MoneySavingExpert.com

Guide to Taking Your Pension 2018

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Who is this guide for?

Anyone who is considering using the money saved in their private or company pension – which usually, though doesn't always, relate to retiring.

Who this guide isn't for.

This isn't about saving into a pension or finding the best pension provider, nor is it about the state pension (see www.moneysavingexpert.com/savings/state-pensions), for those see our Pension Savings Booklet.
It doesn't cover those who used their pension fund before pension freedom came into effect on 6 April 2015.

Martin's Big Picture Introduction

April 2015 saw the most radical changes to private pensions for a generation. The political spin was it's "freedom and choice in pensions". This sounds an unmitigated good. Indeed there are many more options, so for those who know what they're doing, it's great, but it also means it's easier to make a mistake.

I suspect the Chancellor who introduced it, George Osborne, pictured himself as a financial freedom fighter. But only time will tell whether these reforms will paint him as the man who liberated older savers, or who exposed them to huge risk.

The big advantage of saving for retirement in a pension is it comes from your pre-tax income – in other words, to save £100 only reduces most people's take-home pay by £70 or £80. So you'll save more than it costs.

Once it's time for you to use your pot of pension savings, you can take a quarter of it as a tax-free lump sum. That hasn't changed.

The big difference is what you can do with the rest of it.

For decades, most people have effectively needed to use the money to buy an annuity – this is a product paying you an income (that you pay income tax on) each year until you die. Not a bad idea in itself as it means you get the security of knowing exactly how much you can spend.

Yet in recent years annuity rates have been rubbish – so people trading in £100,000 of their pension money may have got as little as £5,000 a year for a standard deal. Plus, instead of shopping around to home in on the best rate, most people just went with the firm they saved with, locking in at a far lower rate than needed, so they lost out every year for the rest of their lives.

Now we're in the 'pension freedom' era. This means anyone aged 55 and over can take the whole amount as a lump sum, paying no tax on the first 25% and income tax as if it were a salary on the rest of it. Most people will be aiming not to withdraw too much in a year so it puts them in the 40% rate tax bracket (so roughly more than £46,350). This, of course, means in future many won't touch an annuity.

This new freedom is welcome but worrying. To quote Spiderman (or technically his Uncle Ben): "With great power comes great responsibility". And to get this right you may need superhuman abilities – not good when you remember most retirees picked the wrong annuity.

My biggest concern isn't the much-publicised worry that some will splash all their retirement savings on a Ferrari in year one. I worry about the opposite – that many will be nervous about releasing the cash and will therefore sit on it, never spending it, depriving themselves of the benefit and living a worse life than necessary. That's why planning early and thinking of the big picture is so important.

Martin Lewis
MoneySavingExpert

Take the long view

You save in a pension pot and once you're over 55 you're allowed to take the money out and use it. The main thrust of this guide is about the most efficient way to take the money out.

Remember, the point of saving for your pension is usually so that you'll have money to use when you're no longer working. If you use the money before you stop working, or even before you stop working full-time, then you could be depriving yourself in later life.

So there are a few things you need to establish before we start:

1. How long will you live?

This may sound like it's needing a crystal ball – but actually a realistic understanding of how long you've got left based on statistical averages can help you work out how much cash you'll need (and don't forget inflation).

The answer depends on your gender, location, current age, fitness and whether you smoke.

In a nutshell though, the typical life span for a man who hits 65 in the UK is another 18 years, a woman 21. Add a little on that for safety and it means unless you've bad health, you probably want to spend around 4-5% of what you've got a year. Yet around one in 10 men and one in five women will live to 100.

Obviously, any illness and lifestyle factors could affect this, but the reality is that your money may need to last a lot longer than you anticipated.

The illustration below outlines the percentage chances of living to certain ages for men and women who are 65 today.

So the biggest thing to remember is not to underestimate your own life expectancy. If you do, you could be looking at having not much to live off from your pension.

A 65-YEAR-OLD MAN	A 65-YEAR-OLD WOMAN
75% CHANCE OF LIVING TO 79	75% CHANCE OF LIVING TO 82
50% CHANCE OF LIVING TO 87	50% CHANCE OF LIVING TO 90
25% CHANCE OF LIVING TO 94	25% CHANCE OF LIVING TO 96
9% CHANCE OF LIVING TO 100	14% CHANCE OF LIVING TO 100

Source: ONS 2014

2. What other income will you have?

The money you have in your private pension pot isn't likely to be your only source of income. It's worth seeing what else you'll have coming in to see how much you'll need. There's also:

The state pension –This is a retirement income you'll get from the Government. The basic state pension is currently £125.95 a week. Or under the new state pension - for people who reached retirement age on or after April 2016 - it's £164.35. To get an estimate of your state pension visit the Government website at www.gov.uk/check-state-pension.

Work – you could decide to carry on working when you retire

Benefits – eg, Pension Credit, housing benefit, council tax benefit

Rental income – if you have any buy-to-let properties

Interest from savings or pensioner bonds

Dividends (income) – from investments

Property – eg, if you decide to downsize

Inheritance money – with people living longer, many will receive inheritance when retired

Spending your capital – taking money from your pension

3. What will your spending be?

Knowing what you've got coming in is only one side of the see-saw. But to be able to work out how much income you need, you'll have to look at your likely continued outgoings too, such as any mortgage repayments or rent, food, gas and electricity, travel costs, insurance policies and more.

