A guide to...
Retirement options.

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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, health, marital status, 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 Edge Securities. There are many different types of Annuities and these are covered later on in this section.

Pension Commencement Lump Sum (PCLS)

Most types of pension plans 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 or can increase at a set rate or in line with an index e.g. Retail Prices Index.

Death benefit

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 dependents pension up to 100% of the pension you had received.
- A guaranteed payment period.

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 less a flat rate tax charge of 55%.

Guarantee periods allow you to opt for your annuity to pay out for a specific number of years, usually to cover the first five or ten years of income, 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 look at a 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.

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

- The selected income level is fixed and cannot be varied in response to changing personal financial circumstances (excluding potential future increases).
- There is no opportunity of participating in future investment returns.
- Any options to provide benefits on death 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, health, marital status, 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 will decrease. Most with profit annuities offer a minimum guaranteed level of pension.

Pension Commencement Lump Sum (PCLS)

Tax free cash must be withdrawn at outset then the residual fund is 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 benefit

The option of what type of death benefits to include must be made at outset. The options available are the same as under the 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 less tax upon your death.
- Tax-free cash is available at outset.
- Charges are taken at outset and are reflected in the annuity rate offered. The with profit 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.

Disadvantages

- The selected income level is not guaranteed and is subject to future investment returns.
- Any options to provide benefits on death 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.

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.

Pension Commencement Lump Sum (PCLS)

Tax free cash must be withdrawn at outset then the residual fund is 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 'Traditional Annuity'. Income will increase or decrease in payment depending on fund performance relative to the assumed growth rate.

Death benefit

The option of what type of death benefits to include must be made at outset. The options available are the same as under the 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 less tax upon your death.
- 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 future investment returns.
- Charges will be higher than under a 'Traditional Annuity'.
- Any options to provide benefits on death 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.

Enhanced life or special situation annuities

Overview

Individuals in poor health (or those with a known medical condition, i.e. diabetes) may apply for higher annuity rates due to their shorter life expectancy – this is often subject to a medical examination. Some individuals may be offered enhanced rates due to their lifestyle or physical condition, i.e. 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 schemes are guaranteed for life.

Pension Commencement Lump Sum (PCLS)

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'.

Death benefit

The death benefits are the same as described under Lifetime Annuity however, the payment of death benefits from a Defined Benefits (or Final Salary) Scheme are classed as a benefit crystallisation event. Essentially, this means that the maximum that can be paid out is the individuals remaining Lifetime Allowance (a Standard Lifetime Allowance figure is declared by the government each year) with any remaining fund in excess of this allowance being subject to a 55% tax charge.

Advantages

- You will receive an income for life and you can elect for your spouse/partner to receive an income or lump sum (which could be subject to tax) upon your death.
- Money purchase plan scheme pensions are regularly reviewed therefore income could be altered according to changes in health/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 to provide benefits on death must be selected at outset and will result in a lower initial pension payment. These selected benefits 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. This would therefore suit individuals who have a 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 fixed income for life.

The balance of your pension fund (i.e. the contracts not cashed in or 'vested' to provide you with a given level of 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) and future investment returns.

Pension Commencement Lump Sum (PCLS)

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 or can increase in payment.

Death benefit

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 vested) can be paid, on death, as a lump sum to your nominated beneficiary. There would be no tax charge on the unvested segments if death occurred before age 75, but after this age a 55% tax charge would be applied.

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 income. It is cheaper for insurance companies to purchase an annuity to provide a given level of income for someone age 70 than for someone age 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 your personal circumstances in the future, although once you have purchased an annuity, this income payment will continue unchanged for the rest of your life. Each year an annuity is purchased you can chose 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 free of Inheritance Tax but see tax charges info above.

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. Of course, 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 may 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, i.e. 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 up front.

Drawdown Pension (DP)

Overview

Under the option of Drawdown Pension (previously known as Unsecured Pension or Pension Fund Withdrawal) you can choose to immediately take a tax-free cash lump sum and then have a further two options with regards to taking an income.

Capped Drawdown Pension

An annual income can be taken from the invested pension fund, if required. This income may vary between limits, set at outset by the Government Actuary's Department (GAD). The maximum limit is reviewed every 3 years up until age 75 and then annually thereafter. The figure is derived from tables published by the Government Actuaries Dept (GAD) and is based on your fund size, age, health, marital status and the current gilt yield. This maximum limit is broadly equal to 150% of a single life annuity that you could have purchased at that point. There is no minimum limit.

