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Jelf | Financial Planning

Your Guide to Pension Freedom

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From April 2015 individuals have more freedom to access their pensions. The changes mark a radical departure from the previous system, by giving greater choices and trusting you with your own finances.

But, with more choice comes complexity. To support you at a time when it is vital for you to select the best option for your future and your retirement, Jelf has produced this step-by-step overview of the options available to access your pension benefits, together with the key issues to consider and actions to take.

Introduction

The first thing to understand about the changes is that there is a lot to take in! Rather than jump straight into the detail, the first point we'd like to make is that you are not alone; there is help available.

Pension Wise

Pension Wise was set up to help you understand your new pension options and is a free service provided by Government.

This service will be provided through impartial organisations such as the Pensions Advisory Service and the Citizens Advice Bureau. The guidance will be offered online, over the telephone and face-to-face. Please note that you are under no obligation to access or follow any of the guidance when making your decisions.

The guidance will be tailored to your personal circumstances but it will not tell you what to do or recommend specific products or providers. The Financial Conduct Authority has made it clear that the guidance does not replace financial advice given by regulated advisers.

Can Jelf help?

Certainly; Jelf can answer your questions and fill in the gaps that Pension Wise will intentionally leave, such as advice regarding the best option for you given your personal circumstances and objectives. There are many tax and investment implications as a result of these changes, so please call us on 0333 400 1106 or email us at **retirements@jelfgroup.com** if you need any help making your choices.

Step 1

Make sure you are clear on the type of pension(s) you have

Different rules apply to different types of pensions, and you may also have more than one pension. The main types are:

Defined Benefit (also known as Final Salary)

Defined Benefits schemes were once very popular but are usually now not available for new members, and many of the new freedoms are not available. The amount of income you receive is expressed as a fraction of your salary when you leave employment. The Government considered banning transfers from defined benefit schemes to defined contribution schemes, but will continue to allow transfers from most schemes with two new safeguards:

- A transfer to a Defined Contribution scheme to secure the new flexibilities would mean you lose the security of a defined income. For your protection, you would need to take advice from a financial adviser before such a transfer can be transacted. You don't need to take advice where the transfer amount required to provide the pension income (and not the pension itself) is below £30,000. This can be accessed as a lump sum from age 55, 25% of which will be tax-free with the remainder taxable.
- To protect defined benefit pension schemes, the scheme trustees will also have new powers to delay transfers and take account of scheme funding levels when deciding on transfer values.

Defined Contribution (also known as Money Purchase)

Defined Contribution pension plans, such as Group or Individual Personal Pensions, are the main focus of the new pension freedoms. Your income depends on the value of the fund you have saved. Traditionally you might have used such pension funds to buy yourself an income through an annuity. Now, there are more options available including being able to take all your funds in one go.

Action point:

List all of the pension plans you have accumulated throughout your career and find out details such as the type, provider, the retirement date assumed and the value.

It is not unusual for pensions to be linked with an employer, so a helpful tip is to think about the jobs you have had throughout your career and whether a pension scheme was offered. If you've lost track of a pension plan you can check with https://www.gov.uk/find-lost-pension.

Step 2

Think about when you want to take your pension benefits

The nature of retirement is changing. An increasing number of individuals are working part-time as a transition to fully stopping work, so lifestyle and the income supporting it has to be flexible. You can normally access your private pension benefits from age 55 (increasing in line with the increase in State Pension age), but that doesn't necessarily mean you should!

The principal purpose of a pension plan is to provide you with an income in retirement. You may be thinking of taking your pension benefits before you stop working, perhaps to clear some debts or pay for home improvements. If so, the question to ask yourself is what impact this will have on the amount of income you receive in your life after work, or indeed, when you can afford to stop working?