Your outgoings in your 60s, will be different than in your 80s – for example, you will have hopefully paid off your mortgage by your 80s, but may need to pay more in care costs.

If you've time it's worth going through a proper budget to see how it all stacks up – which will hopefully try to future proof when you do take your money. Use our free budget planner at www.budgetbrain.com which takes you through it step-by-step.

How much money is in my pension?

Unless you keep on top of the pension statements that land on your doorstep, it can be difficult to know how much money you have stashed in your pension. The wake-up pack you receive from your pension provider about six months before your selected retirement age should help – if you're less than four months away from your pension age and haven't received one, call your pension provider.

If this doesn't help you can look at your pension statement – your provider should send you this once a year. If you can't find that you can contact your pension provider(s) if you know which it is – or if it was an employer pension you could try contacting your old employer to see if it has any details.

If you paid into more than one pension pot, then you'll need to contact each pension provider to find out the value of each pension.

Other benefits you can take advantage of

If you're worried that you're not going to have enough money when you come to retire, don't forget there are a whole host of benefits that you might be entitled to. They include:

Pension credit: Nearly half of all pensioners are entitled to this. It tops up income to a minimum level if you're over 60. You could get extra credit if you have modest savings and are over 65. For more information call the Pension Credit line on 0800 99 1234.

Claim benefits: As your income will usually be less than when you're working, you may be entitled to certain benefits. Some benefits you may be entitled to are income tested, which means you'll have your income assessed. Full details on what you're entitled to and how to do a 10-minute entitlement check-up at www.moneysavingexpert.com/family/benefits-check.

Heating grants: There are some heating grants available for householders who are 60 or over who get means-tested and/or disability benefits. Call the Home Heat Helpline on 0800 33 66 99 for more information about heating grants.

Winter fuel payments: Winter fuel payments are paid to most people 60 or over and can be worth £100s. Contact the Winter Fuel Payment helpline on 0345 915 15 15 for more details.

Help with council tax: You can claim this rebate whether you own your own home or rent it. There are also council tax discounts, for example 25% off if you live alone. If you have a disabled person living in your home you may also be able to claim a disability reduction. This would lower your council tax band so that you would pay less. Plus, check you are in the right band at www.moneysavingexpert.com/council.

Help with your rent: If you pay rent you may be able to get some help from housing benefit, which is paid by the local authority. Housing benefit can also help towards some service charges.

Help with health costs: Everyone 60 or over gets free prescriptions and eye tests. If you have less than £16,000 in savings you may be able to get some help towards dental treatment, glasses and travel costs to hospital if you fill in an HC1 form.

Other benefits to take advantage of:
- Travel concessions if 60 or over
- Free TV licence if 75 or over
- Free passport if 80 or over

For information about these and other benefits, go to the DWP (www.dwp.gov.uk) or Gov.uk (www.gov.uk) websites or see Age UK's website (www.ageuk.org.uk).

Once you've thought about all of that, it should help you when you come to the choice about what you should do with your pension money.

Taking your pension money – an introduction

When it comes to taking the money from your pension you have got a lot of decisions to make, but first of all you need to understand what sort of pension you have.

Pensions fall into two main categories:

1. Money purchase pension – where you've a pot of cash saved

If you've got a pot of cash saved that you and or your employer have been contributing to, whether it's a stakeholder pension, standard pension or self-invested personal pension (SIPP), this is called a 'money purchase' pension. It's this type of pension we'll focus on in this guide.

Be aware that the official name for this sort of pension is 'defined contribution' – because you know what you put into the pension, but not what you're going to get out.

2. Final salary – where you get a percentage of your final salary at retirement

These are pensions set up by employers. They're often seen as the gold-plated option, but are less common now as they promise to give you a certain amount each year when you retire.

How much you get doesn't depend on how much you've contributed or how well the investments have done. Instead, the amount you'll get depends on your final salary, which for many schemes is what you earned in the last year of employment plus how long you've worked for your employer. The official name is 'defined benefit' because you know what you're going to get at the end of the pension, not what you need to put in.

What do I do if I don't know who my pension provider is, or I can't remember the details?

If you've had a few pensions over the years possibly with various employers, then it can be easy to lose track of who your various pension providers are.

If the company that you worked for still exists, you could try calling the HR department if it has one and ask it if it knows who the pension provider is.

Worst case scenario, if you think you've completely lost track of a pension you had, contact the Pension Tracing Service on 0345 600 2537 or visit www.gov.uk/find-lost-pension. This is a database with over 200,000 workplace and personal pension schemes.

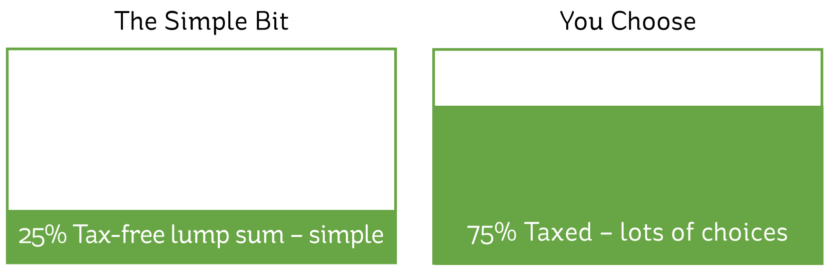
Do consider however whether or not you have actually lost your pension. That's because, even if you have a certificate from a pension scheme, it doesn't always mean that you have a pension entitlement.

For example, you might have had a refund of your contributions when you left that employer. Also, many older pension schemes may have required a certain number of years of membership from you, before giving you any benefits.

