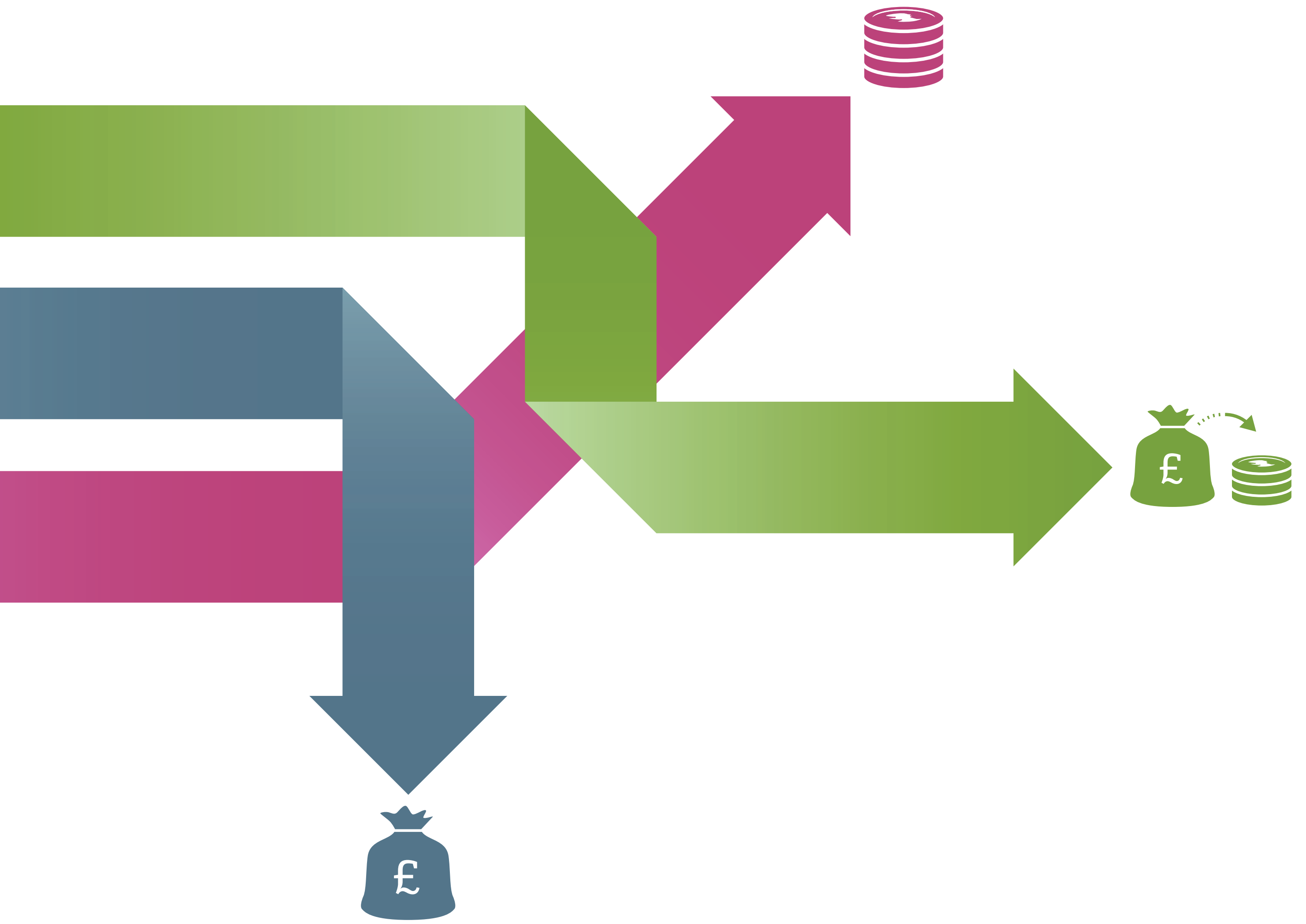
Retirement Intelligence

YOU AND YOUR PENSION POT WHEN YOU RETIRE

A GUIDE TO PENSION OPTIONS FOR THE OVER 55s



PRUDENTIAL

FOREWORD

When George Osborne introduced the pension changes on 19th March 2014 the retirement market changed overnight. Instead of needing to buy an ongoing income, people with individual pensions could simply elect to take their money out of their plan as they wanted, in stages or even in one go. Pension Freedom was born.

The changes have been embraced by many, with the chancellor confirming that 60,000 people have withdrawn over £1 billion pounds during the first few months of the freedoms being introduced. More recently it is interesting to see retirees taking a lower percentage of their overall pot, presumably realising that the fund could need to last them for many years.

The intention of this guide is to provide an independent, easy to read guide, to help people understand their choices. This is more important than ever following the UK's vote to leave the EU, and the additional uncertainty this brings. However, people's fundamental choices haven't changed.

This is the second version of the guide, which received excellent feedback originally. I think once again Billy has managed to make the complicated understandable. Billy is recognised as one of the most knowledgeable and respected experts in retirement planning, a reputation earned through helping people like you.

At Prudential we are committed to making sure that both existing policyholders and new customers have all the information they need in order to make the right choices when they retire and our sponsorship of this guide is part of that commitment.

I hope you enjoy this reading this guide and that it helps you make the right decisions with your hard-earned pension pot.

Vince Smith-Hughes
Director of Specialist Business Support at Prudential

This guide was updated in July 2016, 15 months since the beginning of pension freedoms.

The tax rates and allowances have been updated for the 2016 /2017 tax year.

CONTENTS

INTRODUCTION

When I was asked by Prudential to write an easy-to-read guide about the new pension freedoms last year, I didn't want to write just another paper warning about the dangers of taking your pension as a cash sum or running out of money. I wanted to write a paper that will help you make better decisions about how best to take cash or income from your pension pot when you reach retirement age.

There are many challenges on the horizon not least the impact of Brexit and the prospect of continued low interest rates and uncertainty in the financial markets. However, with the right help and advice, the new flexible pension options can be used to take advantage of any new opportunities arising in the future.

The value of expert help

I think it is simply too difficult for most people to make the right decisions without first speaking to an expert. A pension specialist can help you:

- Understand the industry jargon and pensions terminology
- Analyse the different options and the amount of tax payable
- Help you make the right decisions and ensure you understand all the potential risks.

There are many different types of experts including: pension companies, Pension Wise and financial advisers, but for those who are serious about making the right decisions there is no substitute for advice from a qualified and experienced financial adviser.

The new pension freedoms put you in control of your pension pot and you can now take income or cash in any way you wish (after paying the appropriate tax) and at any time after the age of 55. However freedom comes with responsibility and you owe it to yourself and your family to get the best possible help and information before you make a very important financial decision.

Making it easier for you

The biggest challenge in writing this guide has been to find the right balance between providing detailed information about the new pension freedoms and keeping it simple; if there is not enough information you might miss something important but make it too complicated you will not understand it.

In order to strike the right balance I have used a number of techniques such as my 'top tips' and 'rules of thumb' to make the information easy to understand without compromising the important job of explaining the options in sufficient detail.

One of the best ways to make this guide relevant to you is to introduce John and Mary who are a fictional couple with average circumstances and considering asking some of the same questions that you may have. Looking at their questions might help you find the answers you need to help you better understand your options.

I advised clients for over 20 years on all aspects of annuities and drawdown and over that time I developed a number of techniques that helped me explain complex options in a simple way. I have used many of these techniques in this guide.

