Income Drawdown

The Flexible Alternative Route to Retirement Income

- ✓ How Income Drawdown works
- ✓ The advantages & Disadvantages
- ✓ Drawdown vs Annuities
- ✓ Investment Strategies
- ✓ Flexible Death Benefits

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An Introduction to Drawdown

When looking at retirement income, income drawdown is one of the main alternatives to an annuity. It is extremely flexible, however this can make it more complex for people to understand. This guide explains the benefits of drawdown and also its drawbacks. The aim of this guide is to put you in a more informed position to help you make your own financial decisions, however none of the information should be considered as personal advice. The main aim of Income drawdown is to put you in control of your retirement and your income. Instead of using your pension fund to purchase an annuity (usually a set amount of income for the rest of your life), drawdown allows you to take an income directly from your pension, whilst keeping your pension invested. This gives the advantage that your pension can potentially still grow and gives it the chance to help protect your income against inflation (the rising cost of goods and services). It also provides more flexible death benefits than that of an annuity so that you are able to pass on your pension when you die.

What Are Your Main Options

The main options you will have with your private pensions are:

1. Buying an annuity with your existing pension provider
2. Using the option market option to buy an annuity (with the aim to increase the income over that of your existing provider)
3. Phased retirement, which allows you to take your pension in phases
4. Drawdown, which allows you to keep your pension invested and take slices from the pension as income

When considering your retirement options, you should consider all four options to ensure that you are able to make an informed decision on what is the most suitable option for you.

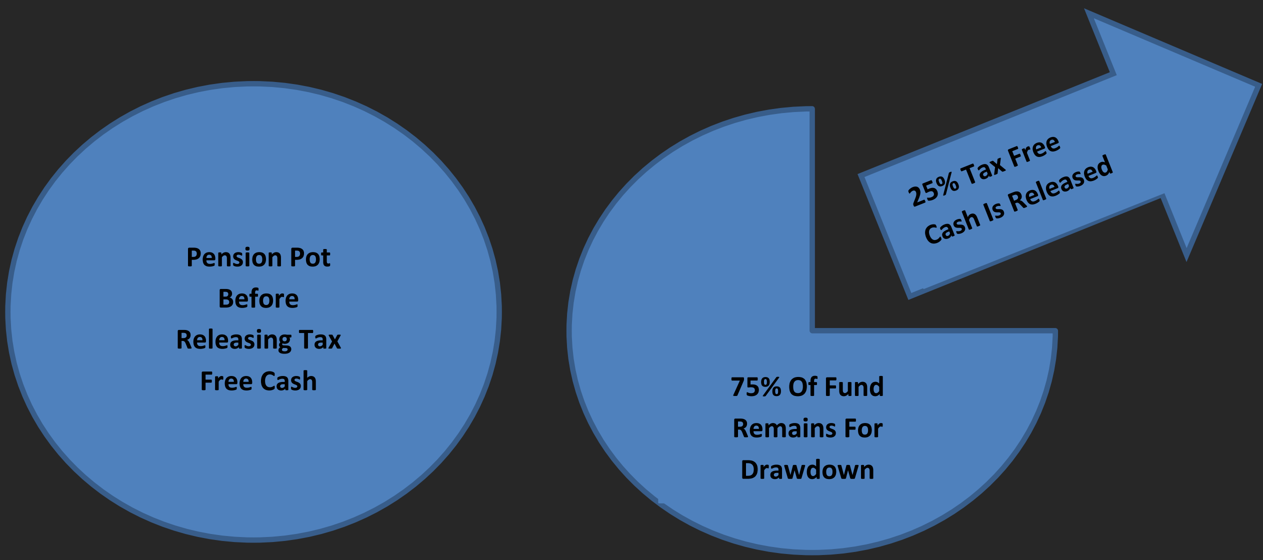
What Is Income Drawdown

Income drawdown allows you to transfer your pension into a drawdown arrangement (either with your existing provider if they offer it or to another provider). From your pension fund you are able to take out for tax free cash (this is usually 25%). The remaining fund is then invested into investment funds in order to provide growth. Any selected investment funds should be suitable for you in regards to risk level, diversification and volatility. Generally it is the job of an adviser to help you select the investment strategy to suit your requirements.

You are then able to take an income from your pension fund. You can choose the amount that you want (within limits if in capped drawdown). It is the purpose of the investment funds to provide the growth to replace any income you take and also to provide any capital growth on top.

This is where the problem can arise with drawdown. In the event that the growth is not enough to replace the income you are taking then this will eat into your capital. Even worse if the investment funds fall in value then this combined with the income you are taking can have a big impact on your pension pot.

