Teachers Financial Planning

Retirement UPDATE

Annuities and drawdown

This guide looks at using annuities and income drawdown to provide an income during your retirement

In the 2014 Budget, Chancellor George Osborne made some significant announcements that will change the way people draw income at retirement. The changes are designed to allow more flexibility when people access their pension investments.

Some changes have already come into effect. These include:

- reducing the guaranteed retirement income needed qualify for flexible drawdown from £20,000 to £12,000
- increasing the amount that can be accessed using a capped drawdown arrangement from 120% of an equivalent annuity to 150%.

From April 2015, if you are aged over 55 you will only be charged your marginal rate of income tax on any amount that you withdraw from your pension (25% will remain tax free).

However, it's important to note that if you take more than the 25% tax free amount as a lump sum this also means that your annual allowance for contributing to a pension is significantly reduced from then on.

Both annuities and drawdown are common methods used to convert your pension into an income at retirement. They work in slightly different ways, so it is important that you fully understand them before choosing your retirement income option.

What are annuities?

The important thing to remember with most traditional annuities is that once you have bought 1 there is no going back. This means it is important to find the right deal for your circumstances.

Annuity rates go up and down so knowing when to buy and which company to go to is important, particularly because there is no longer the requirement to buy an annuity by the age of 75.

Annuities are provided by insurance companies and guarantee to pay you a secure, taxable income for the rest of your lifetime in exchange for your pension fund.

The annuity rate you receive will depend on a number of factors including the value of your pension pot, your age, health and interest rates.

The Open Market Option

The Open Market Option is your legal right to shop around and buy your annuity from whichever provider you choose – it doesn't have to be your current pension provider. Using the Open Market Option could boost your income considerably, so you should consider different providers before making a decision.

Types of annuity

As well as choosing the right rate, you need to ensure that you get the appropriate type of annuity for your circumstances. The types of annuities available include:

Lifetime annuities: This is the most popular type of annuity and agrees to pay you a fixed income for the rest of your lifetime.

Impaired life annuities: If you suffer from certain conditions that are likely to result in a reduced life expectancy you may qualify for an impaired life annuity. This will result in a higher income because the provider expects to have to pay the income for a shorter time.

Enhanced annuities: Like an impaired annuity, an enhanced annuity can result in a higher income. However, you don't

750 Mandarin Court Warrington
Cheshire WA1 1GG
08452 696990 info@teachersfp.co.uk

Annuities and drawdown

necessarily have to have a medical condition, it could be that your lifestyle means that you may have a shorter life expectancy, such as smoking or working in a hazardous occupation.

Value protected annuities: These guarantee to pay out at least as much as you paid for them, even if you die (there is normally an age-related cut-off point). For example, if you buy your annuity with a £50,000 pension pot and have received £30,000 by the time you die, the annuity company will pay out the remaining £20,000 to your beneficiaries.

Other things to consider

Apart from the type of contract, there are other factors to consider when purchasing an annuity, including:

- whether you want a fixed level of income
- an income that increases in line with inflation
- an income that can vary
- how often you want your income paid
- what will happen to your income when you die.

Generally speaking, the more options you add to your annuity, the more expensive it will be and the less income you will receive.

Advantages and disadvantages of traditional annuities

Advantages	Disadvantages
Simple and easy to understand	Inflexible
Income is fixed and secure	Level annuities don't protect against inflation
The income won't run out	Current annuity rates are perceived as low
No minimum pension pot size	Not affected by stock market rises
No investment risk	Benefits have to be decided at outset.
You could qualify for an enhanced annuity	

What is drawdown?

Drawdown allows you to keep your pension invested and draw income directly from your fund while offering the potential for growth. However, this means that while your fund is invested it could still fall in value as well as rise.

Types of drawdown

There are 2 main types of drawdown:

Capped drawdown: From April 2015, you will be able to withdraw as much income as you like from your pension fund. Until then there is a limit on the annual income you can withdraw. This is currently set at 150% of the level of income you would receive from a basic annuity using the same value of pension.

You can alter the level of income you take with capped drawdown, which may help when it comes to tax planning. There is no minimum withdrawal amount, so you could withdraw your 25% tax free amount and keep the rest of your pension fund invested.

Current rules state that income must be reviewed every 3 years, but reviews will be abolished when the new rules come in from April 2015.

Flexible drawdown: Flexible drawdown was introduced in April 2011 and works in exactly the same way as capped drawdown except there is no limit on the level of income you can take.

However, there are currently a number of requirements that must be met before qualifying, although these changed in Budget 2014 and will relax further from April 2015.

Advantages and disadvantages of drawdown

Advantages
You control your investments
Flexible death benefits
You can vary the income you receive
There is potential for growth
Disadvantages
Income is not secure and the value of the fund can fall or the income could run out
They are more complex and require more monitoring
If you live for a long time and your investments perform badly you could run out of income
An annuity may have offered a greater total income over your lifetime
The charges can be expensive

Get advice

Converting your pension fund into a retirement income is important and shouldn't be undertaken lightly. It is vital that you consider your options and find the deal that is right for you and your circumstances.

Important Notice

Pension eligibility depends upon personal circumstances. The way in which tax charges (or tax relief, as appropriate) are applied depends upon individual circumstances and may be subject to change in the future. This document is based on our current understanding of the new pension rules that will come into force in April 2015. Pension drawdown can be complicated and you should seek professional advice if you are in any doubt as to its suitability for your personal circumstances.

This document is solely for information purposes and nothing in this document is intended to constitute advice or a recommendation. You should not make any investment decisions based upon its content. The value of pensions can fall as well as rise and you may not get back the amount you originally invested.

Whilst considerable care has been taken to ensure that the information contained within this document is accurate and up-to-date, no warranty is given as to the accuracy or completeness of any information. E & OE.