

Retirement Options Fact Sheet

An outline of your choices

There are a variety of means of taking benefits from your pension arrangement. The correct choice for you will depend upon your willingness to accept risk and your personal circumstances. You should consider all options before selecting the most appropriate route. This fact sheet has been prepared to provide an outline of the available options and it describes how each option works in practice, the advantages and disadvantages and risks associated with each method.

Please bear in mind that factors such as the benefits from an Occupational Scheme (OPS), including Small Self Administered Schemes (SSAS), or availability of other funds should also be considered in making your decision. Your adviser will consider these when discussing and arriving at a recommended course of action for you.

Please note: - A transfer from an occupational scheme may restrict the amount of tax free cash available.

- The information concerning the taxation treatment of the contracts or action described in this fact sheet is based on our understanding of current HMRC law and practice. Taxation law is subject to change.

- This fact sheet is intended for information purposes only and should not be considered to be advice. Should you require advice with regard to your retirement options, please do contact us on 01733 425818.

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1. Taking Benefits

Pension benefits can be taken from age 50; this minimum age will rise to 55 in 2010. Benefits can be deferred until age 75, income does not have to be taken after this date but it is the last opportunity to take benefits as tax-free cash. It is possible to take 25% of your pension fund (up to the lifetime allowance) in the form of a tax free lump sum. If you had benefits that accrued prior to 6th April 2006 in occupational pension schemes it is possible that you are entitled to an amount in excess of this and your Financial Adviser will be able to establish this for you.

When benefits are taken, the accrued pension funds are tested against the Lifetime Allowance. This has been set as £1.75 million in 2009/10. If your total pension fund is in excess of this amount a tax charge will be levied on the excess.

There are various ways of taking pension benefits and it is generally possible to find a method that can be tailored to your individual requirements. At age 75 it is no longer mandatory to purchase an annuity, however, funds must move into some form of retirement product at this time. Details of some of the options available are detailed below.

2. Annuity Purchase

How does it work?

Buying an annuity means using your pension fund to buy a guaranteed income (an “annuity”) for a specified period of time (usually for life following retirement). A proportion of your fund can normally be taken as a tax-free lump sum with the balance purchasing an annuity. The maximum amount of tax-free cash is 25% of the fund value unless protection is in place from a previous scheme

The amount of pension income you can expect to receive depends on several factors prevailing at the time of annuity purchase:

- ◆ **Age:** generally, the older you are (and your spouse if a widow or widower’s pension is required) the higher the level of income you may expect to receive.
- ◆ **Health:** if either you or your spouse does not enjoy good health there are providers that can offer enhanced levels of annuity.
- ◆ **Annuity rate:** The level of annuity (the “rate”) offered at purchase date is influenced by current and future expectations for interest rates, as determined by the provider. The rate determines the total amount of pension that can be purchased. The higher the rate, the larger the pension that can be secured from your pension fund. In recent years annuity rates have fallen and this has resulted in a general reduction of the level of annuity secured for a given sum. Increased life expectancy also affects annuity rates as product providers now expect to pay annuities for longer.
- ◆ **Value of your pension fund:** The greater your fund the more guaranteed income you will be able to secure. Naturally, where you elect to take part of the fund as a tax-free lump sum this will reduce the level of income attainable.
- ◆ **Extra features:** Benefits may be added where they are of particular interest to you. However, their inclusion will reduce the level of annuity. For example, a pension with a level income will provide a higher income initially than one set up to increase every year. Any features must be selected at outset, as it is not permitted to add these on at a later stage. The most common benefits available are:
 - Spouse’s pension so that income continues to be paid to your spouse in the event of your death.
 - Annual percentage increase to the level of pension income, providing a degree of “inflation proofing”.
 - Guarantee to pay the annuity for a minimum period (e.g. 5 or 10 years).
 - Annuity Protection
- ◆ **Choice of Provider:** When considering annuity purchase, it is important to remember that you do not always need to purchase the annuity from the company used to build up the fund. This company may not offer the best annuity rates, as the level of pension will vary from one provider to another. In recognition of this the majority of providers allow transfer to an alternative annuity provider at little or no cost. This is known as the “open market option”. It therefore makes sense to shop around for the best possible pension.
- ◆ **Timing of purchase:** The annuity rates prevailing at the date of purchase determine the amount of annuity you will receive and the use of the open market option may secure a better annuity. .