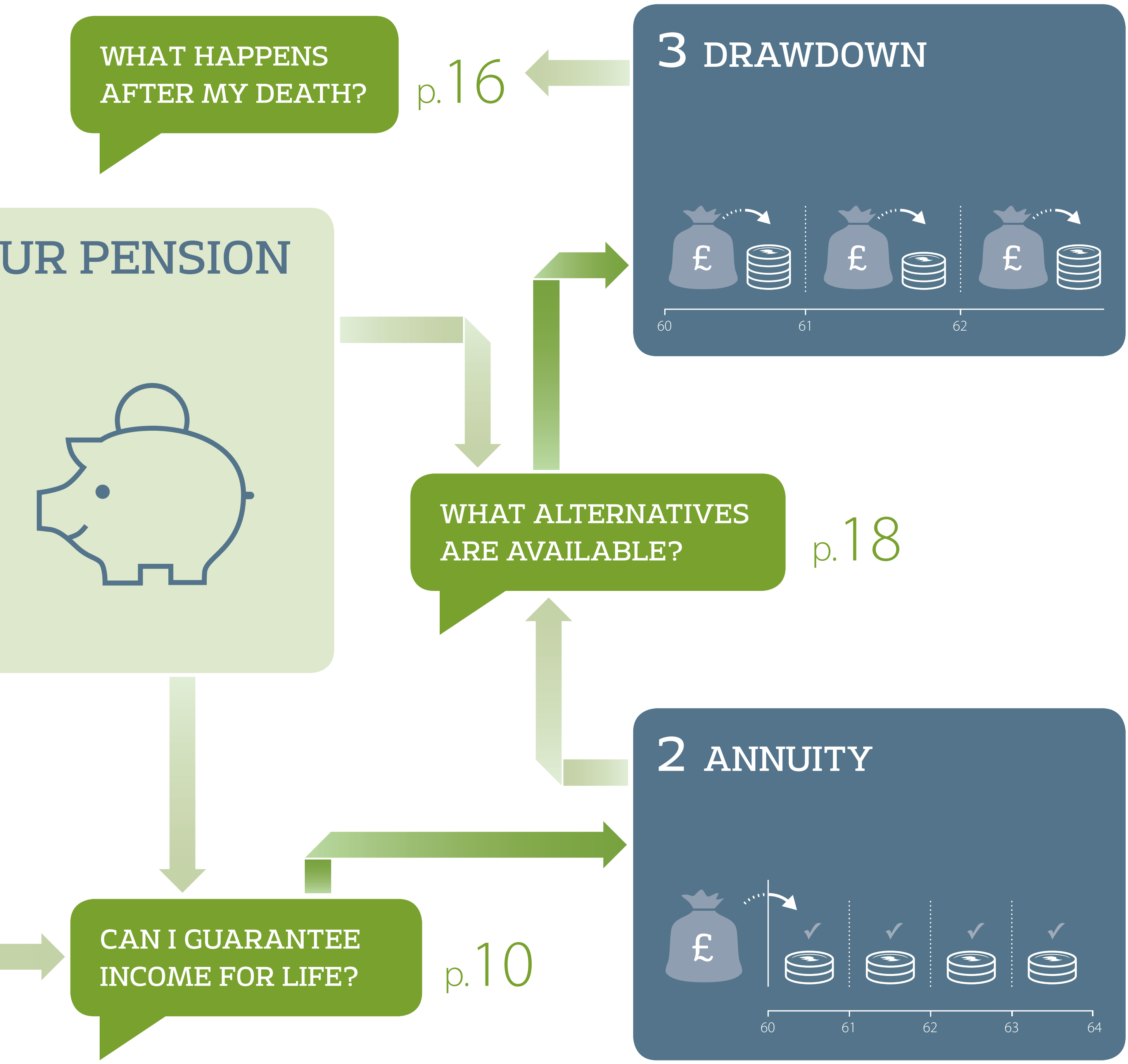
John and Mary
To keep things simple we will assume they both have their own pension funds (about £100,000 between them), are several years from receiving their state pensions and have some savings but no debts.

Like many people in their circumstances they would like to free up some cash so they can enjoy their early retirement but also appreciate the importance of having enough income to last through their retirement.

This guide is published for information only and does not in any way constitute financial advice.
You should take regulated financial advice before making a decision about any retirement income option.

OVERVIEW

The aim of this guide is to explain all the new pension freedom options in easy-to-understand and jargon-free language and to make it easier for you to take the next step which might be to speak with a financial adviser. So where better to start than providing an easy-to-understand overview of what you will find in the coming pages.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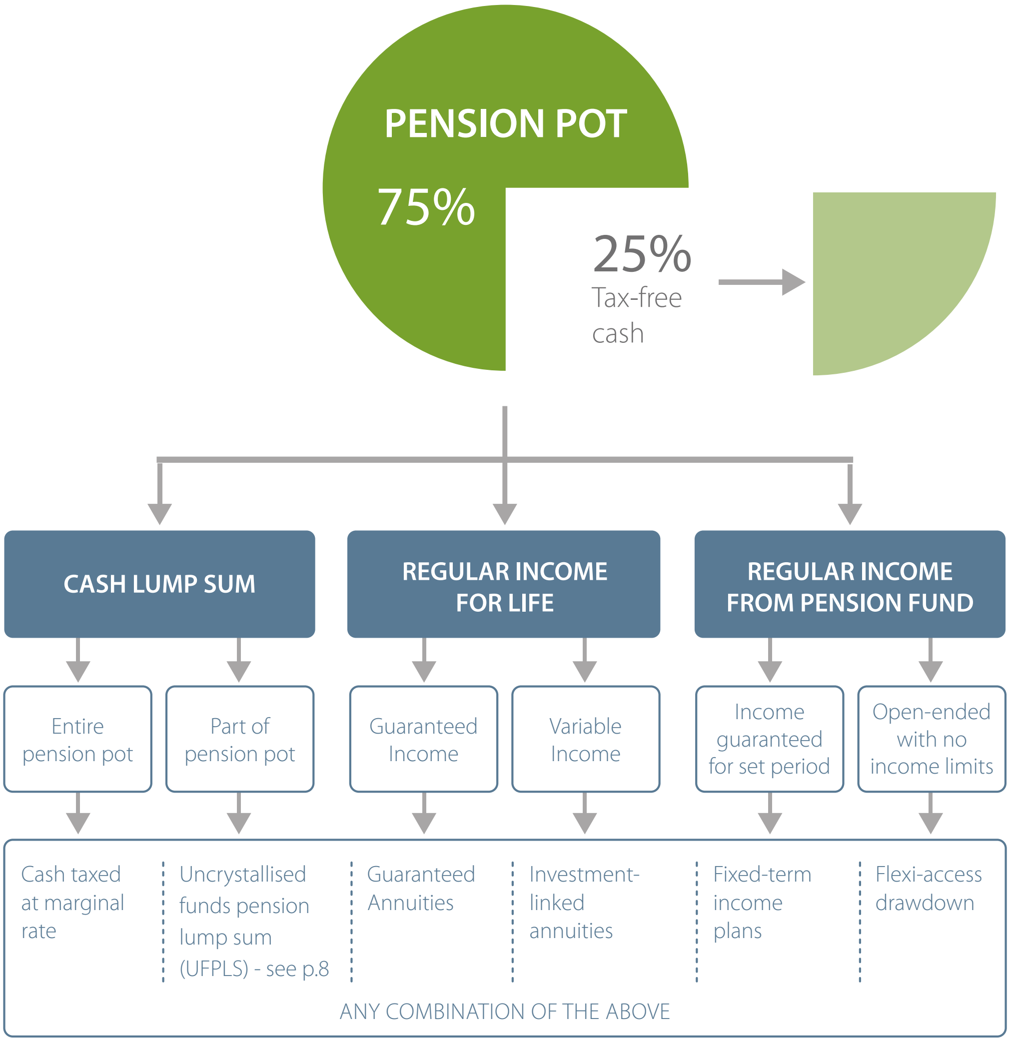
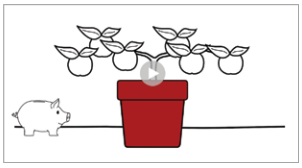
UNDERSTANDING YOUR RETIREMENT OPTIONS

With the new pension freedoms you can decide when to take income or cash from your pension pot at any time after age 55*. After taking 25% of your pension pot tax-free you can choose between any of the following options:





Prudential has produced a video called **"Your pension, your freedom"** which uses animated graphics to explain your retirement options.

This video can be seen at **www.pru.co.uk/pensions-retirement/planning/your-pension-your-freedom-video/**

* The minimum age from which you can access your personal or occupational pension is expected to increase from 55 to 57 in 2028 and remain at 10 years below the State Pension age.

