Ribble Wealth Management Limited

Professionalism . Integrity . Trust

An in-depth guide to the pension options available to you.

Contents

This guide gives you all the key information you need to know about the options available to you at retirement and why making the right decision at outset is so important.

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Introduction

There is a common misconception that a pension is for old people, but in reality a pension is a way any individual can save to fund a time when they don't want to work so hard, a time when they want to relax and enjoy their retirement.

In March 2014, the Chancellor of the Exchequer, George Osborne, introduced new rules in his Budget that hugely increased the number of options available at retirement, but in doing so also opened up numerous potential pitfalls. Attempting to traverse the minefield of pension legislation alone can, at best, be a difficult task, shrouded in uncertainty, and, at worst, lead to irreversible decisions, potentially costly mistakes and severe financial losses and/or penalties.

We, at Ribble Wealth Management Limited, are here to guide you through this area and will work with you to find out what you want to achieve with your hard-earned pension fund – and, importantly, what risk you are willing to take – in order to find an appropriate solution (or combination of solutions) in order to meet your retirement objectives.

If appropriate, we can also assist in the building of an investment solution around your pension plans by making use of our robust, repeatable and proven investment process that makes use of a host of expertise from across the investment profession, designed with the support of leading experts and using leading fund managers, in order to achieve your aims. We can also help in making sure that your pension stays on track and adapt it, as necessary, should your goals and aspirations change over time.

In this booklet we have tried to set out, in as simple terms as possible for such a complex subject, the various options that might be available to you. Some might not apply to you; some might not appeal to you; some may not be available to you – but we hope that this document gives you an overview of all of the potential alternatives.

The income you need in retirement from your pension fund might be a requirement for many years to come, and making the right decision at outset can be vitally important.

It is best to do it with our expert guidance.

Summary of Options

The following pages contain a substantial amount of technical information, so this summary will hopefully be of assistance. It is important to have a full understanding of the type of pension you want or need, so if you have any questions or concerns, we will make sure you understand the options available to you.

LIFETIME ANNUITY	SCHEME PENSION	PHASED RETIREMENT
Regular and secure income for life.	Regular and secure income for life.	Part of your fund and part of your tax-free cash are used in "segments" (i.e. split into multiple smaller policies) to provide annuity income.
Tax-free cash provided at outset and fund used to purchase an annuity paid for life.	Tax-free cash paid at outset and fund used to provide income for life.	The balance of the fund not used for income or tax-free cash remains invested with a view to providing higher future benefits.
Your annuity income is paid at least annually and can increase, decrease or remain level in payment.	Your annuity income is paid at least annually and can increase or remain level in payment.	Your starting annuity is smaller, but a portion of your tax-free cash sum is used to supplement this.
Additional options can be selected at outset such as annual increases, spouse's benefits or guarantees – all of which reduce your own income.	Additional options may be offered at outset such as annual increases, spouse's benefits or guarantees – all of which reduce your own income.	Each year you decide how much fund to use for annuity purchase and how much tax-free cash is used to supplement your income.
Once you have bought your annuity, you usually cannot change your mind or change benefits. On death there may also be the option of a capital payment less tax.	Pension income paid directly by scheme. Once in payment you cannot change your mind or change the benefits.	Because you don't commit all your funds to buy an annuity immediately, you keep your options open.

DRAWDOWN PENSION – CAPPED	FLEXI-ACCESS DRAWDOWN	UFPLS
Tax-free cash lump sum paid at outset and fund remains invested. Income can also be selected if required. Can be split into multiple segments.	Tax-free cash lump sum paid at outset and residual fund (subject to Income Tax) can be accessed immediately. Can be split into multiple segments.	A lump sum is paid up to the full value of the plan. No regular income.
The balance of the fund not used for income remains invested with a view to providing higher future benefits.	Immediate access to the entire fund to provide income with no limits. 25% tax-free cash (capped at £268,275, equal to 25% of the old "Lifetime Allowance"), the rest subject to Income Tax. Funds remain invested.	Immediate access to as much of the fund as required. Of the amount paid out, 25% is paid free of tax (capped at £268,275, equal to 25% of the old "Lifetime Allowance"), with the rest subject to Income Tax.
You can choose the income you want, and when you want it, between nil and 150% of an equivalent single life annuity.	You can choose the income you want, and when you want it, with no cap.	There is no regular income but you can choose when and how much of a lump sum you require.
Whilst there are funds are left in the plan, if investments do well you may benefit from higher future lump sum and/or income payments – and vice versa.	Whilst there are funds are left in the plan, if investments do well you may benefit from higher future lump sum and/or income payments – and vice versa.	As long as some funds are left in the plan, if investments do well you may benefit from higher future lump sum payments.
On death, if there is any fund remaining then it is available to pay benefits to your beneficiaries.	On death, if there is any fund remaining then it is available to pay benefits to your beneficiaries. "Active" pension plan providers must be advised within 91 days to avoid HMRC fines.	On death, if there is any fund remaining then it is available to pay benefits to your beneficiaries. "Active" pension plan providers must be advised within 91 days to avoid HMRC fines.

Lifetime Annuity

Overview

An annuity is simply a series of payments made at selected intervals in return for a pension fund. The level of payment is dependent upon age, annuity rate, size of fund and options selected. Annuity rates tend to mirror interest rates since they are related to the returns earned on Fixed Interest Gilt-Edged Securities. There are many different types of annuities and these are covered later on in this section.

Tax-free cash

Most types of pension arrangement have the option of taking a tax-free cash lump sum before exchanging the residual fund for a series of payments. Once an annuity has been purchased there is no further entitlement to tax-free cash, therefore the decision of whether to access the cash or not needs to be made at outset.

