advice rooms

An Introduction to
Pension Drawdown

To speak to one of our advice team please call:

0808 141 0756

Or email: info@advicerooms.co.uk

Advice Rooms was created as a space for individuals to receive financial advice regarding any area of their financial and/or retirement planning. Today's world makes everything seem impossibly complex with companies leaving a minefield of options when trying to plan your future finances.

Our advisers will help you understand the routes that are available to you and how to create a plan that best suits your aims and aspirations in retirement.

Contents:

Pension wise
Your money. Your choice.

Pension Wise from MoneyHelper

Pension Wise is a free and impartial government service from MoneyHelper that offers you:

- Tailored guidance (online, over the telephone or face to face) to explain what options you have and help you think how to make the best of your pension savings.
- Information about the tax implications of different options.
- Tips on getting the best deal, including how to shop around.

Visit **moneyhelper.org.uk/pensionwise** for more details.

If you'd prefer to speak to someone over the phone or book a face-to-face appointment you can call **0800 138 3944**.

Advice Room's product guides are not intended to replicate or replace the service provided by Pension Wise, but to help you consider which retirement options may be relevant to your needs and circumstances.

What is Pension Drawdown?

Pension drawdown, also known as flexi-access drawdown, allows you to take income directly from the money you have accumulated in your pension fund, giving you the freedom to determine how and when you receive your money. Drawing-down gives you the ability to choose the level of income you receive and adjust it to suit your circumstances at the time.

It is important to understand that if you choose a draw-down policy, your money stays invested, which means that the value of your pension can go up or down depending on market conditions and how your pension funds are invested.

We recommend that you speak to a financial adviser to understand your income capability and ensure you won't run out of money early by taking too much income and determine if pension drawdown is a suitable option for you & and your retirement plans.

Pension drawdown may be suitable for you if you want:

- ✓ Flexibility to withdraw cash amounts from your pension pot as and when you choose
- ✓ The option to adjust your income levels to fit your needs and objectives
- ✓ Potential for investment growth within your pension pot
- ✓ The option to pass any remaining pension pot to your beneficiaries upon your death.

Pension drawdown may not be suitable for you if you want:

- Certainty of a fixed income for life
- Protection from inflation through regular increases in income
- Guaranteed income for a dependant after your death
- Protection from investment risk and fluctuation in retirement.

Understanding your drawdown capabilities

The most efficient way to understand your drawdown capabilities is by speaking with one of our financial advisors with the view to creating a retirement income strategy report which will provide valuable guidance and advice on your pension options, including what you can drawdown over time.

Your financial advisor will use your information to create a detailed retirement plan that takes into account your current and projected income, expenses, and assets. They will also use cash flow modelling to project your capabilities which takes into account the effect inflation has on the value of your money to help to identify potential shortfalls in retirement savings.

Tax Free cash

Normally the first 25% of the total value can be taken as tax free cash, anything you take over this amount is called as taxable income. One of the flexible access benefits to drawdown allows you to you take your Tax Free Cash in any increments so you can use the money as you need it while leaving the rest invested.