It is therefore important to select an investment strategy that meets your needs and have a realistic view on what level of income you take.



How Does Drawdown Work

Capped Drawdown

This is the most common version of drawdown as flexible drawdown (explained later) has certain rules that you need to qualify for in order to have that option available.

With capped drawdown you chose an income between zero and your maximum 'GAD' limit. This means should you so wish you can set your income at zero. People use this option to release the tax free lump sum from their pension and then continue to let the pension to growth, this is generally by people that are still working and do not require the income from their pension, however want to release the lump sum for a purpose (such as to pay off debts or use for a special holiday). The maximum GAD limit (GAD standing for Government Actuary's Department) is roughly the income from a level, single life annuity using the same pension value and is calculated using your age and the 15 year gilt tables.

The income amount you take is totally flexible between those limits. Therefore if you wanted to slow down at work and start taking a lower level of income to start with and then increase at a later stage this can do just that.

Purchasing An Annuity

You are able to purchase an annuity at any stage with your drawdown pension. However you are not required to at any stage. You can therefore hold drawdown until death. This is a major advantage for those people that want to pass on their pension to dependents on their death but do not wish to suffer the costs of doing this.

Reviews

Your income is reviewed every three years before the age of 75 (yearly after the age of 75). At each review the new maximum income could be higher or lower than the limit from the previous three years. A review (resulting in a new maximum income) could be triggered before your three year review if you switch any more money into your drawdown account or if you use some of the drawdown fund to buy an annuity. In some cases funds may also have to be moved out as a result of a divorce court order which could trigger a review. Every year, you also have the option to manually request that a review takes place on the plan anniversary. This will reset income limits and restart the three year period.

Death Benefits

One of the major advantages of drawdown over that of an annuity is the fact that the death benefits are more flexible and also potentially less costly.

With an annuity you have to choose your options at outset (and this includes any death benefits). If you do select death benefits with an annuity (such as guarantees or a spouses pension) the cost of these is taken by providing you with less income throughout the entire annuity than that of an annuity with no death benefits.

If you do choose an annuity with no death benefits (a single life annuity) then when you die the income stops and your pension pot is retained by the insurance company.

This is not the case with drawdown. In the event of your death this can provide a dependants income from the drawdown itself or they can use the fund to purchase an annuity (this does not affect the income you are entitled to unlike an annuity). Also this income is not just exclusive to a spouse, this can be other dependants (however this will depend on the providers terms and conditions of who would be considered as a dependant, so this should be checked).

They also have the option of instead of taking the pension as an income, they can take the pension as a one off lump sum, you should be aware that there is currently a 55% tax charge for doing this.

Table of Death Benefits

	Annuities	Drawdown
Do you have to decide death benefits at outset?	**Yes.** You have to decide these when the annuity is set up. They will affect the level of income you receive. You cannot normally change them.	**No.** No advance decisions required. You can nominate to whom you'd like death benefits paid but this can be changed.
What if no death benefits chosen at the start?	No further payments. The annuity will end on your death.	The options below can apply.
Options for continuing taxable income	**If you've selected a spouse's pension.** Payments will continue to be made to your spouse until their death. However it could be wasted if your spouse dies before you or if you divorce. **If you've selected a guarantee period of up to ten years.** Your annuity will be paid out for the remainder of that period if you die before then. If you survive the guarantee period, the income will be paid for the rest of your lifetime only and then stop, unless you've chosen a spouse's pension.	**Your dependant(s) carry on with income drawdown.** The drawdown fund is passed to them without any tax charge, then any income taken is taxable at their personal income tax rate. **Your dependant(s) use the remaining pension to take flexible drawdown.** Provided they meet the set criteria, (including being in receipt of at least £20,000 secure pension income). Any money taken out as flexible drawdown is taxable at their personal income tax rate. **Your dependant(s) take the fund and buy a lifetime annuity.** The drawdown fund will not be subject to a tax charge but income from the annuity will be taxable at their personal income tax rate.
Any return of pension fund?	**No** unless you have chosen a 'money back' option (value protection) where an amount up to the original purchase price, less any gross income payments received, can be returned less 55% tax if you die before a set age.	**Yes.** Any person you nominate could receive the remaining fund as a lump sum less a 55% tax charge. **OR** A lump sum could be paid to your nominated charity. If you have dependants this payment will usually be subject to a 55% tax charge. If there are no dependants the payment is made free of tax.

Investment Options

A major factor with drawdown is where you invest the pension funds and therefore careful consideration should be taken with this.