Action point:

Put together a budget plan of what income you need when you stop working and where that income might come from. If you would like a budget planner please email retirements@jelfgroup.com

Case Study

Sarah is 57 and would like to stop working when she is 63. Her State pension doesn't kick in until she is 66. She has a Defined Contribution pension plan with her current employer which she can access now. Sarah also has a Defined Benefit scheme from her previous employer, which is due to pay an income from age 65.

Sarah works out that if she took all of her Defined Contribution pension savings in April 2015, she would have to wait until she is 65 before she can afford to stop working. However, if she keeps it until she is 63, she will be able to retire then, at her target date.

Step 3

How are you going to take your pension savings?

The principle of pension saving is simple. You set aside a proportion of your salary throughout your working life to build up a lump sum to provide you with an income in retirement. When you come to take your benefits (from a Defined Contribution arrangement), you will be able to choose from a number of options to provide your income.

Before we explain the new options, it's important to know that the pension provider you have built your fund with doesn't have to offer the new freedoms. However, if your provider doesn't offer the freedom you would like, you will be permitted to transfer to a scheme that does.

Which option will be right for you?

Purchasing a guaranteed income for life

Many people currently use all or part of their pension fund to secure a guaranteed income for life by purchasing an 'annuity'. Your existing pension provider is likely to offer you terms to buy an annuity from them, but you do not have to accept this. You should exercise your Open Market Option to shop around for the best available type and amount of annuity, and in most instances this will mean that you can secure a higher income for the rest of your life. By providing information about your health and lifestyle as part of the search this may result in an increase in the amount of income you receive.

Taking income with flexibility

An annuity provides an agreed guaranteed level of income for the rest of your life but offers little or no flexibility. A drawdown pension allows you to draw income from your pension fund without buying an annuity. You can vary the level of income you take, typically with the aim that there will still be enough money left to last you the rest of your life, but this depends on investment performance.

In summary, a new drawdown pension can be either;

- Income withdrawal – where you can take how much you want, when you want, on the understanding if you take too much income you could deplete all of your savings; or
- A short-term annuity – where all or some of your fund is passed to an insurance company to provide you with income for a fixed number of years. At the end of the agreed period you can effectively choose again what you want to do with the remainder of your savings.

If you have already started a drawdown plan, there are some further changes to the law we've not covered in this summary, but we can provide details on request.

Taking a Tax Free Lump Sum

If you buy an annuity or designate funds as available for drawdown (you may choose not to take an income immediately) you will also be able to receive at the same time, a tax-free lump sum, (known as a pension commencement lump sum). You are normally able to take up to 25% of your pension fund as a tax free lump sum and this could be one of the options you wish to consider.

Taking your savings all in one go

This is a new option from April 2015 providing you are aged at least 55. However, the fact that the majority of the sum is taxable may mean taking the whole lump sum (known as an uncrystallised funds pension lump sum) straight away which could create a large tax bill. 25% of the amount you take will be tax free but the remainder will be taxable.

Taking a scheme pension

This is rare but we have included this for the sake of completeness. Some schemes providing benefits through defined contribution arrangements give their members the option of exchanging the funds built up for a promise to pay a certain pension for life direct from the scheme.

Action point:

Make sure you are clear on what options you have when it comes to taking the benefits from each of your pension plans. Will you have the freedom you need or will you need to transfer to an alternative plan?

Case Study

Helen is thinking of stopping her full time job and taking a year off, before looking for part-time work. She would like some flexibility around the amount of income she wants to take.

Solution: Helen could designate some or all of her savings to provide a drawdown pension.

Case Study

Terry wants a guaranteed income for the rest of his life, so he can be certain how much money is going to come in each month.

Solution: Terry could use his pension fund to buy an annuity. He understands that other options are available but it is the certainty that is most important to him.

Case Study

Mary decides to designate her entire pension savings as available for drawdown, takes the maximum tax free lump sum but no other income to begin with. She then uses the tax free lump sum for the first three years of her retirement to replace part of her salary which stops when she gives up work.

Case Study

Paul would like to take all of his pension savings now as he wants to pay off some debts and clear his mortgage.