What you can do with your pension – the basics

From now on in the guide we're going to be talking about money purchase pensions.

With these, in simple terms, you can usually take a quarter of your cash tax-free.



OK, so we're not going to spend too much time on the 25% tax-free lump sum, although you'll see later the route you choose to take your pension may mean you don't get this all in one go.

So let's explore the five main options for the rest of the money. Then in subsequent chapters we cover each in more detail.

1. Keep the cash in your pension

This is the default holding position until you are ready to take your money. By leaving your money in the pension pot you usually get a wide range of investment choices and can contribute up to £40,000 each year (or the amount you earn if that's less). Once you start taking your pension, you can only contribute £4,000 a year.

Most suitable for... Anyone who doesn't need their pension income yet. Remember you can take your pension from age 55, but certainly most people will be working longer than that and will need that money for later in life and so shouldn't be using it earlier. Full information on page 19.

2. Withdraw all the money in one go

Here quite simply you can take the money out of your pension all at once. The first 25% is tax-free and the remaining 75% is taxed as income – yet it may push you up a tax level which could be costly.

This is because most people can earn £11,850 income without paying tax (known as the personal allowance), then you pay 20% tax on everything up to £46,350 and 40% tax on everything above that.

Most suitable for... People who have small (sub £30,000) pension pots and want access to the money all at once, perhaps to pay off existing debts that are costing them a lot of money.

3. Take lump sums, leaving the rest invested in your pension until you need it

You can take cash as and when you need it, leaving the rest in your current pension. When you do take cash though, rather than taking the tax-free lump sum and then after that everything is taxed, when you take money, a quarter of each amount is deemed to be tax-free, the rest is taxed as income.

For example, you take £10,000 out of a £100,000 pension, £2,500 of it is tax-free, and £7,500 is taxed as income.

Most suitable for... People who don't need access to a large chunk of their pension money all at once and want complete flexibility over how and when they access their money. Full information on page 21.

4. Take the tax-free cash then the rest in a drawdown product

Here you take the whole 25% as a tax-free lump sum straight away and then with the remainder of the cash you buy an income drawdown product which is an investment that pays you income, but also continues to allow you to withdraw lump sums if you need it.

Most suitable for... People who want to access some cash, need income and flexibility to take capital when they want. Full information on page 26.

One big difference between option 3 and 4 is the tax treatment. Taking the tax-free cash all in one lump and putting the rest into a drawdown product could be a useful option if you're likely to earn less income as you get older, therefore be in a lower-tax bracket.

5. Take the tax-free cash then buy an annuity

This is a product that pays you an income each year for the rest of your life until you die. After that it's gone. So for example, if you've converted £100,000 into a standard annuity, you'll get a regular payments of around £5,000 a year. Though there are lots of options such as linking it to inflation, or getting a higher pay out because of your health.

Most suitable for... While annuities have been given a bad rap due to low rates, the great strength here is that you get a payment each year as long as you live so there is real security. It will likely give you less than a drawdown product, but it can't 'run out' if you live a long time. So it is a valid option possibly for some of your cash.

The problem though is if you die early, with some annuities your inheritors get nothing. Yet don't just plump for your pension provider's annuity – rates vary widely so ensure you get the markets best by shopping around (and look for 'enhanced' annuities if you've had health issues). Full information is on page 30.

Martin's Pension Pointer

A taxing question

One of the big differences between schemes is how you are taxed. By taking the money at any time you are 'crystallising it' for tax purposes. So you have to ask how will it be taxed?

The biggest difference is when choosing between 'option 3 – taking cash from your pension as and when you need it' and 'option 4 – income drawdown'.

With option 3 –
Every time you take money a quarter of it is tax-free, the rest is taxed as income.

With option 4 –
You take 25% tax-free, then pay tax on the rest like income whenever you take it.

It's important to understand many people drop down a tax band when they get older because their overall income is lower.

So let's imagine that you're currently a higher-rate 40% taxpayer, but in a few years you will move to the basic 20% rate. Now for the sake of simplicity let's imagine you have £100,000 in your pension and want to take £30,000 after tax now and whatever is left in 10 years' time.

With option 3 – leaving the cash in your pension

To take out £30,000, you'll actually need to withdraw £42,850. This is because only a quarter of what you get is tax-free (£10,710), the remaining £19,290 is after 40% tax is taken off. Here's the maths:

Take out £42,850.

A quarter is tax free = £10,710.

You pay 40% tax on the remaining £32,140 leaving you with £19,290.

So you get £10,710 plus £19,290 = £30,000.

And you're left with £57,150 in your pension.

If the £57,150 grows at 5% a year (and that's an IF), in 10 years you'll have £97,730.

Then when you withdraw that later, once you're a basic 20% rate taxpayer...

You get the first 25% tax free = £24,430.

You pay 20% tax on the remaining £73,300 leaving you with £58,640.

So you get £24,430 plus £58,640 = £83,070.

Therefore in total you'll have received £30,000 plus £83,070 = £113,070.

With option 4 – income drawdown

To take out £30,000, you'll actually need to withdraw £33,300. This is because you can only take a quarter of the £100,000 pot tax-free. Anything you take out above that is taxed at your 40% rate. Here's the maths:

Take out £33,330

A quarter of your total pot (£100,000) is tax free = £25,000

You pay 40% tax on the rest of what you withdraw £8,330 leaving you with £5,000

So you get £25,000 plus £5,000 = £30,000

And you're left with £66,670 in your pension

If the £66,670 grows at 5% a year (and that's an IF), in 10 years you'll have £114,030

Then when you withdraw that later, once you're a basic 20% rate taxpayer...