Income

Annuity payments are taxed at source under the PAYE system. Provided a P45 is presented, the annuity will be paid net of your marginal rate of tax and there will be no further tax liability. Payments can be made monthly, quarterly, half yearly or yearly and can be in advance or arrears. Payments can remain level, can decrease or can increase e.g. at a set rate or in line with an index such as the Retail Prices Index.

Death benefits

The option of what type of death benefits to include must be made at outset. The options available are as follows:

- A spouse's or dependant's pension up to 100% of the pension you had received;
- A lump sum.

Lifetime Annuity (cont'd)

Protecting your annuity

There are ways of protecting your annuity if you're worried about what will happen to it if you die soon after you retire.

Commonly known as "Value Protection", this option can be included to ensure that, on death, the original fund value, less the gross income payments already made, can be paid out. On death before age 75, this will be tax-free. On death after age 75, this is taxed at the beneficiary's marginal rate of Income Tax.

Guarantee periods allow you to opt for your annuity to pay out for a specific number of years – even if you die within this time. On your death the income may continue to be paid for the rest of the guarantee period. You should not consider the guarantee as an alternative to a joint-life annuity, because any income will stop at the end of the guarantee period, not when your spouse or partner dies. You should note that where the value of the annuity on death is below £30,000 it may be possible for the remaining guaranteed payments to be paid as a lump sum.

Advantages

- You will receive a guaranteed income for life, and you can elect for your spouse/ beneficiaries to receive a guaranteed income or a lump sum less tax upon your death;
- Tax-free cash is available at outset;
- There are no additional charges applied to the contract once in force. All charges are taken at outset and are reflected in the annuity rate offered;
- The contract is simple to understand, there is no need to review the contract and there is minimal paperwork needed to start the payment of benefits.

Disadvantages

- There is no opportunity of participating in future investment returns;
- The various options in relation to death benefits and increasing/decreasing income levels, etc. must be selected at outset and will result in a lower initial pension payment. These selected benefits cannot be altered in the future.

Suitability

Lifetime annuities are most likely to suit individuals who want an absolute guarantee on their pension payments and/or for their spouse/partner. They therefore suit individuals with low attitudes to risk and a requirement for security. They also suit individuals who have relatively small pension funds and who will be heavily reliant on their pension income.

With-Profit Annuity

Overview

A With-Profit annuity is similar to a lifetime annuity in that it is simply a series of payments made at selected intervals in return for a pension fund. The level of payment is also dependent upon age, annuity rate, size of fund and options selected. The main difference is that **the initial pension level and future income levels are also dependent on the performance of the underlying With-Profits fund**.

An assumed future bonus rate ("ABR") is selected at outset by the investor. The higher the ABR, the greater the initial income; however, if the actual bonus rate of the With-Profit fund does not equal the ABR then the amount of pension payable in future will decrease. Most With-Profit annuities offer a minimum guaranteed level of pension.

Tax-free cash

Tax-free cash must be withdrawn at outset, the residual fund then being exchanged for a series of payments. Once an annuity has been purchased there is no further entitlement to tax-free cash.

Income

Annuity payments are taxed in the same way as described under 'Lifetime Annuity'. **Income will increase or decrease in payment depending on fund performance relative to the ABR**.

Death benefits

The option of what type of death benefits to include must be made at outset. The options available are the same as under 'Lifetime Annuity'.

Advantages

- You will receive an income for life, and you can elect for your spouse/partner to receive an income or lump sum on death – less tax on death after age 75;
- Tax-free cash is available at outset;
- Charges are taken at outset and are reflected in the annuity rate offered. The With-Profits fund deducts charges before bonuses are declared;
- The contract is relatively simple to understand and there is minimal paperwork needed to start the payment of benefits.

With-Profit Annuity (cont'd)

Disadvantages

- The selected income level is not guaranteed and is subject to increases and decreases based on future investment returns;
- The various options in relation to death benefits, etc. must be selected at outset and will result in a lower initial pension payment. These selected benefits cannot be altered in the future.

Suitability

With-Profit annuities are most likely to suit individuals who want some guarantee on their pension payments but also want the potential to benefit from future investment return. They therefore suit individuals with low to medium attitudes to risk and security. They also suit individuals who have relatively small pension funds and who will be heavily reliant on their pension income.

