PARTNERS WEALTH MANAGEMENT

AN INTRODUCTION TO

Pension Choices

NEW FLEXIBILITY WITH 2015 REFORMS

ANNUITIES VERSUS DRAWDOWN

VIEWING THE WIDER PICTURE WITH US

Not so long ago, what to do with a pension plan at retirement was often just Hobson's choice. That changed with the 2015 pension freedoms, though these place the onus on individuals and their advisers to make the optimal decisions.

Salaried high earners no longer mollycoddled

The 2015 pension freedoms that brought more choice in dealing with a pension pot were an important stage in the evolution of pensions. They came at a time when increasing numbers of defined benefit (final salary) pension schemes had been closed to new members or placed under the care of the Pension Protection Fund. In the wake of the 2008 financial crisis, some schemes had struggled to future-proof their ability to pay pensions based on final salaries.

Since the crisis, higher earners who might have expected effortlessly to join generous final salary schemes have instead found themselves in defined contribution (money purchase) occupational schemes. Not only would the size of their pension depend upon investment performance rather than their final salary, there would be a decision to make about where to invest their pension pot. This shift signalled the end of pension mollycoddling for many high earners.

Meanwhile, in the world of entrepreneurs

Of course, not all high earners are salaried by major organisations. Many are executives and directors of longstanding family firms or businesses they have created themselves. Unsurprisingly, developing Small and Medium Sized Enterprises (SMEs) did not generally adopt the final salary model with its open-ended commitment to pay out defined benefits decades into the future. They inclined more towards defined contribution schemes such as group personal pensions, under which members bear the impact if fund investments underperform.

As in business itself, a good deal of pension innovation has been driven by smaller companies. Their needs played a part in the success of small self-administered schemes (SSASs), launched four decades ago; the ability to invest in a wide range of assets chimed with entrepreneurs' pioneering instincts. The arrival of self-invested personal pensions (SIPPs) in 1989 and stakeholder pensions in 2001 brought further options for personnel at all levels. Then, in 2012, pension auto-enrolment began boosting pension membership among workforces, at some cost to employers.

Reforms in 2015 brought new flexibility

In the 2014 Budget, the government announced major relaxation of the rules governing the way in which defined contribution pension plan holders could take lump-sum payments or retirement income. It said: "People's pensions are hard-earned over years of work. It is only right they have the freedom to choose how and when they access them during retirement." That statement turned pension evolution into pension revolution, coming eight years after the so-called 'A-Day' pension reforms of 2006, which placed new limits on tax-relieved pension contributions and subjected pension drawdown to capping and other restrictions.

Revealing its planned new freedoms, the government added: "We're announcing that from April 2015, people aged 55 and over will only pay their marginal rate of income tax on anything they withdraw from their defined contribution pension – either 0%, 20%, 40% or 45%." This was clearly designed to encourage more people to choose drawdown for some or all of their pension pot, rather than taking the well-trodden path of buying an income for life via an annuity. (It might also have eased the impact for some pensioners of having to wait years longer for their State Pension.)

Annuities versus drawdown

Before 2015, about three-quarters of defined contribution pensioners bought annuities. Whilst providing a secure income, an annuity could be inflexible and the substantial sum committed could be lost in the event of early death. Despite the option of ongoing annuity payments to a surviving spouse and possibility of an enhanced income to take account of life-shortening medical conditions or lifestyles, the government wanted to give more people the chance to keep their pension pots substantially intact after retirement and bequeath what remained to their heirs.

As with SSASs and SIPPs, the pre-2015 drawdown arrangements were more likely to be adopted by higher earners than the lower paid. So-called 'capped drawdown' permitted someone to take income from their pension up to a set percentage above an equivalent annuity. Under 'flexible drawdown', those with guaranteed other retirement income above a set level could withdraw whatever they wanted from their pension pot. The provisos helped prevent pensioners from spending the lot and then throwing themselves on the mercy of the state. Under the post-2015 regime, individuals and their advisers would carry greater responsibility.

The decisions our clients may face

Expressed simply, all options are on the table when a client approaches the age of 55 or such later stage as they elect. They may still buy an annuity, though not necessarily using all of their pot for that purpose. For instance, a carefully calculated portion of it could be deployed to generate steady annuity income to cover regular outgoings.

Whether or not an annuity also forms part of the plan, the income drawdown option can deliver variable income to reflect fluctuating expenditure. There is also a facility to withdraw lump sums and up to 25%, or more in certain scenarios, of a pension pot may be taken tax-free; beyond that, such withdrawals are treated as income, so overall income levels and tax bands in any tax year must be monitored.

As there is no obligation to take anything from a pension pot and some people choose to continue working beyond any notional 'retirement age' or have other sources of income, up to the entire pension pot may be left invested and bequeathed to heirs with very favourable income tax and IHT treatment. Further contributions may be made until age 75, subject to HMRC annual allowances, and can be paid into beyond this age, but without any tax relief.

Viewing the wider picture with us

Pension planning is inherently a long-term process and the earlier it starts the more effective it can be. Aspects such as contribution levels, tax relief and investment choices need considering, whilst dovetailing with financial planning for other significant stages, such as estate planning, is often advantageous. This can include arrangements to hold your pension in trust so that it is held outside of your estate for inheritance tax purposes. Many clients choose to view the wider picture with us to ensure a fully co-ordinated approach to their present and future financial wellbeing.

* We're here to help

We're only a phone call or email away.
If you have any queries or would like to discuss any aspect of retirement options, please do get in touch:

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