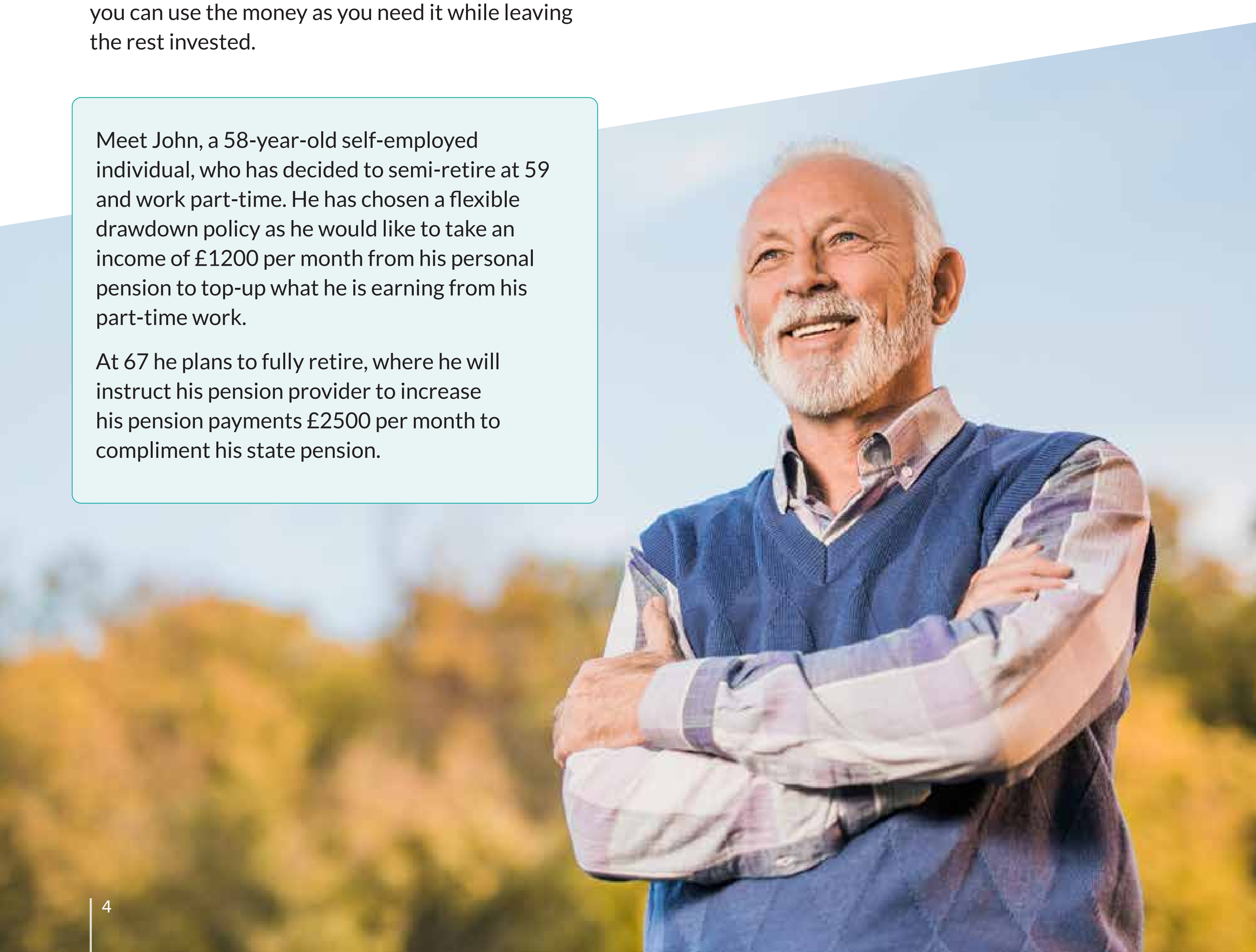
Phasing into retirement

It has become more popular over time for individuals to semi retire and work part time for a period of time before they fully retire . This is especially popular with people who are self-employed and is called phased retirement

Having a flexible drawdown can enable you to design your income around those plans allowing you to change the amount receive from your pension, in line with your other incomes.

Meet John, a 58-year-old self-employed individual, who has decided to semi-retire at 59 and work part-time. He has chosen a flexible drawdown policy as he would like to take an income of £1200 per month from his personal pension to top-up what he is earning from his part-time work.

At 67 he plans to fully retire, where he will instruct his pension provider to increase his pension payments £2500 per month to compliment his state pension.

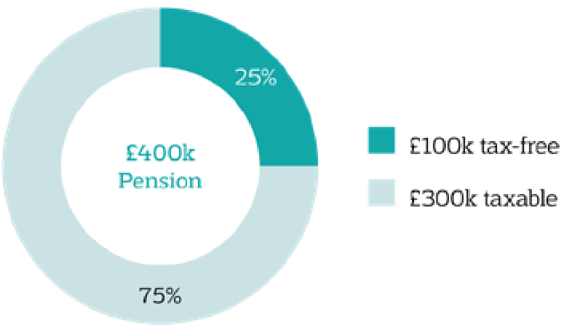


Choosing how you take your income

How you decide to take an income from your drawdown pension will depend on your needs and goals for the future. You might choose one strategy that works best for you, or a mixture.