Please note that Capped Drawdown Pension can be set up as a Phased Capped Drawdown plan and would operate in a similar way to Phased Retirement mentioned previously. The difference under this option is that instead of buying an annuity to provide income, encashment of a certain portion of the fund would be made to purchase a series of Capped Drawdown Pension plans.

Flexible Drawdown Pension

There is no maximum limit with this type of plan allowing immediate access to the remaining funds. You must be able to prove however, that you have a secured pension income already of at least £12,000 pa from other pension arrangements, to select this option. The residual fund if taken in this manner would be subject to the usual income tax rates.

In order to use Flexible Drawdown Pension an individual must:

- Satisfy the Minimum Income Requirement.
- Have paid no contributions (or had any contributions paid on their behalf) in the same tax year in which flexible drawdown is to be taken.

  To be eligible the individual must also not be an active member of a defined benefit or cash balance scheme.

Whilst in Flexible Drawdown, any future contributions made into a money purchase scheme by the individual or their employer will be subject to an Annual Allowance tax charge taxed at the highest marginal rate, resulting in no financial gain. This tax charge will also apply to individuals who build up benefits in a Cash Balance or Defined Benefit arrangement.

Pension Commencement Lump Sum (PCLS)

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 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.

Income

A pension income does not have to be taken but if this is required, it cannot exceed 150% of the maximum GAD rate. This income is taxed as earned income under the PAYE system.

Death Benefits

If you die whilst in Capped Drawdown Pension your spouse/civil partner/dependant has a number of different options available to them:-

a) he or she can take the fund as a cash lump sum (with a tax charge of 55%), or

b) he or she can buy a lifetime annuity with the fund, or

c) he or she can buy a scheme pension with the fund, or

d) he or she can choose to continue taking Drawdown Pension

There are no death benefits under Flexible Drawdown Pension if all the plan benefits are taken at outset.

Advantages

- You are able to take all of your tax-free cash lump sum entitlement at outset.
- You do not receive a set income but are able to vary it to suit your personal circumstances, up to a maximum limit, to supple ment other sources of income or you have the option of taking it all at outset subject to meeting the minimum income requirement of £12,000 p.a.
- 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.

Disadvantages

- 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 annuity purchase takes place. Although annuity rates generally increase with age, they have fallen dramatically during the past 15 years. This trend may 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.

Disadvantages continued...

- Increased flexibility brings increased costs and the need to review arrangements on an on-going basis.
- There is no guarantee that your future income will be as high as that offered by an annuity purchased today.
- 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 Services Authority (FSA) has particular concerns in relation to 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 Draw down 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.

Inheritance Tax Issues

The Government has confirmed that IHT will not typically apply to death benefits from pension schemes. They will however, be monitoring this issue so that pension schemes do not become a vehicle for IHT avoidance.

Critical Yield

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" investment 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.

Suitability

Both Drawdown Pensions and Phased/Drawdown Pensions would be generally suited to the relatively sophisticated investor, who is 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.

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 and they are already very popular in the US and Japan. Essentially they fit in between a Lifetime Annuity and a Drawdown Pension plan as they offer the chance to still 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. Unlike a traditional lifetime annuity, 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.

Drawdown Pension – 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 the income is not guaranteed it may vary between set limits, and will be reviewed at some point between 1 year and 3 years depending on the product chosen. The range of income typically can be anything between nil and 100% of the income that could be paid by a single life annuity and will be based in the main on your fund size, age, health, marital status, assumed investment returns and your expected longevity. The maximum limit is broadly equal to 100% of a single life annuity that you could have purchased at that point. Where a guaranteed level of income is chosen this tends to be a fixed amount although increases may be possible.

Please note that this type of contract can also be set up as a Phased/Drawdown Pension or Phased Retirement plan as mentioned previously.

Pension Commencement Lump Sum (PCLS)

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 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.

Income

A pension income may not have to be taken but if this is required, it cannot exceed 100% of the single life annuity that you could have purchased at that point. This income is taxed as earned income under the PAYE system.

Death benefit

Overview...

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. You therefore need to check the specific product terms and Key Features Document. In general however, they tend to fall into two scenarios:-

Under the annuity option - a return of the original purchase price less withdrawals and less a tax charge of 55%.