What happens when you die?

If you selected only a single life annuity at outset the payments will cease upon your death. However, where you have selected other benefits, for example a spouse’s pension, further payments may be continued, according to the terms and conditions agreed. Annuity Protection will purchase the facility to take the remaining fund (initial purchase price less income taken) as a lump sum less a 35% tax charge. This facility is only available up to age 75. These options are fixed from the outset, and cannot normally be altered to adapt to changes in your personal circumstances.

Taxation issues

- ◆ The income from an annuity is subject to income tax.
- ◆ When tax-free cash is taken at outset and not utilised, it may be included in the value of your estate and therefore increase any potential inheritance tax charge.

Alternative types of annuity

There are different types of annuity available, which are described in more detail below:

a) Conventional Annuities

This is the “traditional” method of converting a pension fund into an income for life. A basic conventional annuity is one that pays out an income for the life of the annuitant (the person purchasing the annuity) and ceases on death, unless any optional features have been incorporated, as described above. By buying a conventional annuity you will be guaranteed an income for life, irrespective of any subsequent movement in the investment markets.

When looking at conventional annuities there are two further areas that must be considered:

- 1) **Enhanced annuity rates.** It is sometimes possible to obtain higher annuity rates than are generally available where the annuitant’s medical history, former occupation or lifestyle are deemed by some insurers to reduce life expectancy. It is therefore important that any reason that may qualify you for an enhanced rate is established.
- 2) **Guaranteed annuity rates.** In the past some pension contracts provided for a guaranteed level of pension income at retirement. Recent economic conditions have meant that in many cases the level of guaranteed income is higher than could be obtained by purchase of an annuity in the open market and hence these can represent particularly good value. These guarantees tended to apply to policies set up before 1988, known as “Retirement Annuity Contracts”.

Advantages (conventional annuities)

- ◆ You are able to take the full tax-free cash sum entitlement at outset.
- ◆ Income is paid at least for life, and longer if relevant features were selected at outset.
- ◆ The benefits selected are guaranteed and income is not affected by future falls in interest and or annuity rates.

Disadvantages (conventional annuities)

- ◆ You lose ownership of the fund in exchange for the purchase of the annuity. Because of this, in the event of early death, you may not get value for money – although this may be offset by the provision of a spouse’s pension, or annuity protection.
- ◆ Annuities are inflexible to the extent that once purchased, they can’t be altered to reflect changes in personal circumstances.
- ◆ Where a level annuity has been selected, inflation may erode its value.

For whom might conventional annuities be suitable?

Such contracts may be suitable for those who have a need or desire for a predictable, guaranteed annual income level.

b) Investment Linked Annuities

Investment linked annuities work on similar principles to those of conventional annuities. The difference is that the level of income is determined, at least in part, by the performance of the underlying funds, rather than by guarantee at outset. Consequently the level of income will depend upon investment returns.

A with profits annuity provides you with a regular income for life. Income is derived from two elements:

- (a) a guaranteed minimum income;
- (b) any annual bonuses paid which, once added cannot be taken away.

Usually you will be asked at outset to select an “anticipated” or “assumed” future bonus rate, for example between 0%-5%. This will in turn determine the actual level of income initially paid. Bonuses actually paid reflect the investment performance of the assets within the with profits fund and, as such, cannot be guaranteed. Thus, if bonuses actually paid fall short of the “assumed” rate, your income could fall. An element of security is added however due to the way with profits funds “smooth” returns to reflect the ups and downs of investment markets.