You pay 20% on your £114,030 leaving you with £91,225

Therefore in total you'll have received £30,000 plus £91,225 = £121,225.

As you can see, if you're likely to drop down a tax band as you get older, income drawdown has a more favourable tax treatment than taking cash from your pension as you need it.

The different pension options explained

	What happens?	What's tax-free?	Do I get an income?	What happens when I die?
Keep the cash in your pension	All money left in pension	n/a	n/a	Can pass on money tax-free to any beneficiaries – restrictions based on whether you die before or after age 75 (see page 21)
Take lump sums leaving the rest invested in your pension until you need it	Access to all pension money as and when you need it	25% of what you take each time tax-free, remaining 75% taxed as income every time	You could use the cash you withdraw each time as an income	Can pass on money tax-free to any beneficiaries – restrictions based on whether you die before or after age 75 (see page 25)
Take a lump sum out, the rest in a drawdown product	Take 25% tax-free lump sum, buy a drawdown product with the remaining 75%	25% tax-free, when you take money from drawdown it's taxed as income	You can choose to drawdown money each month to provide you with an income	Can pass on money tax-free to any beneficiaries – restrictions based on whether you die before or after age 75 (see page 29)
Buy an annuity	Take 25% tax-free lump sum, buy an annuity with the remaining 75%	25% tax-free, income you take from annuity taxed at your income tax rate	The point of an annuity is it gives you a guaranteed income for the remainder of your life	Typically the annuity dies with you, there are a few exceptions (see page 35)
Withdraw all the money in one go	Take 25% tax-free, then remaining 75% taken taxed as income	25% tax-free	No, you take the money all at once, you would have to be disciplined how you spend it to turn it into an income	If you take all the money out and spend it, then your beneficiaries will have nothing when you die, any money left will be passed on as part of the estate

You can combine these options

You can mix your options at different times after the age of 55. For example, you can take some cash from your pot first and buy an annuity later. So for example if your pension pot was £100,000:

- You could take 25% as tax-free cash, which is £25,000.
- Use £20,000 to buy an annuity. This would give you a taxable income for the rest of your life of about £900 a year.
- Put the remaining £55,000 into a drawdown product and take the money the investments make as income.

You don't have to decide to combine straight away

You may take your 25% tax-free lump sum if you want to pay off your mortgage, for example. You could put the rest into a drawdown product, but then if you decide that you want a more guaranteed income, you could buy an annuity later on in your retirement with your drawdown money – though it will depend on what your provider offers.

Leaving your money untouched in your pension

This is the default holding position until you are ready to have your money. And while it sounds strange, leaving cash in your pension is almost certainly going to be the most common option for those who are of an age when they can take their pension.

That's because while you can take your pension from age 55, for many people that is too young because they will still be working – if you're 55 but you've got another 15 years of working, why would you release the money too early?

Even after your income drops because you work less, you may not need the cash and may prefer to keep it invested.

By leaving your money in the pension pot you should have a wide range of investment choices depending on your pension provider. If not that may be a reason to move it elsewhere. For more on choices, see our Saving for a Pension Booklet. You can contribute the maximum amount each year – £40,000, whereas if you started taking some of the money, it would be only £4,000.

Of course as a general rule of investing, the older you are the less risk you should take with your investments so you may want to examine what funds you are in to check that you are not taking too high a risk for your age group.

When should I take my money?

It's important to understand that there are several separate events that can affect when you take your pension money. If you think of your life in relation to your pension like this…

The Pension Timeline

…Just because you reach certain milestones, it doesn't mean you have to act on them there and then. For example…

- If you reach age 55 when you can legally start to take your pension, you don't have to start taking it
- If you reach state retirement age, you don't have to start taking money from your personal pension (or your state pension)
- If you're still working you can still take money out of your pension as long as you're 55+
- Even if you're not working and you're retired, you don't have to take any pension money

Be careful of getting penalised

Under the terms of many old pension policies, you are penalised if you don't buy an annuity or income drawdown product on the date you originally selected as your pension age. Even if your plans have changed and you don't need your pension now, your pension company can charge you for not taking it.

It's not common but it may happen so check your policy carefully to see if such penalties apply, or call and ask your provider. If so, you might also want to see if you can move your pot to another firm that will let you continue to earn returns and have more flexibility (but there may be charges for that too).

What happens to my pension when I die?

If you die before taking any money out of your pension you will be able to pass on your pension tax-free to any beneficiaries. But there are a few caveats:

If you die before age 75

Your beneficiaries can take the whole pension fund as a lump sum. Dependants (but not other beneficiaries) can also choose to buy an annuity, in which case the income will be taxed.

If you die after age 75

Your beneficiaries have three options:

1. **Take the whole fund as cash in one go:** If they choose this, the pension fund will be subject to 45% tax.
2. **Take a regular income:** If they choose this through income drawdown or an annuity (option available only to dependants), the income will be subject to income tax at their income tax rate at the time.
3. **Take periodical lump sums:** If they choose this, the lump-sum payments will be treated as income, so subject to income tax at their income tax rate at the time.

Take lump sums leaving the rest invested in your pension until you need it

You may have seen a lot of news stories about using your pension as a bank account – it is this option that has caused people to draw this somewhat erroneous analogy. That's because here you take cash as and when you need it, but the bulk of your pension money remains exactly where it is – in your pension.