Under the Drawdown Pension option – a return of the fund value at that point less a 55% tax charge.

Alternatively, the spouse / dependent may also have the following options available to them:-

a) he or she can buy a lifetime annuity with the fund, or

b) he or she can choose to continue taking Drawdown Pension

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, up to a maximum limit, 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 and some products allow gains to be locked in.

Disadvantages...

- 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 annuity purchase takes place. Although annuity rates generally increase with age, they have fallen dramatically during the past 15 years. This trend may continue.
- A careful investment portfolio needs to be constructed which will involve some investment risk. If capital guarantees are not included then 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 and the addition of guarantees bring increased costs and the need to review arrangements on an on-going basis.

Disadvantages continued...

- There is no guarantee that your future income will be as high as that offered by an annuity purchased today.
- 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 Services Authority (FSA) has particular concerns in relation to 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 Unsecured Income plans 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 traditional annuity or Drawdown pension plan.

Inheritance Tax Issues

The Government has confirmed that IHT will not typically apply to death benefits from pension schemes. They will however, be monitoring this issue so that pension schemes do not become a vehicle for IHT avoidance.

Critical Yield

For Drawdown Pension versions of the plan you may be provided with a Critical Yield figure. There are two types (A and B).

Type A – the growth rate needed on the investment 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.

Suitability

Both versions of this Third Way plan would generally suit a relatively sophisticated 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.

Triviality

Overview

The £30,000 Rule

Where an individual is aged over 60 and their total pension funds from all occupational and personal pension plans is less than £30,000, the entire fund can be paid out as a lump sum.

Commutation of all pension plans must take place within the same 12 month period. If there is already a plan in payment, the notional value of this is calculated by multiplying the annual gross income by 25 (if the plan started to be paid before 6th April 2006).

The £10,000 Rule

From March 2014, the Government are proposing to allow funds of £10,000 or less held in personal pension arrangements to be paid out as lump sum payment to individuals aged 60 or over, as an authorised payment, provided certain conditions are met.

In summary, these conditions are:

- That all benefits within the scheme are extinguished.
- These payments can be made regardless of the value of the individual's total pension savings and can be made in addition to any trivial commutation lump sum payments or occupational pension scheme small pot lump sum payments the individual may have received.
- An individual can only have 3 such lump sum payments in their lifetime.

The measure will help individuals age 60 or over who have large pension savings and so cannot use the lifetime trivial commutation rules to access a very small personal pension pot and also some who have already taken a trivial commutation lump sum and later discover small benefit rights in a personal pension scheme.

Pension Commencement Lump Sum (PCLS)

Tax free cash can still be drawn and this will usually be a maximum of 25% of the fund value.

Taxation

The remaining fund after the tax free cash has been paid will be taxed as earned income dependent on the individual's current income tax status.

Occupational Scheme Members

The June 2009 Budget proposed some changes just for occupational schemes under the triviality rules, which did indeed become live on 1st December 2009.

The Regulations set out various payments which will be considered as trivial commutation lumps sums (or trivial commutation lump sum death benefits). The most useful of these are likely to be 'de minimis' amounts of up to £10,000 from occupational pension schemes. They will have to be made between the ages of 60 and 75, but there is no need to quantify the member's interests in other, unrelated pension arrangements. This is not available to controlling directors and their relations. There is also additional flexibility where an occupational scheme is winding up. This is to assist trustees in discharging liabilities and timescales.

Where a scheme winds up, a member under the age of 60 may be able to commute benefits on grounds of triviality, providing the following two conditions are met. The conditions are that any employer who has made contributions under that scheme in respect of the member

1. Is not making contributions under any other registered pension scheme in respect of the member, and
2. Undertakes to HMRC not to make such contributions during the period of 1 year from the date the lump sum is paid.

Where such a scheme wind up is 'trustee driven', there is no minimum pension age and benefits for a 24 year old for example, could be commuted on these grounds.