Advantages (investment linked annuities)

- ◆ You are able to take the full tax-free cash sum entitlement at outset.
- ◆ Income is paid at least for life, and longer if relevant features were selected at outset.
- ◆ They offer the potential to improve retirement income through future investment growth.
- ◆ The guarantees implicit in most with profit annuities afford a degree of security as to minimum income level.
- ◆ Investment linked annuities can offer flexibility to alter income in line with circumstances, for example by changing the assumed future growth rate, converting to a conventional annuity or, in the case of a unit linked annuity, switching between a range of investment funds. Note: It is important to check the individual product provider’s contract, as not all will offer these features.

Disadvantages (investment linked annuities)

- ◆ You lose ownership of the fund in exchange for the purchase of the annuity. Because of this, in the event of early death, you may not get value for money – although this may be offset by the provision of a spouse’s pension and annuity protection.
- ◆ Other than any contractual guaranteed minimum income, there is no guarantee as to future income levels generated.
- ◆ The “assumed” future bonus rate will affect the level of income payable, both at outset and in the future and, if the assumed bonus rate is set too high, future income may fall.
- ◆ The cost of guarantees implicit to with profit annuities may limit potential returns.
- ◆ Charges for investment linked annuities are generally higher than a conventional annuity as they are more complex to administer.

For whom might investment linked annuities be suitable?

- For those whose other retirement income is already secure, perhaps from a final salary pension scheme, or who have other assets.
- For those who can afford to take a degree of risk with their retirement income and are attracted by the possibility of improving future income via continued exposure to stock markets.

3. Phased Retirement

How does it work?

Phased retirement allows you the flexibility to take benefits from personal pension funds in stages, leaving the balance of funds invested. There may be a number of reasons for doing so. For example, you may wish to ease into retirement and work shorter hours. This option would allow you to take a low level of income initially, and increase it later as you spend less time at work. It may be possible, depending on how your plan is set up, to continue to make contributions, subject to Inland Revenue limits.

Your pension fund is split into a number of equal segments (typically 1,000) and this allows you to use just some of the segments to buy your pension, leaving the remainder invested until required. However, please note that HM Revenue & Customs rules now permit partial encashment of a single policy as long as the scheme rules allow for this. The segments can be encashed for annuity purchase over a number of years until age 75, at which time a final annuity must be purchased.

You determine how much of your income is required for the first year and the pension company calculates what proportion of the fund is required to provide this level of income (i.e. how many segments need to be encashed). When you take income by encashing segments, you have the option to take up to 25 % of the value as tax-free cash and the balance is used to buy an annuity.

In subsequent years, you will continue to receive income from the annuity or annuities purchased. If additional income is required further segments from the pension fund can be encashed, again using up to 25% of the value as tax-free cash. This process may continue to the age of 75, by which time all contracts must be crystallized either by way of full annuity purchase or alternatively secured pension.

Investment Strategy

The segments not encashed remain invested in your pension fund(s). Future investment returns will therefore be critical to the value of further pensions purchased. The most beneficial way to plan for an investment of this type is to establish the time-scales over which income is required - separate pension dates can then be set for various parts of the arrangement. The investment strategy can then be set according to these dates.

What happens if you die prior to age 75?

The benefits available to your nominated survivor will depend on how much of your pension fund remains invested. The treatment of the annuity element is described earlier, in the annuity section. However, in respect of the remaining invested fund it can either be paid as a lump sum, used to purchase an annuity or used for income withdrawals (see later). The options post 75 depends on the type of benefits selected. Full details can be found below.

Advantages

- ◆ As part of the fund can be taken as tax-free cash, only the annuity derived from the remaining fund is subject to income tax.
- ◆ Segments remaining invested continue to benefit from the tax efficient environment of your pension fund.
- ◆ On death, any benefit payable as a lump sum is normally paid free of both income and inheritance taxes. Please see comments under Unsecured Income for full details.
- ◆ In respect of each annuity purchased, income is paid at least for life and longer, if relevant features were selected at outset.
- ◆ A level of income appropriate to your needs can be obtained in a tax efficient manner.
- ◆ It gives the flexibility to make annuity purchase in stages.
- ◆ The segments not used for annuity purchase remain invested with the potential for future growth.
- ◆ Subject to the proviso of fluctuation in annuity rates, deferment of annuity purchase to a greater age would normally mean that a higher annuity is purchased.
- ◆ The value of death benefits may be more attractive.
- ◆ You may be able to continue contributions to your pension fund.

