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GUIDE TO

PENSION FREEDOMS

HOW WILL YOU TURN YOUR PENSION INTO MONEY YOU CAN USE?

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Chartered Financial Planners

GUIDE TO

PENSION FREEDOMS

How will you turn your pension into money you can use?

You've worked hard for your retirement, but before you can start enjoying it, you'll need to decide how your pension will provide the income you need to live on.

In March 2014, the then Chancellor of the Exchequer, George Osborne, announced a radical reform of the pensions system to give people greater flexibility to access their pension savings. The new pension freedoms took full effect from 6 April 2015 and have given retirees a whole host of new options.

There is no longer a compulsory requirement to purchase an annuity (a guaranteed income for life for a fixed number of years) when you retire. The introduction of pension freedoms brought about fundamental changes to the way we can access our pension savings.

Pension freedom rules mean those aged over 55 no longer have to purchase an annuity to access their pension income but can instead enter drawdown or take a cash amount. There is now much greater flexibility around how you take your benefits from Money Purchase Pension (Defined Contribution) schemes, which includes Self-Invested Personal Pensions (SIPPs).

How pensions can be taken has been dramatically relaxed

Since the rules governing how pensions can be taken have been dramatically relaxed, more people are using pension freedoms to access their retirement savings, but the amount they are individually withdrawing has continued to fall, according to the latest data from HM Revenue & Customs (HMRC).

Pension freedoms have given retirees considerable flexibility over how they draw an income or withdraw lump sums from their accumulated retirement savings. There is no doubt the pension freedoms have been hugely popular.

Average withdrawals have been falling steadily and consistently

The quarterly numbers from HMRC cover money that has been withdrawn flexibly from pensions. Members of defined contribution pension schemes can access their pension savings early, provided they have reached the normal minimum pension age (currently 55). The figures for the third quarter last year show £2.4 billion was withdrawn from pensions flexibly – a 21% increase from £2 billion in the third quarter of 2018.

The average amount withdrawn per individual in the third quarter was £7,250, falling by 5% from £7,600 in the third quarter of 2018. The Government says that since reporting became mandatory in 2016, average withdrawals have been falling steadily and consistently, with peaks in the second quarter of each year.

Deciding what to do with your pension pot is one of the most important decisions you will make for your future. What are your options to consider?

Leave your pension pot untouched for now and take the money later

It's up to you when you take your money. You might have reached the normal retirement date under the scheme or received a pack from your pension provider, but that doesn't mean you have to take the money now. If you delay taking your pension until a later date, your pot continues to grow tax-free, potentially providing more income once you access it. If you do not take your money, we can check the investments and charges under the contract.

Receive a guaranteed income (annuity)

You can use your whole pension pot, or part of it, to buy an annuity. It typically gives you a regular and guaranteed income. You can normally withdraw up to a quarter (25%) of your pot as a one-off tax-free lump sum, then convert the rest into an annuity, providing a taxable income for life. Some older policies may allow you to take more than 25% as tax-free cash. We can review this with your pension provider. There are different lifetime annuity options and features to choose from that affect how much income you would get.

Receive an adjustable income (flexi-access drawdown)

With this option, you can normally take up to 25% (a quarter) of your pension pot, or of the amount you allocate for drawdown, as a tax-free lump sum, then re-invest the rest into funds designed to provide you

with a regular taxable income. You set the income you want, though this might be adjusted periodically depending on the performance of your investments. Unlike with a lifetime annuity, your income isn't guaranteed for life, so you need to manage your investments carefully.

Take cash in lump sums (drawdown)

How much and when you take your money is up to you. You can use your existing pension pot to take cash as and when you need it and leave the rest untouched, where it can continue to grow tax-free. For each cash withdrawal, normally the first 25% (quarter) is tax-free, and the rest counts as taxable income. There might be charges each time you make a cash withdrawal and/or limits on how many withdrawals you can make each year. With this option, your pension pot isn't re-invested into new funds specifically chosen to pay you a regular income, and it won't provide for a dependent after you die. There are also tax implications to consider that we can discuss with you.

Cash in your whole pot in one go

You can do this, but there are certain things you need to think about. There are clear tax implications from withdrawing all of your money from a pension. Taking your whole pot as cash could mean you end up with a large tax bill – for most people, it will be more tax-efficient to use one of the other options. Cashing in your pension pot will not give you a secure retirement income.

Mix your options

You don't have to choose one option: you can mix them over time or over your total pot when deciding how to access your pension. You can mix and match as you like, and take cash and income at different times to suit your needs. You can also keep saving into a pension if you wish, and get tax relief up to age 75.

Financial situation at retirement

The way you draw an income from your pension is likely to be largely determined by your financial situation at retirement. Will you, for example, still be paying off your mortgage, or do you have any other significant debts? What other income sources, aside from the State Pension, will you have at your disposal?

While an annuity can offer you the security of a guaranteed regular income, a drawdown plan gives you the chance to grow your pension and overall wealth during retirement. The latter route is likely to suit those with a stronger appetite for risk, as any significant market swings could potentially cause serious damage to your pension savings. ■

THINK CAREFULLY BEFORE MAKING ANY CHOICES

The pension flexibilities may have given retirees more options, but they're also very complicated, and it's important to think carefully before making any choices that you can't undo in the future. Withdrawing unsustainable sums from your pensions could also dramatically increase the risk of you running out of money in your retirement. Want to find out more? Get in touch to talk to us about your current situation or to arrange a meeting.

Source data:
[1] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/841958/Pension_Flexibility_Statistics_Oct_2019.pdf

GETTING READY FOR LIFE AFTER WORK?

So you're approaching the age when it's time to start thinking about what you're going to do with your pension money that you've been working hard to save all these years.

To discuss how we can help you access your pension money so that it works for you, don't delay – please talk to us.

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