IFA Fact Files
"Pension options"

martin andrews & associates ltd
MAKING BEST USE OF YOUR MONEY WHATEVER YOUR CIRCUMSTANCES

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Fact - Files Fact - Files

If you are approaching retirement it is important for you to understand that with regards to your pension you have a choice to make. If you speak with an Independent Financial Adviser about your retirement options you will soon learn that in fact there are almost too many options to count. The options set out in this sheet primarily cover Money Purchase Pensions (investment based pensions into which you and maybe your Employer have been contributing). At retirement, your pension will have a value which will be known as the "Pension Fund".

Tax Free Cash

For a Personal Pension Plan, the tax free cash would usually be 25% of the Pension Fund value at retirement. This will not always be the case, as older pensions (pre 1988) had a different calculation of tax free cash. If it is a Retirement Annuity (Section 226 policy) which was a pre-1988 Personal Pension, the tax free cash will be 3 times the maximum annuity figure. If your plan is an Executive Pension Plan it will be different again as the maximum tax free cash will be linked to your Final Salary and the number of years service you have completed with your Employer. Broadly however, 25% is a reasonable figure to assume at first until we are able to clarify the type of scheme, although sometimes it will be significantly less than 25%.

Should I take the Tax Free Cash?

In general, as the tax free cash is indeed tax free and the cash can be used in any way you desire, it is unusual not to take the full tax free cash sum. If you do not *need* your tax free cash however, there is an excellent facility to provide income in the early years in a very tax efficient manner from your pension.
Assuming that you take your full tax free cash for a moment (still assuming 25%), you then have a Residual Fund (75%) which must be used to provide you with an income for life. You do however still have some options open to you:

In-House Annuity

Your pension company will almost certainly provide you with some annuity options based on taking the annuity with themselves. It is very rare for this annuity to be the most competitive, and they are contractually obliged to also offer you the open market option.

Open Market Option

This facility allows you to approach other annuity providers at retirement to obtain the best annuity deal currently on the open market. In most cases the open market annuity will be better than the in-house annuity as there is more competition in the market.

Annuity Purchase issues

With an annuity, either in-house or on the open market, you are effectively using your Residual Fund (75%) to provide yourself with an income for the rest of your life. Annuity rates are usually based on a single life pension paid with no increases and no guarantees. The rate given will depend on the individual's age and health. It is important at this stage to note that if you are married and your spouse is in anyway dependent on your earnings, that rather than purchasing a single life annuity, you should ensure that your spouse is protected by way of a joint life annuity. In the case of a joint life annuity the annual payments would be made initially to the person who accrued the pension fund, but on their death would be payable to the spouse for the rest of their life. A Spouse's Pension could be a half of what was paid to the policyholder, two thirds or an exactly the same amount. By building in a Spouse's Pension, the initial income produced would be reduced. If an increasing pension were chosen (to keep pace with inflation) the initial annuity rate would be decreased still further. One of the big downsides with annuity purchase, is early death of the annuitant and/or their spouse.
If death occurs shortly after the annuity has been set up, the pension fund or most of the value of it will be lost to the insurance company.

Annuity options continued ….

When commencing an annuity you must therefore work out the way in which you want the benefits paid. We list below the options that you will have, the more options you build in, the less the initial income will be:

1. Single Life Level Pension – No spouses pension on death, no increases. (This will be the highest pension sum available)
2. Joint Life Level Pension – With anything from 50% to 100% spouses pension and no increases. (The income will be lower, the more benefit provided to the spouse.)
3. Joint Life Increasing Pension – This would provide the lowest possible initial pension, but the income will rise each year.

It is possible to mix & match these options and the end decision will be based on many aspects of your personal & financial situation, and is where quality advice is absolutely necessary.

Another Annuity Option – With Profits Annuity

With Profits Annuities were introduced to try to give some greater exposure to good investment market conditions. With this type of annuity, at outset you have to select an annual bonus rate that you expect the company to produce. This will be anything between 0% and 5%. If you select the 5%, you will achieve the highest initial annuity payment. If you select 0%, and the following year the company declare a 3% bonus rate, your annuity will increase in value. If you selected a 5% annual bonus rate and they only achieved 4%, your annuity would reduce. This option can only really be assessed with some quotations.

Income Drawdown

The last main option which is generally viewed only appropriate for funds in excess of £100,000, allows you to take your tax free cash but rather than purchase an annuity, to "withdraw" an income from your fund between pre-set government provided figures. One of the main advantages of Income Drawdown, is that the financial impact of early death in retirement is much less, in that the fund in its entirety can then be used to purchase a Spouse's Pension *or even passed onto non-dependent children.* The downside to this option is that as the fund remains invested throughout the term, it is also susceptible to losses via poor investment returns.

Income Drawdown with Phased Retirement

This is a sub-option with the above feature. If during your lifetime you have gathered savings together, and when you retire you do not actually need your tax free cash lump sum, but do need a pension, you can opt for this arrangement. Instead of taking your tax free lump sum in one go, you take it gradually over the first few years of retirement. Every payment made to you would be part tax free cash, and part pension income. In this way, you can provide yourself an income in the first few years whilst paying very little tax. If you were to ignore this idea and take the tax free cash placing it say a deposit account, the interest on the cash would be taxable. By leaving as much tax free cash in your fund for as long as possible, you maximise the tax breaks of the pension without impacting on your pension income levels.

Summary

We hope that this document proves that when approaching retirement, it is vital that you seek Independent Financial Advice. At the very least you should ensure that you are getting the best Annuity, at best, it may be that another product is more appropriate to your situation.

If you have any questions or need an independent review of your investment arrangements, please contact Martin Andrews to discuss your situation further. Martin Andrews & Associates Ltd is an Independent Financial Adviser authorised and regulated by the Financial Services Authority.

Information given in this document should not be taken as advice as it is intended for guidance only. If you wish to have an assessment of your own situation, you should contact the office for advice.