Disadvantages

- ◆ The full tax-free cash lump sum entitlement cannot be taken at one time.
- ◆ Future investment returns are not guaranteed and the value of the pension fund may fall. This may therefore result in a lower total income than if a full annuity was purchased at outset.
- ◆ Annuity rates may be lower in the future. As a result, buying a series of annuities under the phased retirement option may result in a lower overall level of income than if purchased in full at outset.

For whom might phased retirement be suitable?

- ◆ Those with significant levels of pension funds.
- ◆ Those who have other capital/assets on which to draw and therefore do not need the tax-free cash in one lump sum.
- ◆ Those who wish to provide the maximum death benefits free of inheritance tax.
- ◆ Those who are uncertain about their health or that of their dependants.
- ◆ Those who are prepared to take an ongoing investment risk.
- ◆ Those who wish to reduce their working hours gradually and ease their way into retirement.

4. Unsecured Income

How does it work?

Unsecured Income provides a means of taking benefits from pension funds without committing to the purchase of an annuity immediately. Under this option you can choose to take up to 25% of your fund immediately as a tax-free cash lump sum (up to the lifetime allowance). This option must be taken at outset; otherwise it will be lost.

In general, instead of buying an annuity with the remainder of the fund, the money remains invested, where it may benefit from investment performance in a tax-efficient environment. You may in this way defer taking an annuity until such time as it is considered more appropriate, although at age 75 you must either move funds into alternatively secured income or use the remaining funds to purchase an annuity.

Withdrawals taken from your fund each year may vary up to a maximum limit set at the time the arrangement is started. The maximum limit is derived from tables published by Government Actuaries Department (GAD) and is based on the size of your fund, your age, sex and the current gilt yield. It is not compulsory to take income from the fund and therefore income can be stopped in future if your circumstances so dictate.

Income levels are reviewed every five years and an appropriate adjustment to the level of income you receive may subsequently be necessary, where the level of income initially selected is above the maximum.

Short-Term Annuities

Instead of drawing income straight from the fund, it is possible to purchase a series of short-term annuities. This will give you peace of mind in relation to the income that will be received for up to five years whilst at the same time giving the flexibility to alter your requirements in future. The annuity payments must be paid at least annually and the maximum term that can be selected is for five years. The maximum income that can be taken is determined by rates produced by the Government Actuaries Department and will be the same as that applicable to income withdrawals. It is not possible to incorporate annuity protection or any form of guarantee into these short-term annuities. These short-term annuities can continue to be purchased up to age 75 when either an annuity must be purchased or when alternatively secured pension must be selected.

Investment Strategy & Management

The value of the fund, the level of income you withdraw each year and the final pension you purchase will all be dependent upon the careful management of the funds remaining invested. It is therefore essential that an investment strategy be adopted when starting this type of plan. Every client's circumstances and requirements are different, therefore there is no "perfect fund" and it is highly unlikely that one fund could meet all needs. However, in most cases a fund selection can be loosely based around basic needs of investing for the short, medium and long term. Basic portfolio planning should therefore look to:

- ◆ Secure current income withdrawals (invest in assets that are reasonably liquid, aimed at consistency rather than high capital growth in the short term).
- ◆ Maintain income requirements (invest to provide a good basis for capital growth within a controlled risk environment over the medium term).
- ◆ Provide growth for the remainder (invest in areas which could experience greater fluctuations, but could be expected to provide a higher level of performance over the longer term).

The level of income you choose to take will have implications for the performance of your invested fund, and will influence future possible levels of annuity you can buy.