When the Government announced the new pension freedoms in 2014 they realised that many people would need a lot of help understanding these new options. Also many people who would not normally go to a financial adviser will now need specialist financial help to avoid making poor decisions. Therefore the Government created a service called Pension Wise.

Pension Wise

This is a service which provides free help and guidance to anybody over the age of 50 who has a money purchase pension arrangement. Guidance from *Pension Wise* is provided by independent organisations over the phone or in person. Currently The Pensions Advisory Service (TPAS) and Citizens Advice Bureau (CAB) are the only two accredited organisations.

You can get further information from **www.pensionwise.gov.uk**

It is important that you don't confuse 'Guidance' with 'Advice' because they are two entirely different things

What types of pension do you have?

Before looking at your options in more detail it is important to take stock of your current and future pensions. Almost everybody will be entitled to a state pension (which can start at your state pension age) and in addition you may have one of the following; a final salary pension, a personal pension, or company money purchase pension.

The options discussed in this paper are only relevant to a personal pension, or company money purchase pension. If you have a final salary pension it may be possible to transfer to a money purchase pension plan in order to take advantage of the new changes but you should take financial advice before considering a transfer.

Billy's Top Tip
Find out about your state pension including recent changes and the age at which your pension can start at **www.gov.uk/state-pension**
You can also apply for a state pension forecast.

STATE PENSION	FINAL SALARY PENSION (FS)	PERSONAL PENSION (PP)	MONEY PURCHASE
This is the pension provided by the government. It is payable from your state pension age and is based on your national insurance contributions.	This is a pension paid by your employer. The benefits are based on how long you have worked and either your final salary or your career averaged earnings.	This is where you (and/or your employer) pays contributions into your own personal pension plan.	This is where your employer sets up a pension plan and makes contributions on your behalf (you can also make payments).
Your pension will be paid directly by the government and will increase each year.	You will normally get a tax-free sum plus regular pension payments for the rest of your life.	At retirement the value of your pension fund can be used for any of the new pension freedom options.	

Before you make any decisions about your options from a money purchase pension it is important that you check your plan details to see if there are any special terms or penalties. You should ask your pension provider for the following information:

- Current fund value and current transfer value – if these are different it means there is a penalty for transferring
- Where is the fund invested? – if you are invested in equities you may wish to review your investment strategy depending on what you will be doing
- Are there are guaranteed annuity rates (GARs)? – some older policies may have valuable guarantees.

If you have a pension buy-out plan (Section 32 policy) check to see if you have a Guaranteed Minimum Pension (GMP). This is a complex area and normally a financial adviser would find out this information.

Cash equivalent transfer value (CETV)
This is the expected cost of providing your final salary pension benefits, calculated using actuarial principles using assumptions about factors affecting the scheme and your future benefits.

FINAL SALARY TRANSFERS
If you have a final salary (FS) pension the benefits payable from your scheme will probably be more generous than any of the alternatives. However in certain circumstances it might be to your advantage to transfer to a personal pension (PP) and take advantage of the new pension freedoms. If you are considering transferring from a FS scheme to a PP arrangement and the cash equivalent transfer value (CETV) is over £30,000, you must get specialist advice from a qualified pension transfer specialist.

Cash sums

Perhaps the most radical change to pensions is the option to convert your pension pot into a cash lump sum. It has always been possible to take 25% of your pension pot as a tax-free lump sum but now everybody can take the remaining 75% of their pension pot as a cash sum, but it will be taxed at your marginal rate.

There are two ways in which you can take cash from your pension:

- By asking your pension provider to pay your entire pension pot as a cash lump sum
- By asking your pension provider to pay part of your pension pot as a cash sum – Uncrystallised Funds Pension Lump Sum (UFPLS)

The most important thing to understand about cash sums taken over your tax free amount is that they will be taxed as income at your **marginal rate,** therefore if you take a large cash sum you could end up paying higher rate tax. Remember that your provider will deduct tax at source, which means that you will only receive the after-tax amount.

ADVANTAGES	DISADVANTAGES
Cash in hand to spend as you please.	Once the cash is spent you will need other sources of income to pay for everyday needs.
Can be used to re-pay debt.	Taxed as income at your marginal rate.
You can invest the cash in any way you wish including assets not allowed within a pension.	It may be less tax efficient to invest outside of a pension. Also some investments may be much higher risk and in some cases unregulated.

Uncrystallised Funds Pension Lump Sum (UFPLS)

UFPLS is a payment option which allows your insurance company to pay you a chunk of your pension pot as a cash sum when you reach retirement age (normally any time after age 55). It is taxed in the normal way; 25% tax free and 75% taxed at your marginal rate. You can take a series of UFPLS payments spread over several tax years in order to reduce your tax bill.

Taking a UFPLS will trigger the Money Purchase Annual Allowance (MPAA) of £10,000. This is complex, but if you are still paying into a pension you will only get tax relief on new contributions up to £10,000 per annum (see the Glossary for more information).

Watch out for

The main thing to watch out for is tax and this is explained on the next page.

You should also watch out for the part of you that puts short-term gain before longer-term financial security. It is your money and you are free to spend as it you wish but you also owe it to yourself and your family to think about your future income needs.

Finally, watch out for 'pension scams' and sales people tempting you to purchase expensive cars and holidays by cashing in your pensions. The Pension Wise website has helpful information about pension scams; **www.pensionwise.gov.uk/scams**

Rule of thumb

If your total income (including any cash over and above the tax free lump sum from your pension) is more than £43,000 you will probably pay higher rate tax. This assumes you do not qualify for any other reliefs.

You should always consult a specialist adviser if in doubt.

John wants to buy a new car and Mary wants a new kitchen so it is tempting to convert their pension pot into a cash sum.

However they will pay a lot of tax and if they spend their pension cash now they may not have enough income in later years.

One possible solution is take some of their pension as a cash sum and use some of it to provide an income for life.

Tax on pension cash lump sums

It is important to remember that you will pay tax at your marginal rate on any lump sums (except the 25% tax free) or income. This means that even though you might normally be a basic rate payer, you could become a higher rate tax payer after taking a cash lump sum.

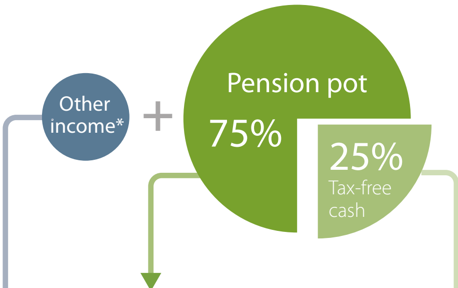
The UK tax system is not that complicated if you understand some basic concepts such as the personal allowance, tax bands and marginal rates of tax:

PERSONAL ALLOWANCE	TAX BANDS	MARGINAL RATES OF TAX
This is the amount of income you do not have to pay tax on. For the 2016/17 tax year the Standard Personal Allowance is £11,000. Your Personal Allowance may be bigger if you claim Marriage Allowance or Blind Person's Allowance. It will be smaller if your income is over £100,000.	All earnings above your Personal Allowance (PA) are taxed in bands as follows: Basic rate band £0 - £32,000 Higher rate band £32,001 - £150,000 Additional rate band Over £150,000	Marginal bands mean you only pay the specified tax rate on that portion of salary. For instance, if you have the standard PA of £11,000 you would pay tax as follows: First £11,000 No tax payable £11,000 to £43,000 20% £43,001 to £150,000 40% Over £150,000 45%

When pension companies make cash or income payment they deduct tax at source using the PAYE system. If your pension provider has your current tax code the correct amount of tax should be deducted. However if you do not have the correct tax code, or their payment systems are not up to speed, emergency tax may be used and you will probably pay more tax than you are liable for. Any overpayment of tax will be refunded but there will be a delay.

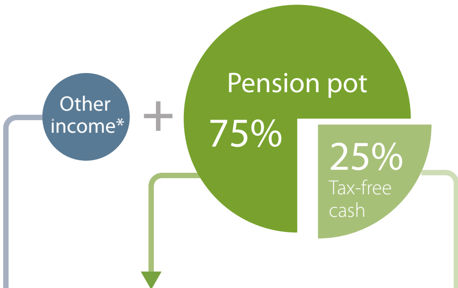
The graphics below show examples of the tax payable if a pension pot is taken as cash sum.