Factors that can affect the decision of where the investment funds are placed are:

- ✓ Is income being taken?
- ✓ If so how much and how often?
- ✓ If not how long is there until income will be taken?
- ✓ Your risk profile
- ✓ Your investment experience and knowledge

Someone who is not taking income can potentially take a higher risk than that of someone who is taking income. This is for two reasons:

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1 – Consistency of returns

For those that are taking an income from their pension, they require a certain level of growth to help replace the income they have taken. The more risk taken the more chance there is that a certain growth level will not be achieved. The same can be said for the converse of this. Therefore your capacity for loss and rate of return required should be looked at to ascertain the appropriate risk level.

2 - Volatility

This can be a big concern for those that are taking an income. Volatility is really talking about how big the swings are with investment returns. The more volatile the investment the larger and more often the ups and downs are with your pension pot value.

If you are taking income regularly (let's say monthly), you will be taking the income when your pension is worth different values. This means that if your pension value has gone down significantly in value, the percentage of the pot you are taking as income is more than if the pot had gone up in value.

Let’s show the potential impact of volatility with an example: (these figures are purely to show an example and are not real returns)

Example

Pot size £100,000
Income £6,000

Example 1

Pot grows to £110,000
The £6,000 income represents 5.45%

Example 2

The pot falls to £90,000
The £6,000 income represents 6.66%

Therefore by income coming out of the pension when it has fallen in value this has a greater impact on your pot size.

The way to combat this is considering low volatile strategies, these are usually strategies that are spread across different assets. Advice should always be sought on this.

Flexible Drawdown

The difference with flexible drawdown is the fact that there are no income limits. This means that you can draw out your tax free cash and then drawdown the entire pension fund over whatever period you desire. Be aware that apart from the tax free lump sum the remainder of the pension will be potentially taxable income.

In order to have flexible drawdown, there are certain rules that you have to qualify, these are:

Main requirement: Secure pension income of £20,000

To qualify for flexible drawdown you must already be in receipt of a secure pension that will pay an income of at least £20,000 in the tax year in which you move into flexible drawdown. When you apply we will ask you for details of this income. There are strict rules on what income can be included. Below we have outlined the basics however if you're not sure contact us for details. For investors who don't quite have the £20,000 of pension income needed, an annuity can be purchased using part of your pension to meet the shortfall, allowing the rest of your fund to be used for flexible drawdown. Please call us if you'd like us to help.

Other requirements

Flexible drawdown can only be taken once you have finished saving into pensions and have ceased being an active member of all your pension schemes. In particular, no pension contributions can be paid to a money purchase pension (e.g. personal pension, stakeholder, SIPP or AVC) in the tax year you make a flexible drawdown declaration. When you apply for flexible drawdown it is not possible to be an active member of a pension scheme containing defined benefits (e.g. final salary, career average schemes, GMP, some company provided life cover). If a contribution is made in the tax year in which you apply for flexible drawdown your plan will lose its flexible status and you will revert back to standard income drawdown and be subject to the maximum income limits. Any income payment already made in that tax year which exceeds the maximum income limit will be treated as an unauthorised payment subject to a tax charge of up to 70%. The flexible drawdown declaration should be signed in the same tax year in which you want your plan to enter flexible drawdown.

What counts as the £20,000 per year in secure pension income?

- Secure private pension income (e.g. an annuity or scheme pension)
- Secure occupational pension income (if this is final salary pension there must be at least 20 members receiving an income)
- Income from a deceased spouse or partner's pension if it is already in payment to the dependant
- State pension income and other social security benefits:
- Basic state pension, SERPS and S2P
- Graduated Retirement Benefit
- Industrial Death Benefit, Widowed mother's allowance, Widowed parent's
- allowance, Widow's pension

Other sources:

- Payments from some overseas pensions
- Payments under the Financial Assistance Scheme
- Regular payments from the Pension Protection Fund

What does not count?

- Some variable annuity income
- Income drawdown income or income from a dependant's drawdown plan
- Income from investments
- Income from property
- Income from Purchased Life Annuities (PLAs)

Advantages & Disadvantages

Your situation and the options that are important to you will depend on what option is right for you. Here is a summary of the main advantages and disadvantages:

Annuities

Advantages

- Simple, easy to understand. No on-going reviews required
- Once set up income is fixed and secure
- Available for any size pension fund, with a number of different features.
- Potentially Higher incomes available if you have health issues
- The income will never run out, however long you live
- Not affected by stock market falls, or economic slumps

Disadvantages

- Inflexible, cannot be changed once set up
- Current annuity rates are low
- Benefits must be set up at outset so don't take account of changing circumstances. For instance a spouse's pension could be wasted on divorce or the death of a spouse
- An annuity (without value protection) cannot generally be passed on to your beneficiaries as a lump sum
- Not affected by stock market rises
- A non-inflation linked annuity has no protection against inflation meaning income in real terms will reduce over time.