Whilst in the short-term drawing the maximum possible income from the plan may be very attractive, this may have repercussions in the medium to long term, as income from the plan is ultimately dependent on investment returns. For this reason, it is important that income requirements are balanced with a suitable investment strategy, which must be kept under regular review.

Critical Yield

This calculation aims to show, in percentage terms, the investment returns required per year from a pension fund withdrawal arrangement to “match” the income that could be paid by a conventional annuity. This is quoted as a “Type A yield.” A second figure “Type B” is also often quoted. This will have more relevance to your specific circumstances as it equates to the yield required to match your selected level of income. The figures take account of plan charges and mortality costs (see below) and assume that during the period of taking withdrawals, the underlying annuity interest rate and mortality basis will not change.

Mortality

The concept of mortality drag and mortality gain and how it impacts on the advice given should be understood.

As the risk of mortality increases with age, this is reflected generally in higher annuity rates. Therefore it could be argued the longer a client postpones the decision to buy an annuity the greater the likelihood of a higher annuity income. However, this decision is not risk free - especially when income withdrawals are being taken from the plan.

With a conventional annuity there is an element of "cross subsidy" between those who die during the early years of annuity payments and those whose payments last longer than expected. This is reflected in the level of annuity payments and is sometimes referred to as mortality gain.

If a client takes income withdrawals equal to the conventional annuity he or she could have purchased, there is no cross subsidy. This may have a cumulative effect over a period of time, which means investment returns have to be high enough to compensate for the absence of a subsidy from those who die early. This is usually referred to as mortality drag.

Looking at it from a different perspective, many annuities tend not to have a death benefit whereas with Unsecured Income there is a return of the balance of the fund. It could be argued that there is a cost for this (in the same way that adding inflation proofing or spouses' benefits increases the cost of annuities) and this cost could also be viewed as the mortality drag. This issue will diminish in future as more annuities start to incorporate some form of death benefit, however it will be sometime before the effect reduces significantly.

What happens if you die?

There are several options available to your nominated survivor if you die while taking income withdrawals:

- ◆ Receive the balance of the invested fund as a cash lump sum, subject to a tax charge of 35%.

- ◆ Purchase an annuity.
- ◆ Continue taking income withdrawals or purchasing short term annuities until either he/she reaches age 75 or you would have reached 75, whichever is the earlier and then purchase an annuity with the remaining fund, or continue withdrawals via alternatively secured pension.
- ◆ (If your spouse is under 60 when you die) leave the value of the fund in the plan and defer purchasing an annuity up until his/her 60th birthday.

Taxation Issues

- ◆ Income withdrawals are subject to income tax.
- ◆ If, on death, the remaining fund is paid as a lump sum, a tax charge of 35% is applied.
- ◆ Generally, any lump sum will be paid free of inheritance tax but, in certain situations, the HM Revenue & Customs may apply such a tax. The Capital Taxes Office (CTO) has confirmed that there are two main instances where IHT may apply. Firstly, where the only possible beneficiaries of the Death Benefits are the policyholder's estate or legal personal representative. Secondly, where the CTO find evidence that the pension arrangement has not been used primarily for the purpose of pension provision. Typically, this is where the policyholder has acted knowing he or she is suffering terminal ill health and this results in increasing someone else's estate at the expense of pension provision.
- ◆ When tax-free cash is taken at outset and not utilised, it may be included in the value of your estate and therefore increase any potential inheritance tax charge.

Advantages

- ◆ You are able to take the full tax-free lump sum entitlement at outset.
- ◆ The pension funds from which you take income withdrawals remain invested, therefore you retain control of your investment portfolio and potentially benefit from the growth provided by the investments selected.
- ◆ It gives the flexibility to either phase and/or defer annuity purchase.
- ◆ Income may be varied, between set limits, to suit your personal circumstances.
- ◆ The facility to vary income levels may provide scope to mitigate your personal liability to income tax in certain years.
- ◆ The value of death benefits may be more attractive than annuity purchase.