How does it work?

When you do take cash, a quarter of each amount is tax-free, the rest is taxed as income. For example...

You take out £10,000, £2,500 of it is tax-free, and £7,500 is taxed as income.

Each time you take money from your pension, the exact same rules apply.

It's time for an analogy...

Imagine a pension is a Swiss roll. A quarter of it is tax-free (the jam bit) and the rest is taxed (the cake bit). You decide you won't eat it all at once, so it's sliced. Each individual slice has a quarter jam and the rest is the cake.

The key is that whatever you're slicing is made of two constituent bits. One of the advantages of this option is that the bulk of your money remains invested in the pension (the remaining Swiss roll), so it is hopefully making you more money for when you want to eventually take it.

PS. Thank you to Radio 2 listeners and Twitter followers for this analogy. Martin was originally using a jam doughnut, but knew it wasn't quite right, so asked on air for suggestions. The Swiss roll was *the winner.*

How do I actually get the money out of the pension?

It's simple: you just need to contact your pension provider and let it know how much you want to withdraw. However, be aware, once you have instructed the pension provider, you can't change your mind – once it's out, it's out.

Depending on the provider this may take days or weeks to process and you would have to specify which account you want the money to go to. If any investments have to be sold to cover the amount you want to take, then it could take even longer to get the money.

Charges when you take out your money

Being able to access your pension this way is a fairly new process for pension providers, so if it doesn't offer it yet, it may be putting in the process to offer it in the future.

Most of the big providers are not charging for ad hoc withdrawals. However, some will allow you to have a certain amount free and then will charge you for the rest.

If you're not sure how much it will cost, or whether your provider offers it, call them up and ask.

What is the tax situation?

Although this option gives you the most flexibility on how you access your pension, the biggest thing you need to be aware of is the tax implications.

As explained above, the first 25% of each lump sum of money you take is tax-free. How much tax you pay on the remaining 75% depends on your total amount of taxable income. Most people will be aiming not to withdraw too much in a year, so it pushes them up a tax bracket.

For example, most people earn up to £46,350 a year (2018/19) before paying the higher 40% rate of tax. So if you earned £30,000 then took a taxable £10,000 out of your pension it'd still be at the 20% basic rate. If you took £15,000 out, £13,000 would be at the 20% rate, the rest at 40%.

Be careful of emergency tax

If you decide to take a lump sum out of your pension, you may be charged the emergency tax rate. That means you are taxed as if you earn that amount every month.

For example, let's say you earn £2,000 a month and take £13,000 out. On emergency tax it'd tax you as if your earnings were £180,000 a year (ie £15,000 x 12 months) – which means you'd be paying tax at the highest 45% rate on some of your earnings.

This will be settled at the end of the year – so you're not out of pocket long term – or you can claim it back more quickly by filling in an HMRC P50 or P53 form – but in the short run it will leave you out of pocket. This needs factoring in.

What happens when I die?

Taking this option means that you can leave any remaining money to your beneficiaries tax-free when you die. But there are a few caveats.

If you die before age 75

Your beneficiaries can take the whole pension fund as a lump sum or draw an income from it tax-free. Dependants (but not other beneficiaries) can also choose to buy an annuity, in which case the income will be taxed.

If you die after age 75

Your beneficiaries have three options:

1. **Take the whole fund as cash in one go:** If they choose this, the pension fund will be subject to 45% tax.
2. **Take a regular income:** If they choose this through income drawdown or an annuity (option only available to dependants), the income will be subject to income tax at your beneficiaries' marginal rate.
3. **Take periodical lump sums:** If they choose this, the lump sum payments will be treated as income, so subject to income tax at your beneficiary's or beneficiaries' marginal rate.

Quick question

Q. Can I continue to put money into my pension once I start taking money out from it?

A. Yes. But it's important to understand that as soon as you make just one withdrawal, you will NOT be allowed to put more than £4,000 a year into your pension (it's up to £40,000 if not). This is to discourage people from simply taking money out of their pension to get the tax-free allowance and then shoving the rest back into the pension and taking it out again, getting tax relief on that too.

Take 25% tax-free, then buy a flexible income drawdown product

With this option you take your 25% tax-free lump sum all at once. Then with the remainder you buy a product called a flexible income drawdown.

What is a drawdown?

It is an investment product. So your money will be buying a mix of investments – shares, funds, gilts, corporate bonds or more. The aim is that your cash will continue to grow as if in a pension. You can also withdraw money if and when you need to.

As this is an investment product there is of course an element of risk – your hope is it will grow, but there is a chance it will shrink. Then again you took the same risk when the cash was in your pension, as that is an investment element too.

If you do this, you should be comfortable with the concepts of investing and making regular checks that it is performing well.

Where is my money invested?

When you go into income drawdown, if your money has been invested in a personal pension or SIPP with the provider that you are going into income drawdown with, then you can keep the same investments, they can just be re-registered to the drawdown account without the need to sell and buy back.

However, you may want to use the opportunity to take stock of what investments you have and see if they are still suitable. You're also able to move your investments to a different provider. This might be a good option if you've been charged a lot with your current provider and are looking to cut costs when you go into drawdown.

How do I drawdown my money?

When you contact your pension provider and tell it that you want to take your tax-free cash and go into income drawdown it will get the ball rolling. Each pension provider will be different, but you will usually be sent an illustration of the drawdown account and application

form to get things set up. Once it has received all your forms back you'll be transferred the tax-free cash and the drawdown account will be set up. It could take a few working days to receive your tax-free cash.