Unit-Linked Annuity

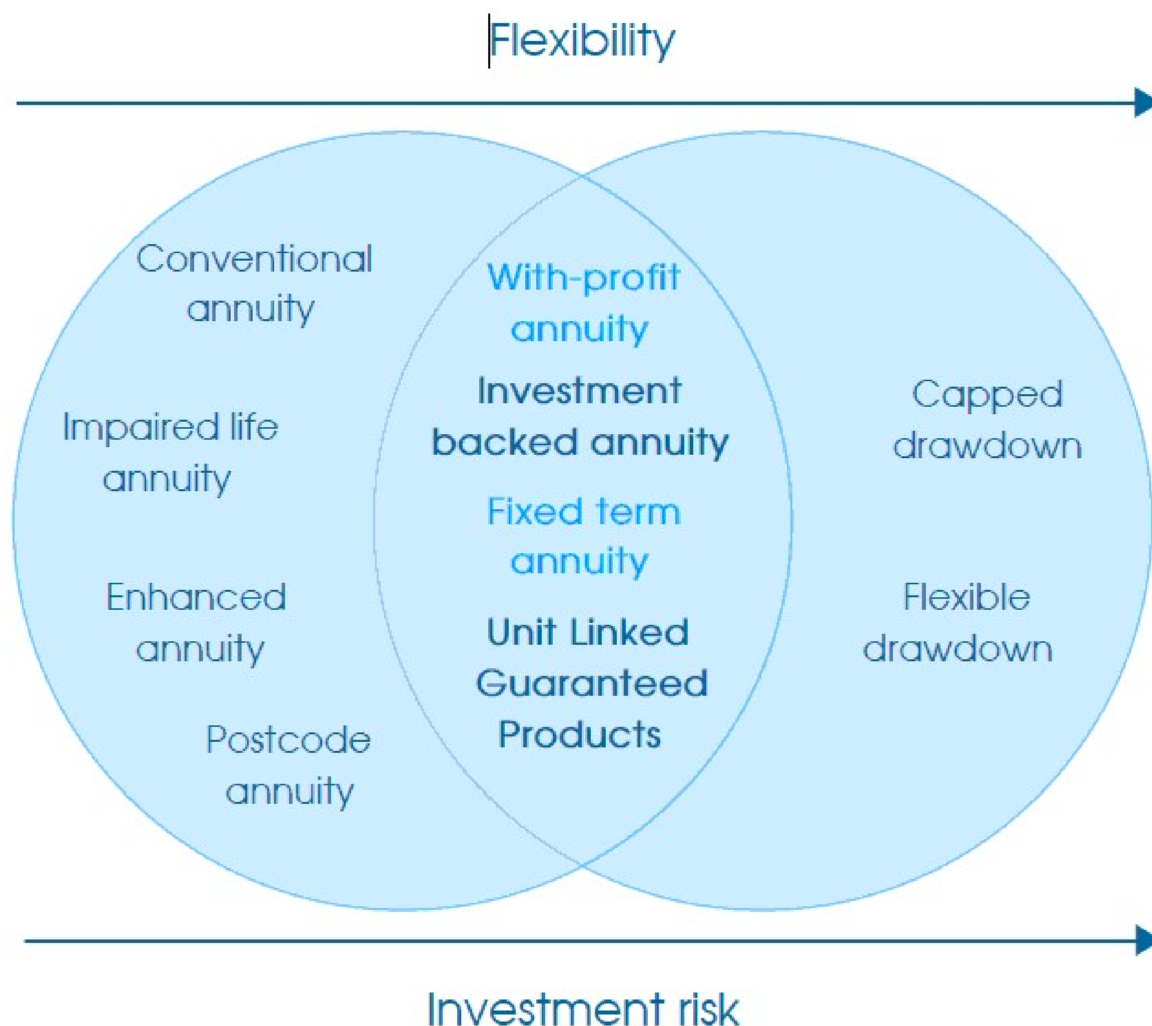
Overview

A Unit-Linked annuity is very similar to a With-Profit annuity in that it has all the same options and features but is invested in Unit-Linked funds rather than a With-Profits fund. **The initial pension and future income levels are also dependent on the performance of the underlying Unit-Linked funds**.

Often the investor is allowed to assume a future rate of growth. The higher this assumed rate, the greater the initial income. However, if the actual growth does not match this rate then the amount of pension payable will decrease.

Tax-free cash

Tax-free cash must be withdrawn at outset, the residual fund then being exchanged for a series of payments. Once an annuity has been purchased there is no further entitlement to tax-free cash.



Unit-Linked Annuity (cont'd)

Income

Annuity payments are taxed in the same way as described under 'Lifetime Annuity'. **Income will increase or decrease in payment depending on fund performance relative to the assumed growth rate**.

Death benefits

The option of what type of death benefits to include must be made at outset. The options available are the same as under 'Lifetime Annuity'.

Advantages

- You will receive an income for life, and you can elect for your spouse/partner to receive an income or lump sum on death – less tax on death after age 75;
- Tax-free cash is available at outset;
- The contract is relatively simple to understand and there is minimal paperwork needed to start the payment of benefits.

Disadvantages

- The selected income level is not guaranteed and is subject to increases and decreases based on future investment returns;
- Charges will be higher than under a "traditional" annuity;
- The various options in relation to death benefits, etc. must be selected at outset and will result in a lower initial pension payment. These selected benefits cannot be altered in the future.

Suitability

Unit-Linked annuities are most likely to suit individuals who want some guarantee on their pension payments but also want the potential to benefit from future investment return. They therefore suit individuals with low to medium attitudes to risk and security. They also suit individuals who have relatively small pension funds and who will be heavily reliant on their pension income.

Enhanced Life or Special Situation Annuities

Overview

Individuals in poor health (or those with a known medical condition, e.g. diabetes) may apply for higher annuity rates due to their shorter life expectancy. This is often subject to a medical examination. Some individuals may also be offered enhanced rates due to their lifestyle or physical condition, e.g. smokers or clinically obese.

More recent developments have seen the introduction of 'Special Situation Annuities', which can be based on occupation and postcode. For example, a bricklayer in Yorkshire will be given a higher rate than a stockbroker in Surrey.

In all other respects, these annuities are the same as a 'Lifetime Annuity'.

Suitability

These annuities are most likely to suit individuals who want absolute guarantee on their pension payments and are eligible for the higher rates. They therefore suit individuals with low attitudes to risk and security, although they may also be suitable for individuals with a high attitude to risk but are in ill health.

Scheme Pension

Overview

This will be the only option – without transferring – for members of their employer's Defined Benefit (also known as Final Salary) Pension Scheme. Those with other types of pension arrangement can also choose this option if they do not wish to purchase a 'Lifetime Annuity'. These pensions are paid either directly from the original pension scheme or on its behalf by an insurance company.

Payment of scheme pensions from Defined Benefit Pension Schemes are guaranteed for life.

Tax-free cash

The scheme pension would allow the option of taking a tax-free cash lump sum at outset. Once income has started, there is no further entitlement to tax-free cash and moving out of the plan cannot be undertaken.