Income Drawdown

Advantages

- More flexible; you keep your options open and do not have to make any one-off decisions
- You retain investment choice and control
- On death, can provide a dependants income without affecting your level of income
- On death, any remaining pension can be passed on to beneficiaries (less 55% tax)
- You can change the income you receive to match your requirements
- Potential for growth, increasing income and protection from inflation

Disadvantages

- Income is not secure. The income and value of the fund can fall and, at worst, the income could run out
- You're responsible for maintaining sustainable income. High income withdrawals and/or poor investment performance can strip the fund bare
- An annuity set up on day one may have offered a greater total income over lifetime
- More complex, you may need advice. Requires regular reviews can be expensive: may not be cost effective for smaller funds.

So Who Should Consider Drawdown

- ✓ **Someone who wants to take their tax free lump sum without taking income –** This means that you can keep the remainder of your pension pot invested and growing whilst you don't need the income with the view to having a higher level of income when you do need it.
- ✓ **Someone who wants flexibility with their income –** Drawdown allows you to change the levels of income you can take, this can help you grow the remainder of the pot whilst taking the income you need.
- ✓ **Someone in good health –** Being in good health is not good for annuities as it means you will potentially get a worse rate. Drawdown allows you to take an income now and be able to buy an annuity at a later stage.
- ✓ **Someone who is retiring early –** Generally annuities are poor for those retiring at an early age and therefore Drawdown allows you to take an income now and be able to buy an annuity at a later age when you could potentially get better terms.
- ✓ **Someone who does not want an annuity –** It is no secret that annuity rates are low and Drawdown allows you to take income without locking into a poor annuity rate.
- ✓ **Someone who is worried about the effects of inflation –** Unlike annuities, Drawdown allows your pot to still grow and help guard against inflation.
- ✓ **Someone who wants more flexibility with death benefits –** Drawdown allows both a dependents pension (that does not affect the income you receive unlike annuities) or to take the pension as a lump sum (although taking as a lump sum will suffer a 55% tax charge).

Drawdown is not for everyone and there are some clear advantages and disadvantages to it. The big thing about using drawdown is to have a common sense approach. You should be realistic with the investment returns to expect from your pension pot, otherwise you could get in the situation of significantly eroding your pension pot. Advice should always be sought regarding the investment funds and also the income levels to help ensure that this does not happen.

Could Income Drawdown Be For You?

If you are looking for a more flexible approach to retirement income and do not want to lock yourself into an annuity then drawdown could be the answer you are looking for.

Take advantage of our Personal Retirement Report. This is a report that we offer for free to all our potential clients to help put you in a more informed position and to help you make the right choice for your retirement income

With this report we will:

- ✓ Do all the hard work and gather the information needed from your pensions.
- ✓ Show you what is the maximum income your existing pension providers will give you.
- ✓ Show you the maximum income you can get from an annuity using the open market option (this will include enhanced rates).
- ✓ Show you the level of income you can get from drawdown.

We will also take the time to help explain the various options available to you and provide you with guidance and advice as to which of the options are right for you. There is never any pressure or obligation, just common sense and honest advice.

If you do decide to take our advice in the majority of cases we can even take payment via the policy instead of directly from you (however we will always give you the choice). This report will help you clearly understand what is right for you and can even help you increase your income by hundreds, if not thousands of pounds a year.

Call us on 01722 717427 to discuss it further
Or visit www.premier-advice.co.uk and fill out the short Personal Retirement Report Form

Important Information

The information in this guide is for information purposes and does not constitute advice, if you don't understand any of its contents we recommend you seek Independent Financial Advice.

Past performance is not a guide to future performance. All investments should be held for the long term as their value can fall as well as rise, therefore you may get back less than you invested.

Premier Financial Planning Ltd is authorised and regulated by the Financial Services Authority. The guidance and information contained in this booklet is subject to UK regulatory regime and is therefore restricted to consumers based in the UK.

Income Drawdown Risk Warnings

- High income withdrawals may not be sustainable during the deferral period.
- Taking withdrawals may erode the capital value of the fund, especially if investment returns are poor and a high level of income is being taken. This could result in a lower income when the annuity is eventually purchased.
- The investment returns may be less than those shown in the illustrations.
- Annuity rates may be at a worse level when purchase annuity takes place.

This booklet is based upon our understanding as at March 2013 of pension's legislation. This is subject to change. The options described in this guide are those generally available; however please note pension scheme rules can be more restrictive than the legislation

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