Drawdown pension (capped) investment strategy

When investing for Drawdown Pension a spread of investment over the short, medium and longer term is required. Short-term monies are used to provide the withdrawals of capital needed in the first two years. The aims of the medium term investments are to provide a secure base to provide for future income, whilst keeping pace with inflation. Longer-term investments are required to build on the value of the fund in order to provide for the future and to ensure the critical yield is achievable. The types of funds suitable for the periods can be generally summarised as follows:

Short term (1-2 years) Cautious

- Cash
- Building society
- Short term gilts
- UK fixed interest
- Index linked
- Derivatives
- Distribution
- Mixed/managed

Medium term (3-5 years) Balanced

- Mixed/managed
- Global
- UK Equity
- With profits
- International
- Tracker fund
- Medium / long term gilts

Long term (5 years+) Adventurous

- Individual sector funds (i.e.Japan, North America, Europe, Far East etc)
- Ethical
- Emerging markets
- European small companies
- Technology

The above list is not exhaustive and is loosely based on the type and range of funds offered by most insurance companies. A brief description of each fund type follows but you should refer to the product providers Key Features Document for further details.

Cash

Invests in short-term deposits managed actively in the UK money market, achieving higher potential returns than those available via normal deposits. This is a secure investment fund, which aims to achieve a higher rate of return from the money markets than that achievable by an individual investor.

Building society

Invests in selected building society accounts. This is a secure investment fund the return of which is dependent upon underlying base rates. The size of building society funds can enable them to achieve a higher level of return than that likely for an individual investor.

Short, Medium and Long term gilts

Invests solely in gilt-edged securities issued by the Government, forming part of the short/medium/long Gilt index. This is a specialist fund which aims to help protect against changes in annuity purchasing power, annuity rates being calculated with reference to the Long Gilt index. The underlying stocks are tradable and are therefore influenced by market fluctuations.

UK fixed interest

Invests mainly in gilt-edged securities issued by the Government, as well as other quality sterling-denominated fixed interest and convertible debt instruments issued by UK Corporations. The underlying stocks are tradable and are therefore influenced by market fluctuations.

Index-linked

Invests predominantly in gilt-edged securities issued by the Government. Interest payments and capital repayment values are linked to movements in the Retail Price Index (RPI) and this provides a 'hedge' against inflation. The interest distributions and redemption values of the underlying securities are guaranteed by the Government to be calculated with reference to the RPI. However, it should be borne in mind that these stocks are traded in the market and prices may be liable to fluctuation.

Controlled risk funds (Derivatives)

There are a variety of controlled risk funds available. They invest in a combination of cash deposits and financial instruments linked to movements in the UK stock market, as measured for example by the FTSE-100 Index. Typically, they are quarterly rolling funds which have been structured with the aim of combining security with potential for growth. The bulk of funds are deposited with one or more major financial institutions for investment in the cash markets with the aim of protecting the capital value of the unit price from one quarterly date to the next. The balance is invested in FTSE-100 Index options with the quarterly unit rice benefiting from the addition of a predetermined percentage rise in the index over the period. Various levels of 'guarantees' may be offered.

Distribution

Invests in UK equities, gilt-edged securities issued by the Government (both conventional and index linked), as well as other quality sterling-denominated fixed interest and convertible debt instruments normally issued by UK corporations. No more than 60% of the fund may be invested in equities. This fund aims to provide a balanced return by investing in a combination of income and medium-term capital growth assets.

Mixed/managed funds

Invests in a variety of the provider's regional and specialist funds with little variation from market average asset allocations, usually the larger portion of the portfolio will always be invested in the UK. Managed funds operate on a similar basis except that the assets are direct held by the fund rather than 'holding' a selection of the provider's sector funds.

Property Funds

These funds are generally divided between those that invest directly in commercial property such as offices and retail units, or those that invest in the shares of property companies. The former tends to be less volatile (less risky) than the latter. Returns from property funds can be made up of a combination of rental income and increasing values in the underlying properties held within the fund. As it is sometimes difficult for fund managers to sell a property holding when investors wish to switch or encash their investment, individuals may experience a delay, although this is not common.

Global fund

This fund is similar to the mixed fund but with wider investment ranges. It may therefore have a substantially higher proportion of assets invested overseas or in bonds and cash. Risk rating is average.

UK equity

Invests in a broad spectrum of stocks mainly on the London Stock Exchange. The portfolio will provide exposure across all major industrial sectors and may include exposure to smaller companies. The mainstream UK equity funds aim to provide capital growth from a well-diversified portfolio of holdings.

With profits

With profits investments aim to provide a relatively steady rate of return over a period. Depending on the fund selected, a certain level of growth by way of an annual bonus may be added through unit price increases. On withdrawal from the funds a terminal bonus may be paid. This will reflect the extent to which the client's share of the performance of the fund's underlying assets over the period of investment (subject to an element of smoothing) exceeds the growth already added to the client's fund.