Income

Pension payments are taxed as earned income under the PAYE system as described under 'Lifetime Annuity'.

Scheme Pension (cont'd)

Death benefits

The death benefits are typically a spouse's or dependant's pension, payable for life, at a set percentage of the original scheme member's pension, e.g. 50% or two thirds. There is also usually an option for the full level of pension to continue to be paid if death occurs within a specified "guaranteed period", e.g. on death within the first five years being the most common.

Advantages

- You will receive an income for life and you can elect for your spouse/partner to receive an income (subject to Income Tax) upon your death;
- Money purchase scheme pensions are regularly reviewed; income could therefore be altered according to changes in health and/or fund performance;
- Tax-free cash is available at outset;
- The contract is simple to understand and there is minimal paperwork needed to start the payment of benefits.

Disadvantages

- For money purchase schemes, the benefits paid on death could be reduced if investment performance has been poor;
- Any options (if offered by the scheme) to provide benefits on death must be selected at outset and will result in a lower initial pension payment. These selected benefits usually cannot be altered in the future.

Suitability

Final Salary scheme pensions are likely to suit individuals who want a guarantee on their pension payments. They therefore suit individuals with low attitudes to risk and a requirement for security. Money purchase scheme pensions can vary and are likely to suit someone who is prepared to accept these income fluctuations. These would therefore suit individuals who have a more balanced attitude to risk.

Phased Retirement

Overview

Phased retirement allows you to control your retirement fund and convert it gradually over a number of years into income. This control is achieved by setting up many contracts (often more than 1,000) and using a number of them each year to provide you with your desired level of income. This income will be made up of part tax-free cash and part annuity. The annuity provides ongoing income for life.

The balance of your pension fund (i.e. the contracts not cashed in, or “crystallised” (sometimes also referred to as “vested”), to provide you with income) continue to be invested, thus providing you with the possibility of higher future income. This will depend mainly on how much income you take out of the pension fund (especially in the early years) as well as future investment returns.

Tax-free cash

Immediate maximum tax-free cash is not available since it is used each year to provide part of your income.

Income

Because the income is made up of annuity payments and a portion of tax-free cash, your overall liability to Income Tax is reduced. Payments are taxed in the same way as a ‘Lifetime Annuity’ and can be made monthly, quarterly, half yearly or yearly, in advance or arrears. Additionally, the payments can remain level, increase or decrease in payment.

Death benefits

The option of what type of death benefits to include is made at outset for the annuity purchases. The residual fund (i.e. units not crystallised) can be paid, on death, as a lump sum to your nominated beneficiary/beneficiaries. Some contracts may allow the unvested benefits to be used to set up a beneficiary’s pension plan e.g. a beneficiary’s annuity or beneficiary’s ‘Drawdown Pension’ (see next section).

On death prior to age 75, the funds remaining in the plan (whether crystallised or not) can be paid out tax-free irrespective of whether they are paid as a beneficiary’s lump sum or as an income.

On death after age 75, any lump sum payments are taxed at the beneficiary’s marginal rate of Income Tax, any continuing income payments (if offered by the arrangement) also being subject to the beneficiary’s marginal rate of Income Tax.

Previously, IHT did not not typically apply to death benefits from pension schemes. However, in her Autumn Budget 2024, Rachel Reeves announced that most unused pension funds and death benefits would be included in the value of a person’s estate for Inheritance Tax (“IHT”) purposes from 06 April 2027.

Phased Retirement (cont'd)

Advantages

- You retain investment control of the segments of your pension fund not yet used to purchase an annuity;
- As you get older there is the prospect of annuity rates rising and providing you with higher level of income. It is cheaper for insurance companies to purchase an annuity to provide a given level of income for someone aged (say) 70 than for someone aged (say) 60 (assuming the returns provided by medium to long-term Gilt yields remain the same);
- You will be able to change the shape of your retirement income to reflect any changes to your personal circumstances in the future. Each year an annuity is purchased, you can choose whether to include death benefits and other options;
- The remaining pension fund (i.e. the policies not cashed in or "vested") can be returned to your beneficiaries (potentially subject to Income Tax and IHT).

Disadvantages

- There is no guarantee that your income will be as high as that offered under the 'Lifetime Annuity' route referred to earlier;
- You must still purchase an annuity to provide income whenever you draw part of your tax-free cash, and it is possible that annuity rates at that time may not be favourable;
- Deferring the purchase of the annuity does not guarantee a higher level of future income, as annuity rates can go down as well as up and the value of the continued investment of your pension fund may go down as well as up;
- The value of your remaining pension fund, when aggregated with any annuity you have purchased, may not achieve an equivalent level of income to that which could have been purchased with the whole fund at outset via a 'Lifetime Annuity'. This is because withdrawals of tax-free cash and annuities purchased will erode the value of your pension fund if investment returns are not sufficient to make up the balance (including charges for the ongoing administration of the plan);
- You may feel that the prospect of future higher income does not compensate you for not being able to enjoy a guaranteed and secure level of income today and for the rest of your life;
- You will not receive all of your tax-free cash as a lump sum at outset, because you are using this cash to supplement your income.

Suitability

Phased Retirement is most likely to suit individuals who want to gradually retire, e.g. the self-employed, or those individuals who are likely to be higher-rate taxpayers. They also suit individuals with a medium or higher attitude to risk and security because there is an element of risk involved due to the balance of the pension fund remaining invested, or those who have no immediate need for the tax-free cash to be taken at outset.