A: £25,000 Pension Pot



Pension pot (75%)	£ 18,750
Other income	£ 10,000
Taxable income	£ 28,750
Tax (basic rate)	– £ 3,550
Tax (higher rate)	– £ 0
Net income	£ 25,200
Tax free cash (25%)	£ 6,250
Cash in hand	£ 31,450

B: £50,000 Pension Pot



Pension pot (75%)	£ 37,500
Other income	£ 10,000
Taxable income	£ 47,500
Tax (basic rate)	– £ 6,400
Tax (higher rate)	– £ 1,800
Net income	£ 39,300
Tax free cash (25%)	£ 12,500
Cash in hand	£ 51,800

* Other income includes; employed or self-employed earnings, other pension income including state pensions and any income from savings or investments. National Insurance may also be payable.

Billy's Top Tax Tips

1. If taking a cash sum from your pension would move you into a higher rate tax band consider taking some income in future tax years, to avoid paying tax at 40% or higher.

2. Allow for the fact that you may pay more tax than is due initially, but it can be reclaimed. Your pension provider can give you more information.

3. Estimate the amount of tax you will pay on a pension cash sum by entering your details into an online tax calculator which you can find on some specialist retirement websites.

John's accountant says that one of the best ways to keep tax bills to a minimum is to spread cash payments over several years and always try to keep annual income below the higher rate band.

He also warns John and Mary that it is important to understand that they may pay more tax than is due initially, but will be able to claim it back later on.

Regular income for life (Annuity)

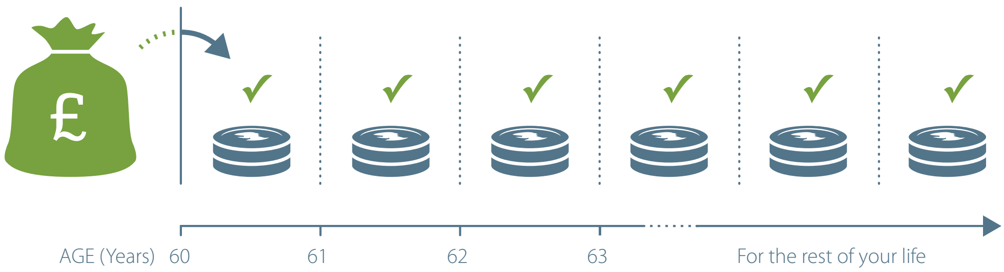
In the rush to take advantage of the new pension freedoms it is easy to forget what a pension actually is. It is an income paid each month for the rest of your life after you have retired from work. The only policy that can pay an income for life is an annuity because it converts your pension pot into a stream of future income.

Quick facts:

Annuity policies
The amount of income payable from an annuity depends on a number of factors: • Your age and health – the older you are the higher the income payments and if you have certain health conditions you may qualify for an enhanced annuity • Interest rates – annuities are priced in relation to the yields on long-term fixed interest investments so when yields are low annuity rates are low and vice versa • The options selected – e.g. single or joint life, level or escalating, income guarantee period or value protection and choice of payment frequencies. Most pay a guaranteed income for life but some annuities, called investment-linked, are invested in the stockmarket and other investments such as property, and future payments may be higher or lower depending on investment returns.

How annuities work in practice

When you purchase a traditional annuity the insurance company invests your money in very safe assets and pays you a regular income every month (other frequencies are available) for the rest of your life. If you select a joint annuity, and you die before your spouse or partner, the income will continue to them for rest of their life.



Billys' Top Tip

You can get an annuity quotation by using one of the real-time annuity calculators available on some specialist annuity websites.

Remember – before you purchase an annuity make sure you have shopped around for the best rate.

Also make sure you give details about your health to see if you qualify for an enhanced annuity.

Enhanced Annuity

You might be able to get a higher annuity income if you smoke, are taking prescription medication or have recently had medical treatment for a condition. You may qualify for an enhanced annuity which may result in a higher income.

The table below shows the typical pay-outs on a range of annuity options.

Annuity basis: 1st annuitant age 65, 2nd aged 60				Gross annual income for £100,000 purchase	
Type	Partner's pension	Guarantee period	Escalation	Standard	Enhanced *
Single	0%	5 years	Level	£4,777	£6,027
Joint	50%	5 years	Level	£4,259	£5,191
Joint	66%	5 years	Level	£4,099	£4,952

Source: Retirement Intelligence / Annuity Exchange – top provider rates, July 2016
Assumptions: Tax will normally be deducted at source before payments are made.
* Smoker with high blood pressure, overweight and diabetes.

Advantages and disadvantages of traditional annuities

ADVANTAGES	DISADVANTAGES
Income for life, no matter how long you live or what happens to financial markets	If you (and your partner) die earlier than expected you may not have had your money back
Your income will be guaranteed	Your annuity will be priced on current yields which are currently at historically low levels
Peace of mind and security	You cannot change your annuity income if your circumstances change

Rule of thumb

The income from a level annuity starts about 40% higher than an annuity escalating at 3% per annum. It takes over 12 years for the escalating annuity to catch up with the level annuity.

Life expectancy

Most people don't like to think about when they will die but it is important to think about this because you don't want to run out of income in later life. An annuity is the only policy that guarantees to pay an income no matter how long you live and as the table below shows, you might live longer than you think.

	MEN		WOMEN	
Age now	Years	To age	Years	To age
60	27	87	30	90
70	18	88	20	90
80	10	90	11	91

Sample Expectations of Life from the CMI (Continuous Mortality Investigation) 2014 Model

John explains to Mary he can purchase a joint life annuity which means that he will get a guaranteed income for life but if he dies before Mary the income will continue to her for the rest of her life.

If either of them smokes, is taking prescription medication or has a medical condition that might affect their life expectancy they might qualify for an enhanced annuity.

Watch out for

It is very important to make sure that you shop around for the highest annuity rate. The annuity rates paid by your current pension provider may be much lower than you can get from another company therefore you should make sure you shop around for the highest paying annuity company.

Also watch out for your health; if you have any medical or lifestyle condition that may reduce your future life expectancy you should apply for an enhanced annuity.

Finally, don't forget if you considering an annuity income you should also consider investment linked annuities. These pay an income for life but as future payments are linked to investment returns the amount of income can go up as well as down.

Investment-linked annuities

Investment-linked annuities are invested in either a with-profits or managed fund. At the outset the starting income is selected between certain limits and in subsequent years the annuity income is recalculated to take account of the actual investment growth or losses.

The rationale for these policies is that an annuity is a long-term investment so it makes sense to invest in assets that may grow over time and provide a higher income in the future. The income could also reduce. As these annuities are more risky they are only suitable for those who understand the risks and can afford any future reduction in income.

Regular income withdrawals (drawdown)

All new drawdown policies are called 'flexi-access drawdown'. There are no income limits so you can decide how much income you want to take. You can withdraw up to 100% of the fund as an income payment but you will be taxed at your marginal rate on any income taken.

Quick facts

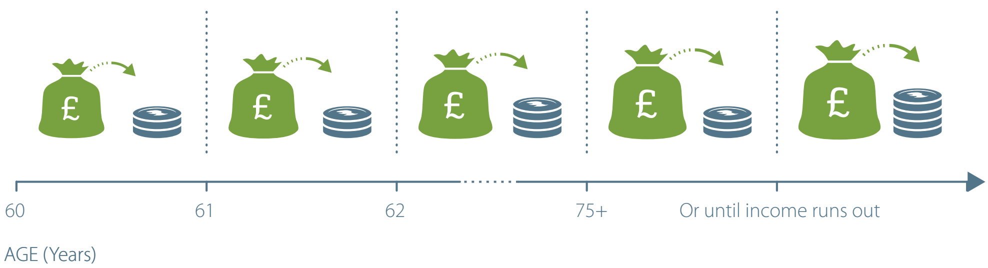
Drawdown policies
A drawdown plan allows you take regular income withdrawals directly from your pension fund and you retain full control over your pension pot so you have: • Income flexibility – you can take as much or little income as you need • Control of investments – you can decide where your pension is invested • Choice of death benefits – you can decide what happens to your pension pot after your death.