Just Tax-free Cash

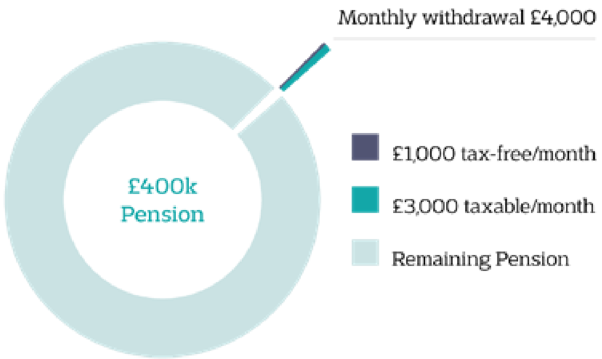
You don't have to take an income if you don't need or want to. You can simply take your tax-free cash and leave the rest invested, to potentially grow over time. You can always take an income later on, or use your drawdown fund to buy an annuity if you want to.



Tax-free Cash

Drip-feed Tax-free Cash

If you do not take your tax free cash as a lump sum you are able use what is known as 'drip feed drawdown' which means you can assign tax free element of up to 25% on each income payment. This may help you design your income around your tax liability at the time.

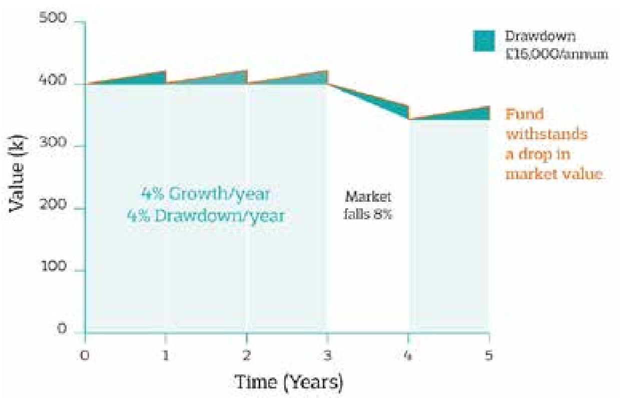


Monthly Drip-feed

Taking the Growth

Taking the growth means withdrawing only the income your investments make, without selling them to fund your withdrawals. So, if you have £400,000 invested in a fund yielding 4%, you'd take the £16,000 income leaving £400,000 invested.

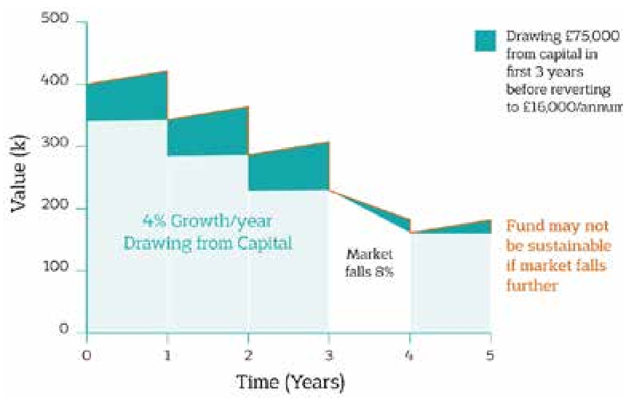
There's less chance of running out of money with this strategy because your investments are left untouched, to hopefully recover from any market falls. But remember, yields are variable and aren't guaranteed.



Drawing from Capital

This means selling your investments and withdrawing the cash. This could give you a higher income, but it's a riskier strategy. Selling investments after markets have fallen could mean you quickly erode the value of your fund.

Remember, taking high income withdrawals may not be sustainable.



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Case study 1

This scenario shows that going into drawdown, instead of buying an annuity, can lead to a fluctuating income and a significant reduction in income over time. It also highlights that high withdrawals are not sustainable and can significantly reduce the portfolio's ability to recover. Additionally, the scenario is based on a healthy, married couple and the portfolio is diversified and invested in a market that performs well.

SCENARIO: A healthy married couple, John and Jane, decide to take their tax-free cash and go into drawdown on their 60th birthday.

- They have a combined pension pot of £500,000 invested in a diversified portfolio.
- Each year, they choose to draw an income equivalent to 4% of their pension pot, which is £20,000.
- Due to fluctuating markets, their fund value falls by 25% in just two years. It then makes a modest recovery before falling again.
- This means the income they take fluctuates in line with their falling fund value.
- At the end of eight years, their income has fallen to just £15,000

If they had decided to buy an annuity, instead of going into drawdown, they would have received £20,000 each year, which would have continued for life.

It's important to consider these risks and seek financial advice before making a decision on how to access your pension savings.

Case study 2

This scenario shows that if the market performs well and the investor takes a steady income, going into drawdown can be a beneficial option. It also shows how drawdown can also be used to design how and when you need to take income.

