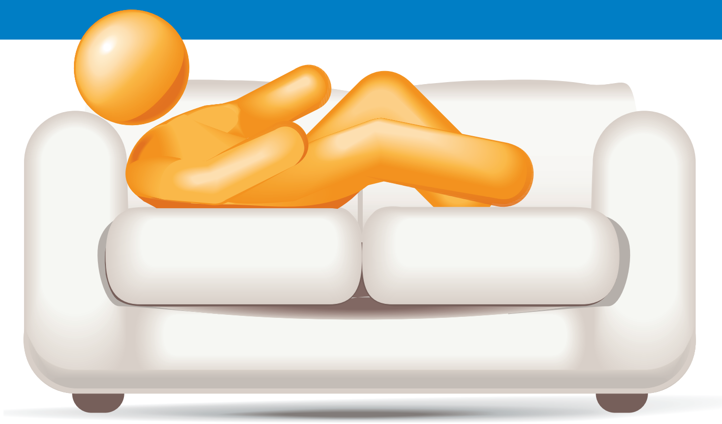
Securing your retirement income: what you can do and need to know



Deciding how to secure the income you need for the rest of your life is one of the biggest decisions you will ever have to make. Once you have made your decision it may well be impractical to revise your choices.

While the "pension freedom" changes that came into effect in April 2015 are, on the whole, for the better, they make drawing your pension more complicated and wrong decisions could have costly and far-reaching consequences.

Who is affected?

You can take advantage of pension freedom when you reach the age of 55 if you have a defined contribution pension (whether from previous or current employers), pay additional voluntary contributions (AVCs) or have a personal pension.

Defined contribution pension schemes, also known as money purchase, are not based on your final salary. They include personal pensions, group personal pensions (for instance company schemes where the pension is not based on final salary), stakeholder pensions and AVCs.

If you have a traditional public sector pension scheme and don't have pensions from previous employers or make additional voluntary contributions (AVCs) you are unlikely to be affected.

What can you do with your pension?

Exchange it for an income for life

In other words buy an annuity. However, once you have done this you generally can't change your mind and you no longer own your pension fund. Also, you need to think about whether the income you get will keep pace with inflation – while it may cover your expenditure now, can you be sure it will do so in 10 or even 20 years' time?

Take all the money out

But you would have little certainty about your income throughout retirement, plus you might use your money up too quickly. Only the first 25% of the money you take out is tax-free and if you take out more you could end up paying a lot of income tax and possibly moving to a higher rate tax band. You need to plan carefully to minimise the tax implications when you take income or capital from your pension.

Leave all the money in

You could do this if you are lucky enough to have enough income from other sources and you want to pass on your pension fund to your loved ones, but this is unlikely to be a viable option for many people.

A combination of the three options above

You could use part of your fund to secure the basic income you need and then draw the rest as income or capital as and when you need it or want to treat yourself. At least you would know that you would always have your basic income secured.

What you need to think about:

- Might you run out of money? If you did, would your state pension give you enough income?
- Is the amount of income you need (and want) likely to increase or decrease at any time?
- Do you want your spouse or other dependants to receive income if you die before them?
- How healthy are you?
- Do you have income from other sources, or other assets?
- What will happen to your pension fund when you die?
- How much tax you will pay whatever you decide.

Beware the upper limit

The lifetime allowance, the maximum amount you can hold in your pension fund when you start taking money out of the fund, is currently £1.25m but will be reduced to £1m from 6 April 2016. When you access your pension you are likely to pay 55% tax on any amount over this, thereby possibly eliminating the tax relief you received on that amount.

A million pounds might sound a lot. However, someone who is now in their 40s and has a pension fund worth £350,000 could find that they have more than a million pounds in their fund when they access their pension if they continue contributing at the same rate. If your pension funds are already worth £1 million or more, or are likely to be soon, you can apply to protect your lifetime allowance, preferably with the help of a professional financial adviser as it is not straightforward.

Continued on next page

Four things you may not know about accessing pensions:

1. Some traditional pension schemes may not allow you to benefit from the new rules.
2. You don't have to take the 25% tax-free cash as a single lump sum. You can spread it across withdrawals as you wish, up to the 25% limit.
3. Any money you withdraw over and above your 25% tax-free amount could result in you having to pay more tax than you expect. Make sure you understand the tax implications before taking action.
4. Your pension pot can be taken into account when calculating means-tested income-related state benefits, depending on your age and other criteria.