How drawdown works in practice

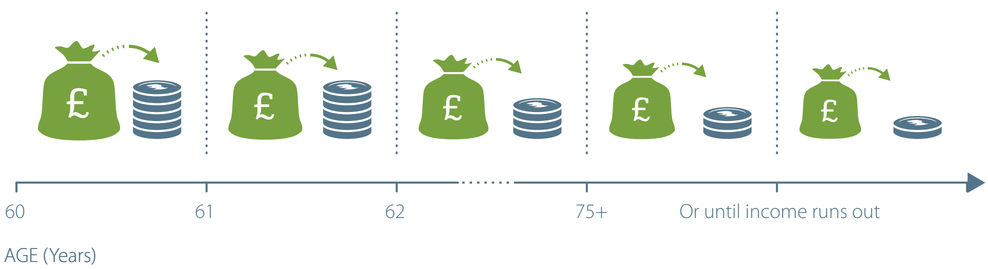
Your pension pot remains invested in a pension plan and you can take regular income withdrawals. You can change the amount of income you take each year but don't forget you pay tax on the full amount of income taken.

The most important thing to remember is that unlike an annuity, your income is not guaranteed and if you take too much income in the early years or if the fund does not increase in value as planned, you could end up with a lower income or even run out of money entirely. The graphics below show how drawdown may play out over the course of your retirement depending on investment returns.

If your pension fund *increases* in value after taking income drawdown payments you can increase your payments in the future.



If your pension fund *decreases* in value after taking income drawdown payments you may have to reduce your income payments.



Rule of thumb

You can take any amount of income from a drawdown plan, but most financial experts recommend you only take an amount that can be sustained over the long term assuming investment returns in line with your attitude to risk.

While there is no hard and fast rule, the recommended sustainable income is between 3% and 4% of the fund value per annum, increasing each year by inflation.

John and Mary's financial adviser explains that with drawdown John would keep his pension fund invested and then make regular income withdrawals e.g. every month.

The pension fund can be invested in cash, fixed interest, the stockmarket or commercial property but residential properties are not allowed.

If they take out too much income and/or the pension fund does not grow as planned they may run out of money.

Advantages and disadvantages of drawdown

Advantages	Disadvantages
Income flexibility – you can change your income at any time	If you withdraw too much income you could run out of money
Control of investments – you are able to invest in any permitted investments	If your invest unwisely you could see the value of your fund fall in value
Choice of death benefits – when you die your remaining drawdown fund can be transferred to your chosen beneficiaries	When you invest in drawdown you do not benefit from the mortality-cross subsidy which is a feature of an annuity

You can also nominate one or more beneficiaries who will receive your remaining pension pot after you die. The table summarises the possible death benefit and the tax treatment:

Death benefit option	Death before age 75	Death after age 75
Take the pension as a lump sum	Tax-free	"Lump sum" taxed at the beneficiaries marginal rate
Continuing with drawdown	Tax-free income	Income taxed at the beneficiaries marginal rate
Converting your drawdown fund to a lifetime annuity	Tax-free income	Income taxed at the beneficiaries marginal rate

The death benefit options are considered in more detail in the next section when we answer the question 'What happens after your death?'

Watch out for

The two most important things to keep an eagle eye on are the amount of income you take out and where your drawdown is invested. These two things are intricately linked because of the sequence of return risks.

Investing while taking income withdrawals is different to investing without taking income and this is because if the returns are low or negative in the early years you will erode your capital fast and it will be hard to recover from early losses.

When you take income from a flexi-access drawdown it will be a trigger event for the Money Purchase Annual Allowance (MPAA).

Although drawdown may seem easy to understand the risks are much harder to understand, especially if compared to the guaranteed income from an annuity. We consider these risks when we look at the important questions in the next section.

The Scotland Rate of Income Tax*

Payments from annuities and income drawdown plans and UFPLS are subject to income tax. The Scotland Act 2012 gives the Scottish Government the power to set a Scottish rate of income tax. However, for the 2016/2017 tax year the UK and Scottish Rate of Income Tax will be the same. The calculations shown in this brochure are based on UK tax rates.

Billy's Top Tip

Drawdown may be very flexible but it is important to understand the risks, which include:

- Income risk – watch out you don't run out of income
- Stockmarket risk – choose investments wisely
- Mortality drag – in simplistic terms the risk of delaying purchasing an annuity.

If John dies Mary can inherit his pension drawdown and spend it as she wishes; for example as a cash sum, continued drawdown, or by purchasing an annuity.

If John dies before he is 75 Mary will pay no tax on money taken from his pension, but if he dies after age 75 she will pay tax at her marginal rate on any income taken.

They are both keen to provide for their children so there is an option to include their children as beneficiaries of the drawdown pension.

*** The Scotland Rate of Income Tax**

The Scottish Rate of Income Tax will come into effect from the 6th April 2016. In future, individuals identified by HMRC as Scottish rate taxpayers may pay a different rate of income tax to the rest of the UK..

For more information please visit www.pru.co.uk/tax or www.gov.uk/scottish-rate-income-tax

YOUR QUESTIONS

The important questions:

You probably have lots of questions you would like to ask so I have taken some of the most frequently asked questions and provided easy-to-understand answers.

1 What has happened so far with pension freedom?

Looking back over the first year of Pension Freedoms which started in April 2015, things have turned out much way as expected. In the run up to pension freedoms there were fears that many people would make bad decisions which they would regret in the future but it seems that pension freedoms have, in the main, been used sensibly.

Cash sums

As expected, a lot of people with small pension pots converted these into cash soon after April 2015. According to the Association of British Insurers (ABI) in the first 9 months of pension freedoms just over 210,000 people cashed in their pension pots totalling about £3 billion and the average payment was nearly £15,000.

After the initial surge, the number of people taking their pension pots as cash has reduced significantly. It also seems that those with larger pensions are converting their pots into income (after taking their 25% tax free cash entitlement) by taking advantage of pension drawdown or purchasing an annuity.

Annuities

Before pension freedoms the majority of people retiring with their own pension fund, especially those with small pots, purchased annuities. Therefore, it is no surprise that the number of annuities arranged has fallen significantly as those with small pots favoured cash lump sums. Also drawdown has become more popular which means many people who may have purchased annuities in the past are now investing in drawdown.

I think there is still a strong case for annuities for those want or need a guaranteed income for life, especially as people get older and become more risk averse. There are signs that annuities sales are increasing and this is partly due to the recent volatility in global stock markets which has made people think again about the risks of drawdown.

Pension drawdown

Drawdown has been one of the clear winners from pension freedoms and according to the ABI in the first 9 months, about 63,000 people invested in drawdown with an average fund of just over £ 66,000.

The increased popularity of drawdown comes as no surprise because it allows people to take full advantage of the new pension freedoms by giving control over income, investment options and death benefits.

The volatility in global stock markets during 2016 has given drawdown investors a rough ride and showed that 'sequence of returns of risk' is a real life phenomenon not just a theoretical possibility. (See page 19)

Pension Wise

The new and free pension guidance service created by the government to help guide people through the maze of options at retirement has successfully helped many people.

The Government seems committed to continue providing a free information and guidance service for the over 50s. Building on the success of Pension Wise, the Government announced plans to enable people to get all their questions about pensions answered in one place and The Pensions Advisory Service and Pension Wise will be replaced by a single pension guidance body.

The remit of Pension Wise will be extended including providing guidance on the new secondary annuity market, proposed to come in from April 2017 (see below).

Pension scams

Thankfully, the number of reported of scams directly linked to pension freedoms has been less than some people predicted. However, it is important you watch out for anyone pretending to be or to represent an official government organisation or regulated adviser and trying to get their hands on your money.

According to Michelle Cracknell, chief executive of The Pensions Advisory Service, one of organisations that provides the Pension Wise service;

"Guidance is about getting people started. We help people get a better understanding of their options and the key issues. As a result of guidance, people better understand their position and the value that speaking to a financial adviser can add."

2 What future changes to pension freedoms can we expect?

There has been so much change to pensions over the last few years it is hardly surprising that industry professional are calling for a period of stability without any major changes so that everybody can plan ahead with confidence that there will be no major disruptions to the pensions landscape.