Scenario: A single woman called Margaret semi-retires at the age of 57 and begins taking a partial income from her pension to supplement her part-time income. She plans to increase her pension income further when she fully retires at age 67.

- She has a pension pot of £600,000 invested in a diversified portfolio.
- Each year, she chooses to draw a fixed income equivalent to 3% of her pension pot, which is £18,000.
- Due to the market performing at an average of 5% per year, her fund value increases by 2% annually after her withdrawals.
- Her fund value at 66 which includes compounded interest is £731,000.

She now wishes to understand what her drawdown capabilities are from age 67 until 95.

Her financial adviser produces a retirement projection report which suggests her maximum sustainable income from 67 to 95 would be £321,524 if the investments continue to perform as they have over the last ten years.

If she had initial decided to buy an annuity with her pension fund instead of going into drawdown, she would have received £21.524 each year for life.

Understanding the risks

The biggest risk with drawdown is that there are no guarantees, so your pension could run out. This could have a serious impact on your lifestyle and that of your partner or loved ones.

If you lose money in retirement it's extremely difficult to get it back again as your sources of income may be limited, and returning to work might not be an option.

If your drawdown pension will be your main source of retirement income, and you don't have secure income to fall back on, you should seriously consider whether a guaranteed income (an annuity) would be more appropriate.

If you're in any doubt at all, you should speak to a financial adviser and discussed an income structure plan that fits your retirement plans.

It is possible to go into drawdown and consider an annuity later however there is a risk that annuity rates may have fallen by that point. Lower annuity rates could reduce your future income dramatically although rates tend to be higher for older people, especially those with medical conditions.

As you age, you'll potentially develop health conditions which, even if they're minor, could boost how much annuity income you'll receive. However, there's no guarantee the rate you get in the future will be higher than the rate you could get now.

Pass on your pension to your loved ones

For many people, having flexibility and control when it comes to passing money on to loved ones is a key benefit of drawdown. When you die, your pension can be passed on, usually free of inheritance tax.

The Flexibility of choosing how and when you take income will be passed on to your chosen beneficiary which mean they have the choice to leave the pension invested, take an take a regular or ad hoc income, or buy an annuity.

The tax treatment depends on when you die:

• If you die before 75, the proceeds will be left to your beneficiaries as a lump sum tax free receive are usually tax free.

• If you die at or after 75, the proceeds will be left to your beneficiaries however any income they that will be taxed against their nominal rate of income tax at the time.

If the payments are taxable, your beneficiaries might be able to reduce their tax bill by spreading withdrawals over a number of tax years.

It's important to think about who you'd like to receive this money when you die, and then nominate your beneficiaries. The nomination isn't legally binding, but it tells your provider your wishes, which must be taken into account.

Creating drawdown retirement projections

To truly understand what your pension is likely to give you as a drawdown over time you need to speak to a financial adviser and produce an income projection report. Part of creating a drawn projection is understanding how you plan to retire including how and when you would like to take income. To have a true understanding of your capabilities the projections must include any other retirement income you plan to receive. You will then be able to create a drawdown plan that best suits your retirement plans.

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What to do next...

The information throughout this guide helps to give an understanding of what you need to consider when choosing to use a drawdown. However, everyone has a unique set of circumstances so please speak to one of our advisers to discuss your plans and understand the best way to create your personalised strategy.

When discussing your plans your adviser will:

- **Discuss** – your circumstance to fully understand your needs moving forward
- **Help define your income needs** – especially your essential expenditure, it is common to use guaranteed income to cover the basics
- **Explain the impact of inflation** – and how costs rise over time
- **Discuss the need for Tax Free Cash** – and check whether you need to take any of your pension fund as cash, this could be sensible if the money is used to pay off existing debts
- **Collect your health and lifestyle information** – this can have a big impact on the guaranteed income available to you in retirement
- **Discuss long term care options** – for you or your dependant
- **Discuss leaving a legacy** – is your intention to leave some of your assets to your children or to others? It may also be important to your discuss your dependant's income and how will those who are important to you be catered for after you die
- **Research the market** – and explore the options that will help you achieve your aspirations in retirement
- **Produce a suitability advice report** – to suggest a suitable strategy moving forward. The report will include retirement projections, suitable product and investment while identifying any other need to be considered. All of this will be discussed with you in detail so you fully understand the recommendations that have been made

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Nothing contained within the report constitutes as financial advice or a personal recommendation.

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