Drawdown Pension

Overview

There have been many different versions of Drawdown Pension over the years. For plans set up prior to 06 April 2015, the most common type was **Capped Drawdown**, under which an annual income could be taken from the invested pension fund, if required. This income varies between prescribed limits, set at outset by the Government Actuary's Department ("GAD"). The maximum limit is reviewed regularly – every three years up until age 75, and then annually thereafter. The figure is derived from tables published by the Government Actuary's Department and is based on the fund size, age and the current Gilt yield. The maximum current limit is broadly equal to 150% of a single life annuity that you could have purchased at that point. There is no minimum limit.

For individuals who took out these plans prior to April 2015, they will continue to run as they are, providing income is kept below 150% of GAD rates. Where this is the case, the current Annual Allowance (£60,000) for new money purchase pension contributions will remain.

However, if more income than the 150% limit is taken, the plan automatically "tips into" **Flexi Access Drawdown** and the Annual Allowance falls to £10,000. The policyholder can also request for the plan to be converted into a Flexi Access Drawdown at any time, if they wish.

Flexi Access Drawdown was introduced with effect from 06 April 2015 and operates in the same way as Capped Drawdown does. However, there is no limit on the level of income taken. After the entitlement to the tax-free lump sum is taken (usually 25% of the policy value taken at outset, capped at £268,275 which is 25% of the now abolished Lifetime Allowance), as much or as little of the remaining pot can be taken, which it will be added to any other income in that tax year to determine the Income Tax rate that will apply.

Please note that if any income is drawn from this arrangement, any future money purchase pension contributions will be limited to a £10,000 maximum Annual Allowance.

If taking an income stream from a Flexi Access Drawdown plan, the policyholder must alert all scheme administrators of any active plans that they have flexibly accessed benefits. This must be done within a 91-day reporting window. Failure to do so will lead to HMRC fines. The responsibility for alerting the scheme administrators lies with the policyholder.

Tax-free cash

Most types of pension plan have the option of taking a tax-free cash lump sum before exchanging the residual fund for a series of payments. Ordinarily up to 25% of the fund – subject to a cap of £268,275 (being 25% of the previous Lifetime Allowance) – may be taken as tax-free cash. However, if the pension funds are, or were, part of an Occupational Pension Scheme, or the individual had applied for transitional protection, then the available tax-free cash may be greater than 25%. Tax-free cash must be taken at outset and once drawn, there will be no further entitlement. However, the policies are often segmented to enable what is known as "Phased" Drawdown, where some of the segments are transferred into Drawdown in order to pay tax-free cash and an income (if required), whilst the other segments remaining unvested.

Drawdown Pension (cont'd)

Income

A pension income does not have to be taken from the Flexi Access or Capped Drawdown options but, if this is required, income is taxed as earned income under the PAYE system.

Death benefits

On death prior to age 75, the funds remaining in the plan (whether crystallised or not) can be paid out tax-free irrespective of whether they are paid as a beneficiary's lump sum or as an income.

On death after age 75, any lump sum payments are taxed at the beneficiary's marginal rate of Income Tax, any beneficiary's Drawdown pension or annuity also being subject to the beneficiary's marginal rate of Income Tax and potential Inheritance Tax.

Advantages

- You are able to take all of your tax-free cash lump sum entitlement at outset;
- You do not receive a fixed level of income but are able to vary it to suit your personal circumstances, to supplement other sources of income, or you have the option of taking it all at outset;
- You are able to mitigate your liability to personal Income Tax in certain years;
- You have the potential to benefit from good investment performance in a tax-efficient environment and to exercise control over your own investment portfolio.

Drawdown Pension (cont'd)

Disadvantages

- You may run out of money and have no pension left;
- Benefits are means-tested by the Department for Work and Pensions ("DWP");
- High income withdrawals may not be sustainable during the deferral period;
- Taking large 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 (and if) an annuity is eventually purchased and could also affect the long term financial security of your spouse/partner;
- The investment returns may be less than those shown in the illustrations;
- Annuity rates may be at a worse level when (and if) annuity purchase takes place. Although annuity rates generally increase with age, they have fallen dramatically during the past fifteen years. This trend may well continue;
- A careful investment portfolio needs to be constructed which will involve some investment risk. This means the fund value could fall which could affect your future income levels;
- Withdrawing too much income in early years may have an adverse effect on preserving your pension purchasing power or preserving the capital value of your fund;
- Increased flexibility brings increased costs and the need to review arrangements on an ongoing basis;
- There is no guarantee that your future income will be as high as that offered by an annuity purchased at outset;
- You may feel the prospect of the future higher income does not compensate for the known income available from an annuity now and for the rest of your life;
- The Financial Conduct Authority ("FCA") has particular concerns in relation to what is known as "mortality risk". If you purchase an annuity, you may benefit from a cross-subsidy from those annuitants that die relatively early. This cross-subsidy is not present with Drawdown Pensions and so to provide a comparable income, a higher investment return will be required. The impact of mortality can be expressed as an annual percentage rate by which the net investment performance of the remaining personal pension fund would have to exceed the interest rate implicit in an annuity in order to break even. This effect has become known as the "mortality drag";
- The charges are explicit whereas under an annuity they are inherent in the annuity rate offered.

Drawdown Pension (cont'd)

Suitability

Both Capped and Flexi Access Drawdown (including combination plans) would be generally suited to the more experienced investor, who is more capable of fully understanding the risks involved.

The contract can be used as a useful tax planning tool and a means of accessing pension fund tax-free cash without having to take the full taxable income.

Inheritance Tax

As with Phased Retirement, ppreviously, IHT did not not typically apply to death benefits from pension schemes. However, in her Autumn Budget 2024, Rachel Reeves announced that most unused pension funds and death benefits would be included in the value of a person's estate for Inheritance Tax ("IHT") purposes from 06 April 2027.

Critical Yield (existing Capped Drawdown only)

Critical yields are illustrated by product providers using a common prescribed basis. There are two types (A and B).