However, there is one very important change that is planned to happen in April 2017 when it will be possible to exchange annuities in return for a lump sum.

If you already have a pension annuity which pays you a regular income you will be able to exchange it for a lump sum as the government is creating a secondary annuity market, or as it will probably be called 'second hand annuities'.

It may seem attractive to sell your annuity and get a cash sum but there some hidden dangers to watch out for. First of all, you may not get a very deal if you sell your annuity because of the charges and uncertainty about how long you may live. Secondly you will pay tax at your marginal rate on the cash payout.

If you have a very small annuity there might be a strong case for turning it into cash, but if you are relying on the annuity income to pay your everyday bills you will have to think carefully because it is very unlikely that the money you get from selling your annuity will be enough to provide the same income for life that your original annuity was paying.

The Government is concerned that people may make the wrong the choices and sell their annuity when it is not to their best interests. Therefore, anyone wishing to sell an annuity over a certain amount will need to take financial advice.

3 Where do I start – I don't know where to go first?

What you do next depends on what you want to do and when you want to do it. If you simply want information about your pension pot you could start by talking to your pension company.

If you want generic information about your options without the need for a specific recommendation you could take advantage of a guidance session with *Pension Wise*

If you want to know which options are most suitable for your circumstances or an in-depth review of your pension arrangements you should contact a financial adviser.

The table below summaries the services provided by each of these:

	PENSION COMPANIES	GUIDANCE	ADVICE
Overview	Pension companies will provide you with information on your policy and their range of products	Pension Wise provides free and impartial information on retirement options from money purchase pension pots	A financial adviser can advise you on all aspects of your financial affairs, not just pension options
Level of expertise	The employees of pension companies should be knowledgeable about their own products but they will not normally discuss products they do not offer	All 'guiders' (especially those with TPAS) will have undergone a rigorous and comprehensive training in all aspects of pensions. Some have professional pension or tax qualifications	All financial advisers will be trained to the high standards demanded by the FCA*. In addition advisers have practical experience of advising clients and they are continually monitored by the FCA
Outcomes	The outcome will be one of the pension company's own products unless they refer you to advice or have an arrangement to sell other company's products	At the end of a guidance session you may be given a written summary of the things discussed but they cannot tell you what the best course of action is	An adviser will make a personal recommendation – which means that they advise you which options are most suitable for your circumstances
Responsibility	Pension providers have an obligation to treat their customers fairly and must have a 'second line of defence' if their own customers want to buy some of their products	Pension Wise will act in good faith but take no responsibility for the guidance or information they provided	Advisers take full responsibility for the advice they give and there is a system for holding them to account if they give the wrong advice
Costs	All financial products have charges such as policy fees or annual management charges.	The service is free	Many advisers will offer a free appointment at the outset and thereafter they will charge a fee for their services
How to contact them	You will find contact details on recent correspondence	www.pensionwise.gov.uk Appointments can also be booked by phone on 0300 330 1001	Directories of financial advisers: www.unbiased.co.uk www.thepfs.org/yourmoney www.moneyadviceservice.org.uk

*FCA – Financial Conduct Authority: the organisation that regulates the financial services industry.

4 How do I keep my tax to a minimum?

There are basically three ways in which you can reduce the amount of tax you pay on your pension income:

1 Avoid paying emergency tax on your income

2 Spread the amount of cash and income you take over several years to avoid paying higher rates of tax

3 Take your pension in slices over several years – known as phased retirement

Avoid paying emergency rate tax

Unless your pension provider holds an up-to-date tax code they may calculate the tax you will pay on an emergency rate basis. This means that you will pay more tax than you should and your after-tax payments will be less than you might have expected. Any tax that is overpaid can be reclaimed using one of the new HMRC forms specifically designed for this purpose but it might take some time to get the overpayment back.

You can avoid paying emergency tax by ensuring your pension provider has an up to date P45 before they make an income payment.

Spreading your payments

Take, for instance, someone aged 60 with a pension fund of £75,000 and other income of £10,000 p.a. If the whole £75,000 was taken as cash lump sum in one payment the amount of tax payable would be £15,700. However, if the cash sum was spread over two years the tax paid would only be £10,850. This is a tax saving of £4,850.

	IN 1 YEAR	SPREAD OVER 2 YEARS*	
	Pension = £75K Income = £10K	Pension = £37.5K Income = £10K	Pension = £37.5K Income = £10K
Tax-free income	£18,750	£9,375	£9,375
Income after tax	£50,550	£32,700	£32,700
Basic rate tax	£6,400	£5,425	£5,425
Higher rate tax	£9,300	£0	£0
Total tax paid	£15,700	£5,425	£5,425
Tax saving			£4,850

* Assuming the personal allowance and tax threshold remain the same over the two years.

Phased Retirement

Phased retirement is where you take a slice of your pension each year. From each slice 25% of the cash will be tax free and you will only pay tax on the remaining 75% of the cash.

The thing to remember about phased retirement is that each year you use your 25% tax-free cash allowance towards your income needs plus the income from the remaining 75% of the pension slice. This means that phased retirement only works for those who do not need their entire tax-free cash sum as a lump sum payment.

Billy's Top Tip

It normally makes sense to avoid paying higher rate tax. If taking a cash sum from your pension means that you will move into the higher rate tax band you could consider taking some of your cash sum in future tax years to avoid paying tax at 40% or higher.

John and Mary's accountant doesn't want to lecture them on tax but explains two very important things they should be aware of:

- Avoid paying higher rate tax if at all possible
- One of the best ways to keep tax payments to a minimum is to spread taking income and or cash over several years

5 What happens after my death?

What happens on your death will depend on what options you had previously chosen for your pension pot(s) and your age.

Death benefit options

If you have money in an untouched pension pot or pension drawdown, and the plan allows it, your remaining fund can be transferred to your chosen beneficiaries who can then take unlimited income from the fund at any time.

If you had purchased an annuity with a joint life option the income will continue to the named person. If there is still a benefit from a guarantee period or value protection option this can benefit your loved ones.

John and Mary have two children and several grandchildren.

They can nominate each other, their children, or their grandchildren as beneficiaries to receive all or part of their own pension pots after their death. They can also split the nomination between different people.

Tax

If you die before the age of 75 your beneficiaries will have no tax to pay on any lump sum or income but if you die after the age of 75 they will pay tax on any income taken at their marginal rate.

The table below summaries the death benefit options.

Pension type	How benefits can be paid	Taxation on death of policyholder	
		Before age 75[1]	After age 75[1]
Pension still untouched	Lump sum payment or drawdown income or annuity	All income and lump sum payments will be tax-free	All income payments will be taxed at the beneficiaries' marginal rate Any lump sum payments[2] will be taxed at the beneficiaries' marginal rate
Annuity being paid	Joint-life, guarantee or value protection		
Drawdown income	Lump sum, drawdown income or annuity		

Notes:
[1] If benefits are paid at the discretion of trustee they will be IHT free
[2] Includes annuity value protection

You can name anybody as a beneficiary. In most cases you will probably choose your spouse or partner as the beneficiary but you can nominate your children, grandchildren, family friend or even a charity. Technically the final choice of beneficiary is at the discretion of the trustees responsible for overseeing the pension plan but in most cases they follow your wishes. This means that any transfers or cash payments are normally free of Inheritance Tax.

On death of the beneficiary any remaining drawdown funds may be passed on to their beneficiaries which means that pensions can be passed from generation to generation.

6 How much risk should I take?

The short answer is enough risk to avoid being locked in very low returns for evermore but not too much risk that you put your future retirement plans in jeopardy.

When assessing how much risk to take you should consider not only your attitude to risk but also your capacity for loss. Attitude to risk is an easy concept to grasp and is normally expressed as low risk, medium risk or higher risk (see table below). Your attitude to risk is normally measured as your tolerance to taking investment risk and financial advisers have special questionnaires and tools to help assess your risk profile.

Capacity for loss is described as your ability to absorb falls in the value of your investments or income without it causing you adverse financial hardship or emotional strain.

