option is restricted to a maximum of three pots each up to £10,000 per person. As with UFPLS, 25% is tax free with the remaining 75% taxable as earned income.

Cash In Whole Pot

You may cash in your whole pot and take it all as a lump sum. Again, 25% is tax free and 75% is taxable. There may be a number of risks associated with this – for instance, the size of the taxable part could land you with a large tax bill and withdrawing all your money could mean that you have much less to live on in the future.

Taxation

As we've stated above, all methods of taking Defined Contribution pension benefits normally allow you to take 25% as tax free money*****. The remainder is taxed just like normal earned income.

This means that it's added to any other taxable income that you might have at the time (such as the State Pension) and then the total income you have for the Tax Year determines how much tax you pay and at what rate. Just like when you were employed, you have a tax-free Personal Allowance, then income above this is taxed at the Basic Rate, with some potentially being taxed at Higher Rates if your total income is high enough.

*There may be some exceptions to this with some older pensions. Before making decisions, you should make sure that you fully understand the options available.

Defined Benefit Pensions

This type of pension includes 'Final Salary' schemes. Typically, Defined Benefit pensions give you a guaranteed income for life that is determined by how long you worked for the employer that sponsored the scheme and what your salary level was.

As this Guide is designed for those taking income from Defined Contribution pensions, we won't go into much detail here but as a general rule, you may have the following options:

- Guaranteed income for your own lifetime
- Guaranteed Income for your spouse/partner's lifetime if they outlive you
- Some form of annual increase to offset the effect of inflation
- A tax-free lump sum. This may be variable and usually means you giving up part of your pension in exchange for the lump sum.

Other Frequently Asked Questions

Annual Allowance

This is the amount that individuals may contribute to a pension that will qualify for tax relief. You may carry on contributing to a pension after you have taken pension benefits but exercising some of the flexible options listed above will significantly reduce your Annual Allowance to £10,000 per year – this is called the Money Purchase Annual Allowance.

If you intend on making pension contributions after you have accessed pension benefits it is therefore imperative that you make sure that you fully understand the implications.

What age can I take my pension?

Under the current rules, most pensions can be accessed from age 55 onwards. This is due to change to age 57 in 2028 when the State Pension Age increases to 67.

Defined Benefit schemes will tend to have a 'Normal Retirement Date' set as part of the scheme rules although most will have options for early retirement with a reduced pension or later retirement with an enhanced pension.

Further Information:

Government sponsored MoneyHelper service: https://www.moneyhelper.org.uk/en/pensions-and-retirement/taking-your-pension/your-options-for-using-your-defined-contribution-pension-pot?source=mas#

Worth taking advice?

Clearly, there are a lot of considerations, and a number of risks. Through your employee benefits package you have free access to expert consultants from Shackleton who can help you better understand your situation and options so please feel free to get in touch with any questions.

However - this is likely to be the point in your life when 'hands-on' professional financial advice would be the most useful. This, of course, comes at a cost but an Independent Financial Adviser can:

- Identify the most appropriate pension and investment providers from the market for you
- Recommend an investment strategy that is tailored to your own attitude to risk, circumstances and objectives
- Manage your money on an ongoing basis, monitoring your investments regularly as world events change the economic outlook
- Help you manage your money in the most tax efficient way
- Help ensure that as much of your money as possible passes to your loved ones when you die
- Keep you in touch with what's going on with your money and help you understand how to keep your income in retirement secure

Your Shackleton Employee Benefits consultant can help you understand whether paying for specialist advice is likely to be right for you.

If you'd like to find out more, please contact Shackleton Employee Benefits on

0208 125 4300 **eb@Shackletonadvisers.co.uk**

Important notes:

This document is designed as an overview of the main ways of taking retirement income from a pension and, as such, only deals in generalisations and does not look in detail at all of the options that may be available to an individual. This is not intended to provide advice.

Levels and bases of taxation will depend upon individual circumstances and are subject to change. Shackleton recommends that individuals take specific guidance before taking any action.

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