Disadvantages

- ◆ Future investment returns are not guaranteed and the value of the pension fund may fall. This may therefore result in a lower total income than if an annuity was purchased at outset.
- ◆ Annuity rates may be lower in the future. As a result, the eventual annuity may be lower than the annuity that would have been available at outset.
- ◆ High withdrawals of income may not be sustainable during the income withdrawal period and may also reduce the amount of any potential annuity.
- ◆ The higher the level of income withdrawal chosen, the less that may be available to provide for dependants, particularly when the original fund is small and/or investment returns are poor.
- ◆ Increased flexibility brings increased administration costs. Charges are likely to be higher than those relating to the purchase of a conventional annuity and may increase in the future.
- ◆ It is possible that the level of income selected at outset may need to be decreased or increased to comply with new limits arising from a review.
- ◆ The value of death benefits may not be as attractive as phased retirement or combination of phased retirement and income withdrawal or short term annuity options.

For whom might Unsecured Income be suitable?

- ◆ Those who need the maximum tax free cash but do not require all the income that an annuity would provide.
- ◆ Those who are not entirely dependent on the income from the pension plan and can therefore afford to see fluctuations in its level.

- ◆ Those who understand the degree of risk involved and can afford to take such risks because, for example, they have substantial investments outside the pension plan.
- ◆ Those who are not married but have dependants, given that the death benefits compare favourably to annuity purchase, where survivor pensions for anyone other than a spouse may be difficult to arrange.
- ◆ Those in ill health, although careful comparison should be made with any available impaired life annuity.
- ◆ Those who do not wish to be “locked” into buying additional benefits that are not required. For example, some pension schemes require a widow(er) pension to be purchased, which will be of no benefit if there is no spouse, or the spouse is in poor health.

Other Points to Consider

- ◆ Those with larger funds, requiring lower incomes, will derive most benefit; fund size being important to cope with the extra administration costs involved and income levels to reduce the possibility of poor investment performance eroding fund value.
- ◆ Considerable caution is therefore needed if you need to take the maximum income. An annuity providing a similar level of income, guaranteed for life, is probably better suited to risk adverse clients than the riskier option of unsecured income.

Whether unsecured Income is the correct strategy for you will depend both upon your willingness to accept risk, including the need to attain investment performance above a “critical” level.

5. Phased Retirement & Unsecured Income (Phased Drawdown)

How does it work?

This option combines phased retirement and unsecured income. You may set up a phased retirement arrangement but, instead of using the segments encashed to purchase an annuity, they can be used for income withdrawals. This gives control over the continuing investments as well as the ability to defer annuity purchase.

By only phasing in the part of the pension fund you need, and not being restricted to buying a fixed annuity, you can, if you so wish, defer buying all annuities. You can build up your income as and when you wish, with the added flexibility of varying the income between certain limits.

With the continued investment in a tax-efficient environment and the ability to take a series of tax-free cash lump sums as part of your income, this option offers you the maximum flexibility for tax planning purposes.

Investment Strategy & Management

The value of the fund, the income you withdraw each year and the final pension you purchase will all be dependent upon the careful management of the funds remaining invested. It is therefore essential that a good investment strategy be adopted when starting this type of plan. Where a combination of phased retirement and unsecured income is entered into, this makes the investment process particularly complex as it will require a combination of the two strategies, as referred to in the previous sections.

What happens if you die prior to age 75?

The benefits available to your nominated survivor depend on how much of your pension fund remains invested. In respect of the segments not yet encashed for unsecured income, the value of the fund can either be paid as a lump sum, used to purchase an annuity or used for income withdrawals.

In respect of the fund already being used for unsecured income, there are generally several options available:

- ◆ Receive a cash lump sum, subject to a tax charge of 35%.
- ◆ Purchase an annuity.
- ◆ Continue taking withdrawals until either he/she reaches age 75 or you would have reached 75, whichever is the earlier. At age 75 withdrawals can continue via an alternatively secured pension
- ◆ (If your spouse is under 60 when you die) leave the value of the fund in the plan and defer purchasing an annuity up until his/her 60th birthday. It is not possible to take income withdrawals once this option has been selected.