LEVEL OF RISK	DESCRIPTION
Low risk	You would prefer to have most of your investments in cash and fixed interest securities in order to protect the value of your capital.
Medium risk	Someone who would like to take advantage of equity investment with the prospect of good long-term returns but can accept some short-term volatility which may result in a fall in the value of the investment.
Higher risk	You will consider exposure to higher risk investments despite the potential loss of capital.

There are many other different risks you should take into consideration during your retirement. These range from the risk that you might be too cautious and therefore get locked into low returns to being too optimistic and therefore run the risk of losing your cash or running out of income.

Other risks that you should consider include:

- **Income risk** – If you don't plan wisely you may end up short of income in later life and at the very worse run out of income
- **Annuity rate risk** – You may decide to purchase an annuity at some time during your retirement and if annuity rates reduce you will get less income. If annuity rates improve you will get more income
- **Stock market risk** – If your pension pot is invested in the stock market the value will rise or fall depending on equity prices. If you invest in drawdown you must watch out for 'sequence of returns risk' (see right)
- **Inflation risk** – This affects your future spending power so if your income does not increase over time over time you might not have enough income to maintain your lifestyle
- **Health risk** – If your health deteriorates you may have to pay for long term care or help with daily living. It is important to consider this when thinking about your income requirements

Billy's Top Tip

There is no single retirement income policy that can effectively help you manage all risks you will face in retirement.

Therefore it might make sense to consider arranging your pension income so that you have a combination of annuities to provide guaranteed income and drawdown to provide flexibility.

Sequence of returns risk

If you are taking income from a pension pot invested in the stockmarket and your fund falls in value during the early years, the amount of income that you can take in the future may be less than you expected. Your future income may be less because your pension pot may not increase in value sufficiently to make up for the early losses.

John is an optimistic person and is prepared to take some risks so he is interested in having a drawdown plan invested in the stock market. Mary is very cautious and likes the idea of purchasing an annuity.

They were surprised to hear their financial adviser tell them that it is not as simple as this, and that they consider the longer term and a range of options, as John may be taking undue risks and Mary may be too cautious.

HOW TO DECIDE WHICH OPTIONS ARE MOST SUITABLE FOR YOUR CIRCUMSTANCES

There are some things you may find easy when making decisions about how to take cash and income from your pension and there are some things you may find difficult. The easy things may include: doing some background reading about your options, finding out what types of pensions you have and much they are worth and forecasting your future expenditure. The difficult things include: analysing complex financial products, understanding the risks associated with different options, and working out how to save tax.

The best people to help you with the difficult things are financial advisers because they understand all the technicalities and have been specially trained to make sure you get the best outcome for your circumstances. One of the most important things an adviser will do is help you plan ahead for your future retirement.

Setting out a plan

As with most things in life it is important to have a plan, no matter how basic, because without one you cannot navigate your way forward. At first you might be reluctant to make a plan but time spent thinking about your future retirement objectives will put you in a much better position to make the right decisions. There are a number of factors to take into account when setting out your retirement objectives including:

Objectives	Examples
Income needs	Sufficient income to enjoy all the things you have planned to do
Goals	To have financial independence with peace of mind and security
Aspirations	To enjoy more holidays and leave an inheritance to the family

Working out your future retirement objectives does not have to be difficult, especially if you concentrate on the following four things:

- Your income requirements
- The amount of flexibility you need
- Your attitude to risk and capacity for loss
- What will happen after your death

Billy's Top Tip

Try and separate your strategy from the tactics. Strategy is about having a plan. It does not have to be complicated but you do need a plan. Tactics is about choosing the right options.

Your income requirements

Most people naturally want as much income as they can get but it is important to think about your future income requirements and to take account of inflation. You may also need more income in the future to help pay for increased living expenses if you need to pay for home help or care.

Generally speaking, the more income you take from your pension pot in the early years the less income will be available in later retirement. Financial advisers talk about the importance of 'sustainable income', that is an income that will last for the rest of your life and ideally keep up with inflation.

How much certainty and/or flexibility do you need?

The need for certainty hardly needs explaining, especially if you don't want to take any risks but the need for flexibility may not be so obvious.

You might need some flexibility for the following reasons:

- In case your income requirements change
- In order to benefit from any increases in the stockmarket or long-term interest rates
- In the event your health deteriorates and you will qualify for an enhanced annuity
- If you wish to have flexibility in deciding who will be the beneficiaries of your pension pot after your death

Your attitude to risk and capacity for loss

As explained above, your attitude to risk is linked to your tolerance for risk whereas as your capacity for loss is about how much you can lose before your financial security is jeopardised.

It might be unpleasant to think about but it is important to look at what would happen if your retirement plans all went wrong and you were to lose a significant amount of your capital and income, and ask how you would cope.

What will happen after your death?

The focus for retirement income planning should quite rightly be on your income needs and the needs of those directly dependent on you such as your spouse or partner. However it is only right to want to leave an inheritance to your wider family if that is possible and does not adversely affect your own personal income position.

Once you have set out your retirement objectives and attitude to risk you can turn your attention to working out which product options will give you the best solution. A good financial adviser will use their specialist skills to identify the options which meet your objectives and then recommend the solution that is most suitable to your circumstances.

John and Mary are discussing what they have learnt so far about their retirement options.

Mary says "It all sounds too complicated and there are so many options to consider."

John reminds her of some words of wisdom he heard from a financial expert: "When things appear complicated, go back to basics and ask yourself some simple questions."

For John and Mary these include:

- How much income do they need throughout retirement?
- How much flexibility do they need in case their circumstances change?
- How do they deal with the various risks they will face during their retirement?

Right, said Mary, let's start making a list.

Billy's top tip

Always make sure you consider your capacity for loss.

This is your ability to absorb falls in the value of your investment.

If any loss of capital would have a materially detrimental effect on your standard of living, this should be taken into account in assessing the risk you are able to take.

BILLYOGRAPHY

I have tried to avoid using jargon but inevitably I have had to use some technical names in this guide. Where I have used jargon or a technical term it has been highlighted and I have provided a plain English explanation below:

Pension jargon	Plain English
Annual allowance	The annual allowance is a limit to the total amount of contributions that can be paid to defined contribution pension schemes and the total amount of benefits that you can build up in defined benefit pension schemes each year, for tax relief purposes. The annual allowance is currently capped at £40,000 although a lower limit of £10,000 may apply if you have already started drawing a pension. The annual allowance applies across all of the schemes you belong to, it's not a 'per scheme' limit and includes all of the contributions that you or your employer pay or anyone else who pays on your behalf. Higher earners (those typically earning above £150,000 also taking into account employer contributions) can also have their annual allowance reduced.
Annuity	An annuity converts a pension pot into regular income payments for the rest of your life. These payments can continue to someone else after you die if a joint life option is chosen.
Beneficiaries	You can choose who you would like to benefit from your pension fund after your death. Although you can nominate who will be the beneficiary, it is normally at the discretion of the trustees who are in charge of the pension fund because this avoids any IHT
Buy-out plan (Section 32 policy)	A special type of plan where a previous final salary pension or contracted-out benefits will have been transferred into a personal pension plan. These are special because the plan normally has to guarantee a minimum pension (GMP).
Capacity for loss	Refers to your ability to absorb falls in the value of your income or investments without it having any material or detrimental effect on your standard of living.
Cash equivalent transfer value (CETV)	The expected cost of providing your final salary pension benefits, calculated using actuarial principles using assumptions about factors affecting the scheme and your future benefits.
Citizens Advice Bureau (CAB)	Citizens Advice delivers advice services from over 3,300 community locations in England and Wales, run by 338 individual charities. They provide free, independent, confidential and impartial advice to everyone on their rights and responsibilities.
Enhanced Annuity	If you smoke, take prescription medication or have a medical condition you might qualify for an enhanced annuity which pays more income because of your reduced life expectancy.
Final salary pension	A company or government sponsored pension which is based on your final salary rather than the amount you actually pay in. These are sometimes called 'gold plated' pensions because the benefits are normally very generous.
Fixed-Term Income plan	Pension plans which guarantee an income for a specified term and at the end of the term a fixed amount is paid back into the pension plan. See GMA below. Some companies refer to these as 'fixed-term annuities' but they are in fact an option under a drawdown plan.
GMP benefits	Guaranteed Minimum Pension (GMP) is the minimum pension which a UK occupational pension scheme has to provide for employees who were contracted out of the State Earnings-Related Pension Scheme (SERPS) between 6/4/78 and 5/4/97.
Guidance	Guidance is given by specially trained individuals, sometimes called *guiders,* who will discuss your personal circumstances and explain the options available, but they cannot give specific product recommendations.
IHT	Inheritance Tax (IHT) is paid if your estate (property, money and possessions) is worth more than £325,000 when you die. Currently IHT is charged at 40%.