Type A – the growth rate needed on the Drawdown Pension sufficient to provide and maintain an income equal to that obtainable under an equivalent immediate annuity.

Type B – the growth rates necessary to provide and maintain the actual level of income chosen.

Means-testing by the DWP

There are rules around how pension benefits, will be treated in the calculation of an individual's entitlement to the following income-related benefits:

- Employment and Support Allowance (income-related);
- Housing Benefit;
- Income Support;
- Jobseeker's Allowance (income-based);
- Pension Credit;
- Universal Credit.

These rules apply from an individual's qualifying age for Pension Credit, i.e. for women, her State Pension Age ("SPA"), and for men, the SPA of a woman with the same date of birth.

Drawdown Pension (cont'd)

Means-testing by the DWP (cont'd)

For individuals living on their own, the means-testing is done solely on the individual. For those living as a couple (whether or not they are married or in a civil partnership) the means-testing is undertaken on the couple and either party's pension funds could impact on either party's means-tested benefits. In both cases, wherever we use the term "claimant" we mean the individual, or the individual and their partner, as appropriate.

Whilst we set out the new rules below, it is worth mentioning that these are less stringent than the rules that applied prior to 06 April 2015. Under those rules, for many means-tested benefits, the notional income rules applied from age 55 for personal pension plans and the scheme's Normal Retirement Date ("NRD") in respect of occupational pension schemes.

The New Rules

The DWP state that, in all cases, it is the responsibility of each individual claimant to inform the DWP and (where appropriate) the Local Authority, if they, or their partner, withdraw any benefits from a money purchase pension scheme. Already the DWP are provided details by HMRC of bank interest received by individuals so that they can cross-check this information with claimants. One would assume that in due course they will look to obtain similar data relating to pension schemes. It should of course not be forgotten that the DWP run the existing Pension Tracing Agency.

Where a claimant below the qualifying age for Pension Credit does not access any benefits from a money purchase pension scheme (or any pension for that matter) then the existence of an uncrystallised pension will not impact on the eligibility for any means-tested benefits. However, as soon as benefits are crystallised, the claimant must inform the DWP and (where appropriate) the Local Authority. The benefits crystallised will be treated as either income or capital, depending on, for example, how regularly withdrawals are made.

Claimants who have attained the qualifying age for Pension Credit are expected to use their pensions to help support themselves. Where benefits are taken in a form other than an annuity after reaching the qualifying age for Pension Credit, an amount of income taken into account when calculating any means-tested benefits is the greater of the "notional" income or the actual income withdrawn. Notional income is an amount equivalent to the income the claimant is expected to have received if an annuity had been secured.

Deprivation Rule

If a claimant spends, transfers or gifts away any money withdrawn from a pension, the DWP will consider whether the claimant has deliberately deprived themselves of that money in order to secure (or increase) a benefit entitlement.

If the DWP decide that the claimant has deliberately deprived themselves, they will be treated as still having that money and it will be taken into account as income or capital when calculating benefit entitlement.

Uncrystallised Funds Pension Lump Sum (“UFPLS”)

Overview

From 06 April 2015, this new type of payment has been introduced which will allow for a lump sum to be paid from an existing money purchase pension plan. An investor can withdraw as little or as much as they wish from their plan and any payment will allow for 25% of the monies to be paid tax-free (subject to a cap of £268,275, equal to 25% of the previous Lifetime Allowance) and the remainder will be subject to their marginal rate of Income Tax.

This piece of legislation is likely to be useful for so called “zombie” companies who are no longer open for new business e.g. Equitable Life and Phoenix. It ensures that all policy holders enjoy the same pensions freedom even if the particular provider does not want to offer a ‘Flexi Access Drawdown’ contract.

If you use this option, any future money purchase pension contributions will be limited to a £10,000 maximum Annual Allowance.

If taking an income stream from a ‘Flexi Access Drawdown’ plan, the policyholder must alert all scheme administrators of any active plans that they have flexibly accessed benefits. This must be done within a 91-day reporting window. Failure to do so will lead to HMRC fines. The responsibility for alerting the scheme administrators lies with the policyholder.

Tax-free cash

Most types of pension plan have the option of taking a tax-free cash lump sum before exchanging the residual fund for a series of payments. Ordinarily up to 25% of the fund – subject to a cap of £268,275 (this being 25% of the previous Lifetime Allowance) – may be taken as tax-free cash. However, if the pension funds are (or were) part of an Occupational Pension Scheme, or the individual had applied for transitional protection, then the available tax-free cash may be greater than 25%. You should note that these higher entitlements **cannot be paid** if the UFPLS option is used as only 25% of the payment will be paid tax-free.

Income

With this option, a lump sum is paid rather than a regular income, with 75% of the lump sum paid being subject to Income Tax under the PAYE system.

It should be noted that, by taking the UFPLS option, Income Tax may be under an emergency coding initially. This may mean that considerably more tax is deducted than appropriate. It may therefore be necessary to liaise with the local Income Tax office to correct the level of tax paid.

Uncrystallised Funds Pension Lump Sum ("UFPLS") (cont'd)

Death benefits

On death prior to age 75, any funds remaining in the plan will be paid out tax-free, usually as a lump sum (although some pension plans may offer income options for beneficiaries on death).

On death after age 75, any remaining funds paid out as a lump sum are taxed at the beneficiary's marginal rate of Income Tax. A beneficiary's income option (if offered by the arrangement) would also be subject to their marginal rate of Income Tax. They might also come under the scope of Inheritance Tax.

Advantages

- You are able to take as much or as little of your existing pension plan as necessary;
- You are able to mitigate your liability to personal Income Tax in certain years;
- It offers one of the most straightforward and simple options for pension payments at retirement.