International

Invests internationally in equity markets specifically excluding the UK to provide exposure to both the assets and currency of the markets in which it invests.

Tracker funds

Tracker funds are a relatively recent development which have proved to be very popular for large group schemes that wish to follow a 'passive' approach to fund selection and management. In simple terms the aim of the tracker funds is to track a selected index such as the FTSE-100. This is achieved by the fund manager buying shares in the top 100 companies in direct proportion to that share's position in the FTSE table. For example, if BP represented 5% of the FTSE-100 then the fund manager would have 5% of his investments in BP.

Individual sector funds (eg. Europe, Japan, North America)

Invests in a broad spectrum of stocks quoted on their respective market(s). The portfolio will normally provide exposure across all major industry sectors. Such funds aim to provide capital growth from a well-diversified portfolio of holdings.

Ethical fund

Usually invests in a wide range of predominantly smaller companies whose activities comply with a strict set of ethical criteria. These specialist funds aim to generate growth from a broad-based portfolio and are for those who wish to impose ethical criteria in relation to their investments.

Emerging markets fund

Invests in companies generating in, or whose shares are listed in, the emerging markets of usually Asia, Europe, Latin America and Africa. The fund will typically be invested across all major emerging markets. This provides opportunities for capitalising on the above average returns which may be available from countries which are at an early stage of economic development.
A diversified portfolio of holdings spreads the risks which, by their inherent nature, are associated with investment in these markets. These specialist funds aim to produce growth over the medium to longer term, subject to short-term volatility.

European Smaller Companies

This fund invests in smaller companies listed on European stock exchanges. Typically, the fund will be invested across all major and most secondary markets within the region, although it may invest in developing markets when conditions appear to be appropriate. Risk rating is above average.

Technology

Invests in companies involved in technology-intensive industries on a worldwide basis. Its risk rating is ‘higher’.

Other Investment Options

In addition to the above investment funds, those clients who take their Drawdown Pension from plans with a self-investment facility, such as a SIPP, would also have access to a much wider investment choice. This range could include OEICs, Unit Trusts and shares along with the facility to invest in commercial property.

Where commercial property or direct share purchase is considered, clients should bear in mind that larger fund sizes would generally be required so that the overall fund has a mixture of different assets (known as diversification). This helps to reduce the investment risk as you are not then relying on the performance of one asset in isolation.

Crystallisation Events

Overview and Declaration

The Lifetime Allowance figure for the current year is £1.5 million (2012/2013).

The pension benefits that you have accrued will be tested against this Lifetime Allowance upon a Benefit Crystallisation Event (BCE). If the total of your pension fund values exceed the Lifetime Allowance at that point, an extra tax charge will be levied of 55% if excess benefits are taken as a lump sum and 25% if you choose to take the excess benefits as pension income (which, depending on your circumstances, is also subject to income tax).

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

- On using a money purchase pension plan to set up Drawdown Pension.
- 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 purchasing a Lifetime Annuity from Money Purchase scheme benefits.
- 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.

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.

Transitional Measures For Clients in Existing Pre April 2011 Unsecured Pension (USP) or Alternatively Secured Pensions (ASP)

The Government announced changes to retirement options from April 2011 onwards.

This booklets takes account of these changes for all new contracts entered into after that date. However please note that individuals who were already in USP before the 6th April 2011, will only become subject to the new 'Drawdown Pension' limits from the earlier of:

- Their next review date; or
- Transferring the plan; or
- Reaching age 75.

This will also affect some existing Third Way Contracts. If in doubt, please check with the product provider.

Until that time, existing GAD limits will apply i.e. minimum GAD 0%, maximum GAD 120%.

For existing ASP plans, these will revert to the new GAD limits from 6th April 2011
(i.e. no transitional period).

The tax charge on death, which has been changed to 55% from 6th April 2011, applies immediately on all existing plan holders.

Pending Annuity Changes

On the 1st May 2011, the European Court of Justice ruled that in the insurance services sector, gender-based annuity rates will be ruled discriminatory with effect from 21 December 2012. We await further guidance in relation to this matter.

Note

In March 2014, The Chancellor announced that from April 2015, investors with personal pensions will have the option of withdrawing their entire fund value as a lump sum (subject to taxes).