Taxation Issues

- ◆ As part of the income can be taken as tax-free cash, only the part used for income withdrawal is subject to income tax.
- ◆ Funds remaining invested continue to benefit from the tax efficient environment of your pension fund.
- ◆ If, on death, the remaining fund opened for PFW is paid as a lump sum, a tax charge of 35% is applied.
- ◆ Generally, any lump sum will be paid free of inheritance tax but in certain situations HM Revenue & Customs may apply such a tax. Please see comments under “Unsecured Income” for full details.

Advantages

- ◆ The combination option gives you a high degree of control over your tax planning.
- ◆ It gives the flexibility to defer annuity purchase.
- ◆ It gives the flexibility to take income withdrawals in stages.
- ◆ A level of income appropriate to your needs can be obtained in a tax efficient manner.
- ◆ Both the funds being used for Unsecured Income and the balance not yet encashed remain invested. You therefore retain control of your investment with the potential for future growth.
- ◆ Income may be varied, up to a certain limit, to suit your personal circumstances.
- ◆ Flexibility in income levels may provide scope to mitigate your personal liability to income tax in certain years.
- ◆ The value of death benefits may be more attractive.
- ◆ You may be able to continue contributions to your pension fund.

Disadvantages

- ◆ The full tax-free cash lump sum entitlement cannot be taken at one time.
- ◆ Future investment returns are not guaranteed and the value of the pension fund may fall. This may therefore result in a lower total income than if an annuity was purchased at outset.
- ◆ Annuity rates may be lower in the future. As a result, the eventual annuity may be lower than the annuity that would have been available at outset.
- ◆ High withdrawals of income may not be sustainable during the income withdrawal period and may also reduce the amount of any potential annuity.
- ◆ The higher the level of income withdrawal chosen, the less that may be available to provide for dependants, particularly when the original fund is small and/or investment returns are poor.
- ◆ Increased flexibility brings increased administration costs. Charges are likely to be higher than those relating to annuity purchase and may increase in the future.
- ◆ It is possible that the level of income selected at outset may need to be decreased or increased to comply with new limits arising from a review.

For whom might Phased Drawdown be suitable?

- ◆ Those who have significant levels of pension funds.
- ◆ Those for whom careful tax planning and therefore maximum flexibility is required.
- ◆ Those who wish to defer annuity purchase.
- ◆ Those who wish to maintain control over all the remaining investments.
- ◆ Those who do not need the maximum tax-free lump sum in one go, particularly where there are significant levels of non-pension assets/capital to draw on.
- ◆ Those who can afford to postpone taking withdrawals in periods of adverse investment conditions.
- ◆ Those prepared to take a significant investment risk, as the entire pension fund will remain invested.

6. Alternatively Secured Pension

How does it work?

This option was introduced following the new pension rules introduced on 6th April 2006. The primary aim was to provide an alternative for people who do not wish to purchase an annuity on religious grounds. The benefits are far more wide-ranging as it is becoming more and more common for people over the age of 75 to have an interest in actively managing their investments.

Alternatively secured pension works in much the same way as unsecured income. The last opportunity to take tax-free cash is at age 75 and after this date, it is possible to take income withdrawals between minimum and maximum limits. The minimum income level is 65% of a comparable annuity and the maximum income level is 90% of a comparable annuity. Income levels will be reviewed annually, however, the rate used will be based on that applicable at age 75 rather than actual age.

Investment Strategy & Management

This can continue in much the same way as that applicable for unsecured income. Where income is being taken it will be important that a strategy is implemented to satisfy ongoing income requirements, alternatively, there may be an overriding aim to preserve capital with a view to providing benefits for non-dependant partners or relations.

What happens in the event of death?