Then going forward, any income that you want to receive from your drawdown product will usually go through the provider's payroll system, so will be paid out on a designated day of the month.

What are the charges?

As well of the cost of investing within the drawdown product, you will normally have to pay an annual cost. This varies between different pension providers. Below is a list of some of the most popular pension providers and their charges.

Cost of going into income drawdown

Provider	Annual cost of drawdown
Aegon	£75
Aviva	£0
Bestinvest	£0
Fidelity	£0
Friends Life	£0
Hargreaves Lansdown	£0
Legal & General	One off £250 set up fee
LV	n/a
Prudential	£0
Royal London	One off £186 set up fee
Scottish Widows	£0
Standard Life	£0
Zurich	£0

How much income should I take from my drawdown product?

As your money is invested when it's in a drawdown product it will obviously have to ride waves in the market – there will be ups and downs, but hopefully on the ups you will make up the money that you lost on the downs.

But if you take money from your capital (the amount you have in drawdown) when you're going through a dip, your money will have to work even harder to make up the shortfall.

Keep this in mind if you are thinking about taking money from your capital. It's a perfectly acceptable approach (remember Martin's worry that too many people will leave the capital untouched, not having enough to live off), but also one that needs to have some thought put into it.

What is the tax situation?

The money you take will be added to any other income received in that tax year. This is something worth thinking about if you're planning on taking large withdrawals as it may push you up into a higher tax bracket. In the worst-case scenario you could even become an additional-rate taxpayer and end up getting stung with 45% tax when you take your money.

When you first take a taxable lump sum or income from a pension in drawdown, it is likely that emergency tax will be deducted, unless your retirement provider has been supplied with a P45.

If it is not provided with this, emergency tax will be deducted until HMRC sends your correct tax code directly to your pension provider. More tax may be deducted than you owe, in which case you will need to reclaim this from HMRC directly.

CHAPTER 5
TAKE 25% TAX-FREE, THEN BUY A FLEXIBLE INCOME DRAWDOWN PRODUCT

What happens when I die?

Going into drawdown means that you can leave any remaining money to your beneficiaries tax-free when you die. But there are a few caveats:

If you die before age 75

Your beneficiaries can take the whole pension fund as a lump sum or draw an income from it tax-free. Dependants (but not other beneficiaries) can also choose to buy an annuity, in which case the income will be taxed.

If you die after age 75

Your beneficiaries have three options:

1. **Take the whole fund as cash in one go:** If they choose this, the pension fund will be subject to 45% tax.
2. **Take a regular income:** If they choose this through income drawdown or an annuity (option only available to dependants), the income will be subject to income tax at your beneficiary's or beneficiaries' marginal rate.
3. **Take periodical lump sums:** If they choose this, the lump sum payments will be treated as income, so subject to income tax at your beneficiary's or beneficiaries' marginal rate.

For a lot of people, one of the main choices will be whether they should go into drawdown, get an annuity or do both. For a table of annuity versus drawdown options, see page 36.

Take 25% tax-free, then buy an annuity

With this option you take your 25% tax-free cash, and then with the remaining 75% you buy an annuity. This is a product that usually pays you a lump sum each year for the rest of your life. When you die, it's gone.

Annuities are actually a decent concept – but they've been slated by many. It means you get the security of knowing exactly how much you can spend each year and that it'll last for the rest of your life. Yet there are three main reasons for their bad rep:

a) In recent years, annuity rates have been poor – so people trading in £100,000 of their pension money for a standard deal may have got as little as £5,000 a year.

b) Instead of shopping around to home in on the best rate, most people just went with the firm they saved with, locking in at a far lower rate than needed, so they lost out every year for the rest of their lives. Avoiding this mistake is especially important if you have health issues that could've entitled you to an enhanced deal.

c) With simple annuities when you die they just stop, so if you died after a year or so, they proved very bad value and your inheritors got nothing.

> "A good annuity at the best rate can still be valuable as it offers a definite income for life."

Yet a good annuity at the best rate can still be valuable as it offers a definite income for life, so for some it may be worth using for a chunk of your savings.

If you decide to take an annuity, there are many different types. But it's important to understand that once you've bought an annuity, you can NEVER change your mind. So make sure you find the right one for you.

The importance of enhanced annuities

Poor health can mean a better annuity because the insurance company calculates on average it won't need to pay out for as long as you're more likely to die earlier. If you have had certain illnesses or are a smoker, your pension income could receive a big boost. In the past, you had to be seriously ill, but now you can qualify for one of these annuities on grounds such as blood pressure, high cholesterol or being overweight.

Your postcode could also have an impact. If you've lived in a leafy suburb, statistics predict you're likely to have had a good diet and no manual job, and the result is you're likely to live longer than someone in an area with high crime rates. This can make a big difference to your quote, as the longer you're predicted to live the lower the annuity rate.

The importance of comparing across the market

There are massive differences between providers so ensure you compare them (especially as you can't change your mind). Plus annuity rates change daily, so do the comparisons on the same day.

1. **Find out what your pension provider pays.** See what rate it'll give you. If nothing else, you should end up with a satisfactory glow later when you realise how much more you have earned by not going with it.

2. **Check out the rates.** All annuity rates are published on the Association of British Insurers (ABI) website (www.abi.org.uk), so check here before you do anything. You can also check on the Money Advice Service's website (www.moneyadviceservice.org.uk).