Solution: Paul will have the option to cash in all or part of his pension plan by taking an uncrystallised funds pension lump sum.

Step 4

Are you clear on the tax implications of the choice you have in mind?

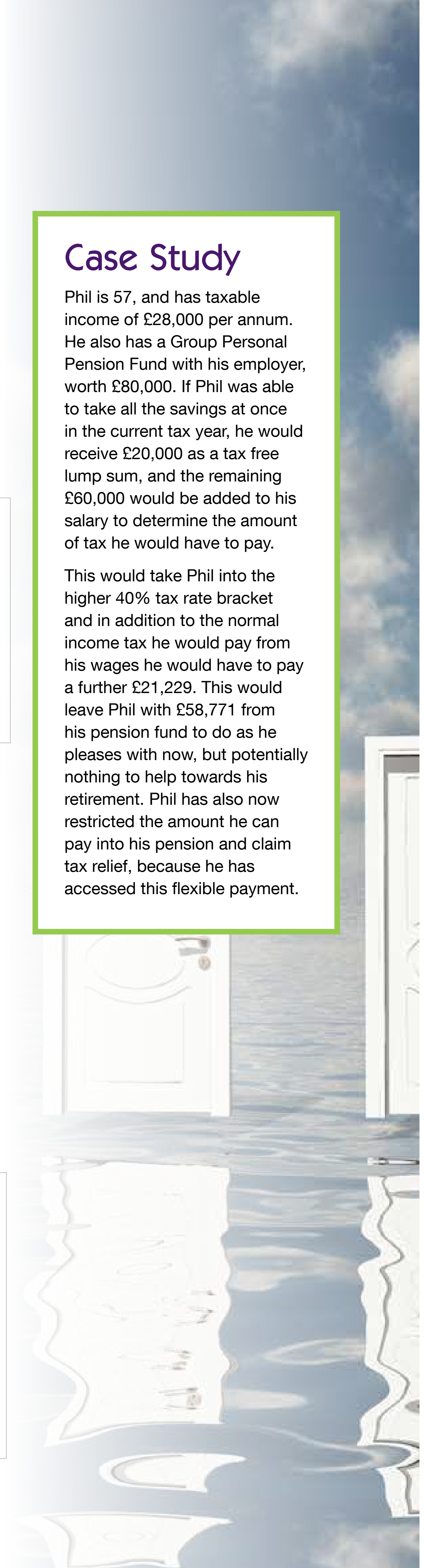
With the exception of any tax free lump sum, usually limited to 25% of your fund, the rest of the money you take is taxable. It will be added to and assessed for income tax along with any other taxable income you receive.

The Government has taken steps to reduce the possibility that individuals could avoid paying National Insurance and less tax on their current earnings by diverting their salary into a pension plan and then immediately withdrawing 25% tax free plus any additional income they would need.

From April 2015, if you take income from a new drawdown pension or a taxable lump sum from your pension savings in addition to any tax-free cash, you will still be able to make pension contributions, but only up to a reduced annual allowance of £10,000 a year (would otherwise be the lower of £40,000 per annum or your salary).

Action point:

When doing any calculations regarding the income or lump sum you might receive from your pension savings, make sure you have taken off the correct amount of tax.



Case Study

Phil is 57, and has taxable income of £28,000 per annum. He also has a Group Personal Pension Fund with his employer, worth £80,000. If Phil was able to take all the savings at once in the current tax year, he would receive £20,000 as a tax free lump sum, and the remaining £60,000 would be added to his salary to determine the amount of tax he would have to pay.

This would take Phil into the higher 40% tax rate bracket and in addition to the normal income tax he would pay from his wages he would have to pay a further £21,229. This would leave Phil with £58,771 from his pension fund to do as he pleases with now, but potentially nothing to help towards his retirement. Phil has also now restricted the amount he can pay into his pension and claim tax relief, because he has accessed this flexible payment.

Step 5

Ask yourself, are your savings going to last?