Disadvantages

- You may run out of money and have no pension left;
- Benefits are means-tested by the DWP;
- Any funds remaining in the plan are subject to investment risk. This means the fund value could fall which could affect your future income levels;
- You may feel that the flexibility of having payments made in the form of a lump sum as and when required does not compensate for the known income available from an annuity now and for the rest of your life;
- The Financial Conduct Authority ("FCA") has particular concerns in relation to what is known as "mortality risk". If you purchase an annuity, you may benefit from a cross-subsidy from those annuitants that die relatively early. This cross-subsidy would not be present in a plan from which UFPLS payments are made and so to provide a comparable income, a higher investment return will be required. The impact of mortality can be expressed as an annual percentage rate by which the net investment performance of the remaining personal pension fund would have to exceed the interest rate implicit in an annuity in order to break even. This effect has become known as the "mortality drag".

Uncrystallised Funds Pension Lump Sum (“UFPLS”) (cont’d)

Inheritance Tax

As with Phased Retirement and Drawdown Pension, death benefits from pension schemes are to be included in the value of a person’s estate for Inheritance Tax (“IHT”) purposes from 06 April 2027.

Suitability

The UFPLS option would be suited to an investor who already has enough income from other sources to rely on in retirement. Alternatively, it may be appropriate for an investor who only has a very small amount of money in a pension plan and the alternative retirement income options would prove to be uneconomical.

Means-testing by the DWP

As with ‘Drawdown Pension’ (please refer to pages 17 and 18 of this booklet).

“If people do get a Lamborghini… that is their choice”

Steve Webb (former Pensions Minister)

Third Way Pensions

Overview

Against a background of increased volatility in stock markets, perceived poor rates being offered for 'Lifetime Annuities', concerns regarding future inflation and the fact that people are now living longer, the retirement market was in need of a new type of product. These new plans are commonly known as "Third Way" products (sometimes referred to as "Guaranteed Drawdown" or "Guaranteed Income" options) and they are already very popular in the US and Japan. Essentially, they fit in between a 'Lifetime Annuity' and a 'Drawdown Pension' as they offer the chance still to participate in stock market growth but with guarantees attached to either income, capital or both.

Whilst each specific product does differ in its features, the "Third Way" pension is usually structured in one of two ways:

Annuity – this option is commonly structured as a fixed term, value protected annuity plan, typically running for 5 years at a time, with the option to include guarantees to protect maturity values or the level of income. These products tend to offer the ability to alter income levels between certain limits and, importantly, also allow the facility to provide a lump sum on death.

Flexi Access Drawdown – the second type of "Third Way" plan is structured as a 'Drawdown Pension' plan but with the option to apply a guarantee to the initial investment so that your fund value will never fall below what you originally paid into the plan. Some plans also allow all or a portion of any growth in the plan's value to be locked in and a new minimum guaranteed level is then set. Finally, the option to select a guaranteed level of income is also commonly available.

Under both of the above options, you can choose to immediately take a tax-free cash lump sum and then, instead of buying an annuity, leave the remainder of the fund invested in a tax-efficient environment.

If you use this option, any future money purchase pension contributions will be limited to a £10,000 maximum Annual Allowance.

If taking an income stream from a 'Flexi Access Drawdown' plan, the policyholder must alert all scheme administrators of any active plans that they have flexibly accessed benefits. This must be done within a 91-day reporting window. Failure to do so will lead to HMRC fines. The responsibility for alerting the scheme administrators lies with the policyholder.

Tax-free cash

Most types of pension plan have the option of taking a tax-free cash lump sum before exchanging the residual fund for a series of payments. Ordinarily up to 25% of the fund – subject to a cap of £268,275 (the equivalent of 25% of the previous Lifetime Allowance) – may be taken as tax-free cash. However, if the pension funds are (or were) part of an Occupational Pension Scheme, or the individual had applied for transitional protection, then the available tax-free cash may be greater than 25%. Tax-free Cash must be taken at outset and, once drawn, there will be no further entitlement.

Third Way Pensions (cont'd)

Income

There is no maximum income, any income being taxed as earned income under the PAYE system.

Death benefits

If you die whilst in a "Third Way" product, the death benefits can differ depending on how the particular plan you are using has been set up, i.e. based on an Annuity or on 'Flexi Access Drawdown'. You therefore need to check the specific product terms and Key Features.

Advantages

- You are able to take all of your tax-free cash lump sum entitlement at outset;
- Unless a guaranteed income is selected, you do not have to receive a set income but are able to vary it to suit your personal circumstances in order to supplement other sources of income;
- You are able to mitigate your liability to personal Income Tax in certain years;
- You have the potential to benefit from good investment performance in a tax-efficient environment and to exercise control over your own investment portfolio;
- You are able to add a safeguard in the form of a guarantee to limit any drop in your fund value; further, some products allow gains to be locked in.