The different sorts of annuities

Annuities fall into two main categories, conventional and investment linked.

Conventional/level annuities

In a nutshell, you get a fixed income for life (whether at one level or varying, eg, linked to inflation). This is the simplest and most straightforward annuity you can get. These annuities have the benefit of certainty.

If you die, even after one payment, the fund is lost. If you're the type of person who has always sought security and you reckon you've always taken a low-risk route with your money, this could be for you.

Investment-linked annuities

Here, the amount you get for your annuity depends on the performance of one or more stock market-type investments. In other words, you're taking the risk you may get less for the hope you get more.

While you may hope your annuity will grow over the years, you could see a drop in income if the underlying investments do not perform as hoped (however, there is usually a MINIMUM limit below which your annuity income cannot fall).

Unless you're very financially savvy, investment-linked annuities should only be considered after taking independent financial advice. There are variations on each theme. Which one you pick will depend on your circumstances and what you want from your retirement income.

"You get a fixed income for life. These annuities have the benefit of certainty."

Variations on a theme

Within both of these categories, there are an array of different options that you can have and can be combined.

Single or joint life annuities

With an individual retirement income, your spouse, partner or any dependants generally won't receive an income after your death. However, a joint life annuity continues to pay the same amount (or sometimes less) out after one partner dies.

Guaranteed annuity

Annuities with guarantees offer payments for a fixed number of years (usually five or 10) whether you live long enough or not. These guarantees reduce the income, but not by much if you're younger. If you die within the guaranteed period, your partner (or someone else you nominate) will receive the balance for the rest of the time, but if you die after the guaranteed period ends, the annuity will stop paying.

Escalating annuities

Inflation – the measure of the rise in the cost of living – can have a detrimental effect on your income after you retire. Even an inflation rate as low as 3% would lead to a pension being halved in real terms. So, whether you want your annuity to increase with the cost of living is another important consideration.

Fixed-term annuities

Here, you invest in a plan which provides guaranteed income payments for a set number of years or until you reach 75. At the end of the period, you get a lump sum and are free to go back into the market to buy another type of annuity. So you have the flexibility to change your income, but you have no guarantee that your maturity amount will buy a replacement annuity at the same level. Fixed-term annuities allow you to choose from a range of income and death benefit options now, as well as deciding what maturity amount you wish to have returned at the end of the term.

You can combine annuities

For example, you could split your pension pot and use half to buy a conventional, level annuity and the other half to buy an escalating annuity. This way, you'll mix your levels of risk and perhaps provide a greater retirement income.

You're gambling against a number of risks when you buy an annuity. You might live to old age, or die the next day. Inflation could run away with itself, or your personal situation could change. There's no one product that guards against all of the risks so, especially for those with large pension pots, thinking about having a combination of them may provide a solution.

What is the tax situation?

Annuity income is taxed just like any other income. That means you have a personal allowance you can earn tax-free, above that you pay 20% tax, and the next band is 40%. Some additional-rate taxpayers pay 45%.

Check you are getting the correct allowance and that you have the right tax code at www.moneysavingexpert.com/tax-calculator. This tells the pension company how much tax to deduct. There's no guarantee it'll be right, particularly if you have more than one pension.

If you have overpaid tax, you can reclaim the overpayment within six years. For more info, see www.incometaxcalculator.com. Specialised help for older people is available from www.taxvol.org.uk.

"This way, you'll mix your levels of risk and perhaps provide a greater retirement income."

CHAPTER 6
TAKE 25% TAX-FREE, THEN BUY AN ANNUITY

What happens when I die?

Unlike all the other products, if you get a bog standard annuity, when you die it stops paying out. There are options you can take to avoid this, but in general, unlike the others...

AN ANNUITY STOPS PAYING WHEN YOU DIE

Remember that once set up, an annuity cannot be changed or cancelled, so it's important to choose options carefully.

Your options are:

- **Choose a joint life annuity** – Income will be paid to the person who's on the joint plan (usually your spouse or partner) if they outlive you. You can choose how much income they receive (usually 50%, 66% or 100% of the income you were receiving).
- **Choose a guaranteed period** – Income is guaranteed for a set number of years, even if you die before this. The remaining income for the guaranteed period would be paid as a lump sum into your estate when you die.
- **Choose to build in an annuity protection lump sum (value protection)** – On death the fund used to purchase the annuity, less income already paid, can be paid out as a lump sum. Lump sums paid out as value protection are subject to income tax. In addition, if the lump sum is paid to your estate rather than to your beneficiaries, it may be subject to inheritance tax.

Depending on your circumstances, there is the choice of selecting as many (or as few) of the above options as required. These options usually reduce the starting income to cover the cost of providing additional benefits. However, without them the pension will be lost on early death and any surviving spouse or partner may be left short of income.

Annuity vs Drawdown

For many who want income, the choice is about whether to use pension money to get an annuity or go into drawdown. Here's how they stack up:

	Income drawdown	Annuities
How flexible is it?	Free to withdraw money when you want. You choose where your pension is invested and are responsible for it.	Once your annuity is set up, your income is fixed for life and cannot be changed. It doesn't need to be reviewed and will never run out.
Is my money safe?	While your fund remains invested, it is not guaranteed and is subject to the ups and downs of the market, so your income could fall. If you live longer than expected you could outlive your income.	Your income is secure, will be paid to you for at least the rest of your life no matter how long you live, and is not affected by market performance.
What options do I have?	There is huge flexibility of where you can invest your pension when in drawdown.	Before you buy your annuity you can shop around to find the best rates and could increase your income significantly by doing so.
What happens when I die?	If you die your funds may be inherited by your dependants as a taxed lump sum, via income drawdown or as an annuity.	Once it has been set up, your annuity cannot be altered. It cannot be inherited by your dependants unless you selected a spouse's income or a guarantee period before the annuity was set up.
Can my personal circumstances get me a better deal?	Income drawdown does not take health or lifestyle into account, as it's based on investment return.	If you smoke, suffer from any ill health or currently take any prescribed medication, you could enhance your annuity income significantly.