After the age of 75 it is not possible for lump sum death benefits to be paid. If there are dependants remaining the fund must be used to provide pensions for them, these payments can be made as annuity payments or unsecured income if the recipient is under the age of 75. If they are over 75 benefits must be paid as an annuity or alternatively secured pension. Alternatively secured income payments can be guaranteed for ten years and therefore income may continue for the remainder of this period. The income payments cannot be commuted and paid as a lump sum.

If there are no surviving dependants the remaining fund can be paid to a charity nominated prior to death. The payment will be made without suffering any form of death tax or inheritance tax. The other option is for a lump sum transfer benefit to be paid. These payments can be made to other people who are members of the same pension scheme; it will be possible to nominate these recipients prior to death. If this option is selected the value of the pension fund will be incorporated into the estate and subject to Inheritance Tax.

Taxation

- ◆ Income withdrawals are subject to income tax.
- ◆ Inheritance tax may be levied if a lump sum payment is made to another pension scheme.
- ◆ When tax-free cash is taken at outset and not utilised, it may be included in the value of your estate and therefore increase any potential inheritance tax charge.

Advantages

- ◆ You are able to take the full tax-free lump sum entitlement at outset.
- ◆ The pension funds from which you take income withdrawals remain invested, therefore you retain control of your investment portfolio and potentially benefit from the growth provided by the investments selected.
- ◆ It gives the flexibility to either phase and/or defer annuity purchase.
- ◆ Income may be varied, between set limits, to suit your personal circumstances.
- ◆ The facility to vary income levels may provide scope to mitigate your personal liability to income tax in certain years.

Disadvantages

- ◆ Future investment returns are not guaranteed and the value of the pension fund may fall. This may therefore result in a lower total income than if an annuity was purchased at outset.
- ◆ Annuity rates may be lower in the future. As a result, the eventual annuity may be lower than the annuity that would have been available at outset.
- ◆ High withdrawals of income may not be sustainable during the income withdrawal period and may also reduce the amount of any potential annuity.
- ◆ The higher the level of income withdrawal chosen, the less that may be available to provide for dependants, particularly when the original fund is small and/or investment returns are poor.
- ◆ Increased flexibility brings increased administration costs. Charges are likely to be higher than those relating to the purchase of a conventional annuity and may increase in the future.
- ◆ It is possible that the level of income selected at outset may need to be decreased or increased to comply with new limits arising from an annual review.

For whom might Alternatively Secured Pension be suitable?

- ◆ Those who need the maximum tax free cash but do not require all the income that an annuity would provide.
- ◆ Those who are not entirely dependent on the income from the pension plan and can therefore afford to see fluctuations in its level.
- ◆ Those who understand the degree of risk involved and can afford to take such risks because, for example, they have substantial investments outside the pension plan.
- ◆ Those who do not wish to purchase an annuity for religious reasons.
- ◆ Those who do not wish to be “locked” into buying additional benefits that are not required. For example, some pension schemes require a widow(er) pension to be purchased, which will be of no benefit if there is no spouse, or the spouse is in poor health.

7. Use of a SIPP

How does it work?

It is possible to set up a personal pension, Unsecured Income or Alternatively Secured Income plan under what is known as a Self Invested Pension Plan (SIPP). In simple terms, this route would offer you the ultimate retirement planning flexibility for the future. Self investment gives you the opportunity to invest wider afield than the chosen provider’s insured funds if you so wish, for example stocks and shares, investment trusts and investment funds offered by other providers.

Although legislation introduced early in 2001 allows clients already in pension fund withdrawal to switch to another provider, for example for reason of “under performance”, this is an exercise involving costs. Setting the original plan under a “SIPP” facility will often negate the need to consider such transfers.

The following should however be noted when considering use of the self-investment facility:

- ◆ Only “Insured” investments held within a SIPP are covered by the Financial Services Compensation Scheme. This Scheme protects the policyholder generally for 100% of the first £30,000 and 90% of the next £20,000 of the value of the assets of the fund(s), in the event of insolvency of a Life Office.
- ◆ Commercial property is a popular investment under SIPPs, but purchases of such property are subject to stringent controls.