Pension jargon	Plain English
Investment-linked annuity	This is an annuity which is invested in the stockmarket and other investments such as property and fixed interest and therefore future payments will rise or fall depending on future investment returns.
Lifetime Allowance (LTA)	There is a limit on the total size of pension pot you can accumulate without having to pay tax other than Income Tax when you take income and or cash. It is set by the Government and is set at a high level so that only those with very large pension pots are affected. In 2016/2017 the LTA is £1m. Normally pensions from defined benefit schemes are multiplied by 20 to calculate the lifetime allowance use. E.g. a pension of £10,000 p.a. uses up the equivalent of £200,000 of lifetime allowance.
Marginal Rate of Tax	The UK income tax system is based on marginal bands, which means different tax rates apply to the amount of income that falls into each band. Your marginal rate of tax rate is applied to your highest band earnings.
Money purchase annual allowance (MPAA)	This is where you have a reduced annual allowance (see above) if you have taken cash lump sums as UFPLS or tax-free cash and income using flexi-access drawdown or you have exceeded the drawdown limit that applied under the old rules, if applicable. The reduced annual allowance will be £10,000 for 2016/2017 and applies to both your own contribution and any other contribution paid on your behalf, e.g. by your employer.
Money purchase pension	This is a pension where you (and your employer) pay money into a pension pot each year. Contributions get tax relief and at retirement you have a pension pot which you can take in cash or as income.
Pension freedoms	The new rules which came into force in April 2015 which allow you to take your personal pension in cash or as income.
Pension transfer specialist	This is a financial adviser who has a special pension qualification which allows them to advise on transfers from final salary to personal pensions and other complex pension matters.
Pension Wise	A Government-backed service that provides free 'guidance' for those over the age 50 who have a personal pension. At present only two organisations are permitted to provide guidance; TPAS and CAB.
The Pensions Advisory Service (TPAS)	TPAS is an independent organisation that is grant-aided by the Department for Work and Pensions (DWP). They provide independent and impartial information and guidance about pensions, free of charge, to members of the public.
Self-invested personal pension (SIPP)	This is a special type of personal pension which allows you to invest in any investment that is permitted by HM Revenue and Customs. SIPPs are commonly used to invest in commercial property or in conjunction with a discretionary fund manager.
Sequence of returns risk	This is the risk of receiving lower or negative investment returns in the early years when income withdrawals are being made from a fund invested in the stockmarket. If a pension drawdown fund falls in value during the early years future income payments may not be sustainable because the fund may not increase in value sufficiently to make up for the early losses.
Uncrystallised Funds Pension Lump Sum (UFPLS)	Your pension provider can pay part or all of your pension as a cash payment without the need to convert your pension fund into a drawdown plan. You must be over the age of 55 and 25% of each payment will be tax-free and the remainder will be taxed at your marginal rate.

CONCLUSION

Retirement is not what it used to be! In the past many people thought of their pensions as a black box which they didn't look into until they retired and even then they didn't really understand what was going on except they were getting a regular income.

What you want to happen to your pension fund is now a matter for you and nobody else. You are free to take your pension in cash if you wish or you can secure a guaranteed income or do anything in between. You have total freedom do whatever you want.

However, as my late headmaster used to say "Freedom is not licence." Just because you have freedom it does not mean you should spend your pension pot unwisely. It is not my job to preach to you about the consequences of blowing your pension pot on holidays and luxuries but it is my job to point out the only person who will suffer from bad decisions at retirement is you and perhaps your family.

Finally, it is worth remembering that "Retirement is like a long holiday. The goal is to enjoy it to the fullest, but not so fully that you run out of money."

This guide might not help you enjoy your retirement to the full but it might help you avoid running out of money.

What to do next

The next step is either to speak to your insurance company, book an appointment with Pension Wise and/or get financial advice. Before taking one of these steps it will make it easier if you think about the questions you should be asking and some of these are listed below.

1	Questions to your pension company	What type of pension plan do I have? The value of the plan and where it is invested? Are there any special terms or penalties?	*If your insurance company offers you one of their financial policies make sure you shop around to see if there is a better deal elsewhere*
2	If you go to Pension Wise	What options are available to me? What are the risks of the various options? How do I find a financial adviser?	*Pension Wise can only give you general advice – they cannot give financial advice*
3	When you speak to your financial adviser	What is their typical process for advising me? Do they provide independent or restricted advice? What are the fees and charges and do they offer a free initial consultation?	*Financial advisers must be authorised by the Financial Conduct Authority – you can check at www.fca.org.uk/register*

CHECKLIST

By now you should have a good understanding of your options and have had some of your questions answered but there will be probably be many more questions you want to ask and you might be wondering what to do next.

The first step is to ask yourself a few questions so you can have a clearer picture of your own priorities and retirement objectives. You can refer to page 20 if you need any help.

Questions to yourself:

How much will my state pension be?	Find out by going to **www.gov.uk/state-pension-statement**
Do you have any outstanding debt?	You might want to re-pay this before you fully retire
How is your health?	You might be able to qualify for a higher annuity

1	When you do you want to access your 25% tax-free cash sum (TFC)?	☐ As soon as possible	You must be over age 55
		☐ In the future	When? ______
		☐ Do you need all the tax-free cash in one go?	You could spread your 25% tax-free cash over several years
2	How much cash (in addition to TFC) do you need?	☐ No cash in addition to TFC	Go to the next question about income
		☐ Some additional cash	How much cash? ______
3	How much income do you need now and in the future?	☐ A specific amount	How much income? ______
		☐ Enough to last my lifetime	The equivalent to a level annuity
		☐ Sustainable income	An income that will hopefully keep pace with inflation
4	How much of this income do you need to be guaranteed?	☐ All of my income guaranteed	Consider a lifetime annuity or fixed income plan
		☐ Some of my income guaranteed	You could split your income between annuity and drawdown options
		☐ None of my income guaranteed	Consider pension drawdown
5	How much flexibility do you need?	☐ Flexibility is less important	This probably means that certainty (guarantees) is more important
		☐ As much flexibility as possible	The more flexibility you have the less certainty
		☐ Some flexibility and some certainty	You could split your income between annuity and drawdown options
6	How would you describe your attitude to risk and capacity for loss?	**Attitude to risk:**	**Capacity for Loss (C for L):**
		☐ Risk averse	☐ Little C for L
		☐ Medium risk	☐ Some C for L
		☐ Higher risk	☐ Significant C for L
7	Do you think you will remain a basic rate tax payer?	☐ Yes – basic rate tax	Have you taken all sources of income into account?
		☐ Don't know	You should get expert help
		☐ No – higher rate tax	Consider ways of reducing tax on income
8	Have you thought about the longer term?	☐ Yes	Very good – it's important to plan ahead
		☐ No	It might be in your interest to think about this or you could run out of income

Billy Burrows – Retirement Intelligence

Billy Burrows has been involved with annuities for over 20 years, advising clients on all aspects of annuities and retirement income options. Since January 2013 he has concentrated on strategy, marketing and consultancy.

In 1993 he helped establish Annuity Direct and then in 1997 he set up William Burrows Annuities. A year later he joined Prudential Annuities as their Marketing Director for annuities. In 2001 he returned to running William Burrows Annuities and in 2010 the business was incorporated with Better Retirement Group Ltd to provide clients with a wider range of services.

Billy now divides his time between hosting the popular consumer retirement options website www.williamburrows.com and running Retirement Intelligence which provides consultancy services to insurance companies on new product development, marketing and strategy.

He is frequently quoted in the national press and appears on radio, podcasts and videos and writes extensively on annuity and drawdown options.

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