Quick question

Q. Can I cash in my annuity?

A. No. There had been plans to allow people to do so from April 2017 but these were shelved after concerns that existing annuity holders might lose out financially. If this changes we will update this guide.

Getting help with your decision

Deciding how to turn your pension pot into an income for the rest of your life is one of the most important decisions you will ever make.

In recognition of this and all the pension changes that came into force in April 2015, the Government introduced free guidance for everyone over the age of 55 thinking about taking their pension. It's called 'Pension Wise'.

However, this is just guidance and NOT advice. This isn't just a semantic difference – the guidance system will tell you what you can do, not what you should do. It won't include help on your benefits or on what product to get.

Getting free guidance

When you phone up your pension provider and tell it that you want to start taking money from your pension, it has to direct you to the free guidance as a first port of call. While you're on the call, it is also there to act as a 'second line of defence', and warn you, for example, of any tax implications of your decision.

If you choose to get the free guidance, it is given in one of three ways. You can get it online via www.pensionwise.gov.uk, over the phone from the Pensions Advisory Service – call 030 0330 1001 between 8am and 10pm, Monday to Sunday – or face-to-face from the Citizens Advice Bureau. Phone and face-to-face sessions are a max of 45 minutes.

"Deciding how to turn your pension pot into an income is one of the most important decisions you will ever make."

Getting independent financial advice

If you've a sizable pension pot it's worth spending the £300 to £1,000 it'll cost to meet with an independent financial adviser who can tell you what to do (get quotes from a few first). It's also worth noting that from April 2017 you will be able to take out up to £1,500 from your pension pot tax- free to contribute towards the advice.

You may already have an IFA of your own, or know a good one through a friend, or you can simply go to www.vouchedfor.co.uk/pension-check or www.unbiased.co.uk to find one near you. It should certainly enable you to get face-to-face advice, and can deal with other issues while there.

Often the initial meeting or conversation with a financial adviser where they find out what sort of products you need is free. If you have specific questions that you want advice on then make sure you go armed with them.

Check the initial meeting is free just in case you get a bill and make sure you know how you're going to get charged after that if you go with the adviser. You'll usually get charged in one of three ways:

Percentage fee: This is the most common way for advisers to charge. It's based on a percentage of the money you want to get advice on or have managed.

Fixed fee per service: These fees are charged each time you go to the adviser for different 'projects', such as consolidating your pensions or investing. These are best for people who don't want ongoing advice and just need help with a specific job.

Hourly charge: If you choose to go down this route, make sure you're given a full breakdown of the work the adviser's done and how long it took. Hourly charges can be anything from £50 to £250 an hour, so make sure you ask before you go ahead.

FAQs

Q. Will the amount I withdraw affect any benefits I get?

A. If you get a means-tested benefit such as Jobseeker's Allowance or Pension Credit, then pension income can reduce that.

If you get a lump sum, then this may count towards your savings total – if you've over £6,000 of savings it can reduce your benefit, and over £16,000 it can stop it.

In fact, once you reach state pension age, ie, roughly 63 for women and 65 for men, you may lose some benefits even if you don't take your pension, because it counts as 'notional income'. For more help on pensions and benefits, speak to Citizens Advice and use the 10-minute benefits checkup at www.mse.me/benefitscheck.

Q. I have been called by a company that says I can invest my pension with it and get massive returns, should I go with it?

A. No is the simple answer! Often it's almost certainly what is known as a 'pension liberation' scheme. These are set up by fraudsters and place your pension money in unregulated investment schemes. They will be targeting the over-55s in the knowledge that some people may be confused about exactly what they can do with their pension under the new rules. But they offer no protection if, but more likely when, you lose your money. It is effectively the equivalent to handing your pension money to a bloke down your local pub.

Q. Can I change my final salary pension into a money purchase pension?

A. Yes you can. In fact, to take advantage of the various options explained in this guide you would need to transfer your final salary pension into a money purchase one. However, think very hard before turning down the benefits of a final salary pension.

That's because if you have a final salary pension, the income you'll receive from this can be very valuable. What you'll get is calculated from your salary in the final year of employment. Your employer will typically take 1/60 of your final salary and multiply it by the number of years you have been in the pension scheme. An example may help:

If your final salary is £80,000, then 1/60 of that is £1,333. If you've been with your employer for 25 years, times that by 25 and you'd be set for a pension of £33,325 a year.

It's a requirement that you get financial advice before taking this step if the value of your pension benefits is more than £30,000, so financial advisers will be able to explain the potential benefits to you of keeping your final salary pension over trading it in for a money purchase pension.

Q. Do I have to stop contributing to my pension when I start taking money from it?

A. No. You can continue to contribute up to £40,000 a year to your pension for as long as you like, but as soon as you start taking money from it you can only contribute £4,000 a year. If you want to continue to contribute the maximum to your pension, don't start taking money from it.

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