Disadvantages

- You may run out of money and have no pension left;
- Benefits are means-tested by the DWP;
- 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 and could also affect the long term financial security of your spouse/partner;
- The investment returns may be less than those shown in the illustrations;
- Annuity rates may be at a worse level when (and if) annuity purchase takes place. Although annuity rates generally increase with age, they have fallen dramatically during the past fifteen years. This trend may well continue;
- A careful investment portfolio needs to be constructed which will involve some investment risk. If capital guarantees are not included, the fund value could fall which could affect your future income levels;

Third Way Pensions (cont'd)

Disadvantages (cont'd)

- Withdrawing too much income in early years may have an adverse effect on preserving your pension purchasing power or preserving the capital value of your fund;
- Increased flexibility and the addition of guarantees brings increased costs and the need to review arrangements on an ongoing basis;
- There is no guarantee that your future income will be as high as that offered by an annuity purchased at outset;
- You may feel the prospect of the future higher income does not compensate for the known income available from an annuity now and for the rest of your life;
- You may be prevented from withdrawing your chosen level of income due to the action of the GAD limits;
- The Financial Conduct Authority ("FCA") has particular concerns in relation to what is known as "mortality risk". If you purchase an annuity, you may benefit from a cross-subsidy from those annuitants that die relatively early. This cross-subsidy would not be present in a plan from which UFPLS payments are made and so to provide a comparable income, a higher investment return will be required. The impact of mortality can be expressed as an annual percentage rate by which the net investment performance of the remaining personal pension fund would have to exceed the interest rate implicit in an annuity in order to break even. This effect has become known as the "mortality drag";
- If you opt for an annuity version of the "Third Way" plan, the charges are typically built in to the annuity rates offered. If you decide to choose a 'Drawdown Pension' version of a "Third Way" plan, the charges are added on top;
- Both of these are generally more expensive than a 'Lifetime Annuity' or 'Drawdown Pension' plan.

Inheritance Tax

As with 'Drawdown Pension' (please refer to page 16 of this booklet).

Suitability

Both versions of this "Third Way" plan would generally suit a more experienced investor, who is capable of fully understanding the mechanics of the plan and the risks involved. The contract can be used as a useful tax planning tool and a means of accessing pension fund tax-free cash without having to take the full taxable income and it importantly allows the individual to defer annuity purchase until their future plans are clearer. The availability of guarantees allows this type of contract to be suited to more cautious individuals who would not normally suit a 'Drawdown Pension' plan. However, the guarantees do come at a cost. How the new system will affect you will depend on your individual circumstances and whether you have an income from other sources.

Triviality

Overview

In April 2015, the “Triviality” and “Small Pots” rules were changed to allow access from age 55 (as opposed to age 60, as it was historically).

The “General Triviality” combined limit of £30,000 is only available for Defined Benefit (Final Salary) schemes.

All such commutations must take place within a single 12-month period from the “nominated date” and must extinguish all the member’s rights under the scheme or annuity.

The “nominated date” can be within at any point within the last three months, so this may allow some flexibility if the fund value is just over £30,000 currently.

Once this period expires, it is no longer possible to commute any further small pension funds (with the exception of the “Small/Stranded Pot” rules – see below). Previously, Triviality had to occur before the individuals 75th birthday but this rule no longer applies (and has not done so since 06 April 2011).

The “Small/Stranded Pot” rules (schemes with a value of less than £10,000) will continue to be available to both Defined Benefit and Defined contribution schemes.

There is no need to quantify the member’s interests in other, unrelated pension arrangements. An individual can only have three “Small/Stranded Pot” payments during their lifetime.

Tax-free cash

Tax-free cash can still be drawn and this will be a maximum of 25% of the fund value (capped at £268,275, or 25% of the previous Lifetime Allowance). However, if the pension funds are, or were, part of an Occupational Pension Scheme, or the individual had applied for transitional protection, then the available tax-free cash may be greater than 25%. You should note that these higher entitlements **cannot be paid** if any of the above Triviality options are used as only 25% of the payment can be paid tax-free.

Income

With this option, a lump sum is paid rather than a regular income, with 75% of the lump sum paid being subject to Income Tax under the PAYE system.

Death benefits

As the entire fund is paid out, there are no death benefits available if accessing funds under the “Triviality” rules.

Triviality (cont'd)

Advantages

- You are able to take your entire pension plan in one lump sum;
- It offers one of the most straightforward and simple options for to "tidy up" redundant pension plans.

Disadvantages

- Withdrawing the entire fund results in having no pension left;
- Benefits are means-tested by the DWP.

Suitability

The Triviality option would be suited to an investor who already has enough income from other sources to rely on in retirement. Alternatively, it may be appropriate for an investor who only has a very small amount of money in a pension plan and the alternative retirement income options would prove to be uneconomical.

Means-testing by the DWP

As with 'Drawdown Pension' (please refer to pages 17 and 18 of this booklet).

Crystallisation Events

Overview

The Lifetime Allowance figure was £1.0731 million (2023/2024) subject to transitional protection.

The pension benefits that you have accrued were previously tested against this Lifetime Allowance upon a Benefit Crystallisation Event ("BCE"). If the total of your pension fund values exceeded the Lifetime Allowance at that point, an extra tax charge was levied of 55% if excess benefits are taken as a lump sum and 25% if you chose to take the excess benefits as pension income (which, depending on your circumstances, may also have been subject to Income Tax). This charge was abolished in the 2023 Spring Budget, this coming into effect on 06 April 2024.

There are 12 types of BCE and the following list provides a summary:

- On purchasing a 'Lifetime Annuity' from Money Purchase scheme benefits;
- Becoming entitled to a 'Scheme Pension';
- The payment of a 'Scheme Pension' above the maximum level permitted by law at the date the pension started;
- On using a money purchase pension plan to set up 'Drawdown Pension';
- Becoming entitled to a 'UFPLS';
- Reaching age 75 with uncrystallised Defined Benefit scheme pension and lump sum;
- Reaching age 75 with crystallised Money Purchase scheme benefits within a 'Drawdown Pension' plan;
- Becoming entitled to a lump sum payment;
- A lump sum death benefit being paid;
- A transfer to a Qualifying Recognised Overseas Pension Scheme ("QROPS").

Disclaimer

Please note:

- Unit prices can fall as well as rise;
- Past performance is not necessarily a guide to future performance and past performance may not necessarily be repeated;
- This guidance is based on present legislation, which may be subject to change.

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