Already drawing your pension?

If you are already drawing your pension and want to continue making contributions you should talk to a professional financial adviser.

- If you started taking money from your pension on or after 6 April 2015 you can pay in up to £10,000 a year.
- If you started taking money from your pension before 6 April 2015 and the income you are taking is 150% of the rate set by the Government's Actuary Department (GAD) or less, you can pay In up to £40,000 a year.
- If you started taking money from your pension as capped drawdown before 6 April 2015 and you take income that is higher than 150% of the GAD rate, you can pay in up to £10,000 a year.

Passing it on

You are now able to pass funds remaining in your pension when you die, irrespective of whether you have started taking your pension, to any beneficiary you nominate. Pension funds generally fall outside your estate for inheritance tax purposes. However, your beneficiaries may have to pay income tax on the funds they inherit. If you die before turning 75, your beneficiaries won't have to pay tax, providing that the money is paid to them within two years of your death.

If you die after turning 75, your beneficiaries will pay income tax at their highest marginal rate, unless the entire fund is withdrawn as a lump sum, in which case they will pay 45% tax (tax years 2015/16 and 2016/17).

You therefore need to think about whether you should take income or lump sums from other assets before touching your pension, as this may be more tax-efficient. Also, pension funds are not taken in to account when calculating payment for long-term care. These changes also apply to annuities bought on or after 6 April 2015. If you have a joint life, guaranteed term or value-protected annuity and you die before turning 75, your beneficiaries will be able to receive payments tax-free. If you die after turning 75, they will pay income tax at their marginal rate.

Guidance… and advice

The government is offering free guidance, under the Pensions Wise brand, to help you understand your options. However this won't provide you with comprehensive advice that takes into account your particular situation and needs. For advice and recommendations specific to you, you need to talk to a professional financial adviser who has detailed knowledge of pensions.

Call 08000 85 85 90 or email appointments@lighthousefa.co.uk to book an appointment with one of our professional financial advisers.

Five steps to secure your income in retirement

Step 1: know the basics of tax and retirement

People estimate that living reasonably comfortably in retirement requires around 60% of the income they had while they were working. You can take up to 25% of your pension pot tax-free, as a lump sum or gradually over time. Any additional money taken from your pension pot is added to any other income, eg paid work, taxable income from savings and your State Pension, and you are taxed on your total income.

Step 2: Understand and compare your options

In broad terms you have four options for drawing your income. You don't have to choose a single option – you can mix and match to suit your needs.

A guaranteed income for life: an annuity

You could be paid a set amount every month for the rest of your life, so you'll know exactly how much you're getting and when.

- Decide how much of your pension pot you want to use – you don't have to use it all.
- Take up to 25% tax-free.
- Buy an annuity with the rest of the amount you have allocated to it and get a guaranteed income.

Flexible access: flexible drawdown or partial encashment

Once you reach the age of 55, you can take out what you like when you like from your pension pot. The rest is left invested so it has the potential to grow.

- Take some money tax-free.
- Leave the rest invested.
- Take bits when you need it.

Take it all in cash

You can take all your pension pot out in cash. However, you could end up with a lot of income tax to pay.

Combine the value of your pension pots. Take up to 25% tax-free. Get the rest subject to tax.

Leave it for now

You can decide not to touch your money for now. This gives you time to think about your pension options and you can plan how best to use it to provide for your future. Your pot is left invested so it has the potential to grow.

Step 3: Find out what your income could be

You should find out how much each option could give you and how much tax you will pay when taking all or some of your money out. If you have the information about your pensions, you can use one of the many online calculators to work this out, or ask a professional financial adviser.

Step 4: Important things to consider

Don't rush into anything – there are lots of things to think about. You could start off by getting some free guidance from the government via Pension Wise. You need to understand the features and constraints of your pension plan and what they could mean for you. It is advisable to compare products and providers to ensure you get the best result.

You also need to be sure you understand how much tax you'll be paying on any income or money you take. You should take professional financial advice specifically for you – it could cost less than you think and mean you get a higher retirement income.

Step 5: Choose your retirement income

Choosing the right option is a big decision that will affect the rest of your life. You need to be confident that you are making the right choice.

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