Your pension savings need to last for the rest of your lifetime, which can be decades, so you need to be careful that you do not run out of money. The tricky part is that you don't know how long you will live! For a 65 year old in the UK today, men can expect to live until 83 and women to 86.*

With this increased flexibility, there is plenty of temptation to overspend or use your pension savings for purposes other than funding your life after work. You do need to spend money and enjoy life, but this has to be balanced with the real danger that you could run out of money in retirement and have to rely on what the State is willing to provide, both in terms of income and potentially long term care. You might have to go back to paid employment.

Action point:

Think about what would happen if your pension savings ran out? Do you have a backup plan, such as accessing other savings or, if you own a property, releasing some equity from that property?

*Source: Office of National Statistics

Step 6

How is your money going to be invested?

You are likely to have investment decisions to make before and after you decide how you are going to access your pension savings. The key issues to consider are:

Before

- Where are you investing your savings right now? Are you comfortable with the level of risk you are taking, in terms of the extent to which the investments go up and down, but also how the returns compare to inflation?
- Does your approach make sense depending on whether you are going to purchase an annuity, take your money in regular instalments over time or take the money in one go?

After

- Firstly you'll need to select an appropriate investment vehicle for your savings, such as a drawdown pension plan or an Individual Savings Account.
- You'll then need to pick the provider of that investment vehicle, such as a bank or insurance company
- And finally the type of fund or funds you want to invest in.

Action point:

Make sure you know how each pension you have is invested now and be clear that the way your money is invested aligns with what you want to do with it in the future.

Step 7

Are you clear on what would happen to your pension savings if you were to die?

It's important to understand who gets what when you die as far as your pension savings are concerned. This may well vary on whether you have started taking your benefits or not.

If you have a Defined Benefit plan, there is likely to be a dependant's pension payable if you have a spouse or civil partner, after you're gone.

If you have Defined Contribution savings, the plan value would normally be paid to whomever you've nominated, if you were to die prior to taking your benefits. If you die after taking your benefits, the type of benefit you select will determine what might be payable. Prior to the April 2015 changes any money left in a drawdown plan was available as a lump sum, less a tax charge of 55%. However, from April 2015 any money left in a drawdown plan will be payable free of this tax if the drawdown owner dies before age 75. Anyone with a joint-life, value protected or guaranteed annuity who dies before turning 75 may also pass on funds tax free from April 2015.

Action point:

Do you need to update any expression of wish forms for each of your pensions to indicate who you would like any money to paid to if you were to die? Also, when selecting how to use your pension savings, give some thought to whether you would need or like to make sure there is money left for any dependants you may have after you're gone.

Case Study

Alan plans to purchase an annuity with his pension savings but is worried that if he dies soon after retiring, nothing will be paid to his family.

Solution: Alan can select a guarantee period for his annuity. This will ensure that even if he dies shortly after taking out the annuity the income will continue to be paid for a minimum period of at least 5 years from outset.

Step 8

Would it make sense for you to pay more money into pensions?

There have always been tax benefits when saving into a pension plan, but that was typically accompanied by the restrictions on how you could take the benefits. From April 2015 you have more flexibility to access your savings sooner.

The table below details how much it would cost you from your take home pay to pay £100 into a pension, and if you took it out straight away how much you would get when you take that £100 out assuming you take the maximum tax free lump sum.

To save £100 into a pension, your take home pay would reduce by	
£80	as a Basic rate tax payer
£68	as a Basic rate tax payer saving via salary exchange
£60	as a Higher rate tax payer*
£58	as a Higher rate tax payer saving via salary exchange
To take £100 of benefit out of a pension, including the tax free element you would receive	
£85	as a Basic rate tax payer
£70	as a Higher rate tax payer

Action point:

Make sure you are clear on whether the amount you are currently paying will meet your needs. Your pension plan provider will be able to provide you with a current valuation of your savings and a projection of what the future benefits might be.

*Please note you may only get basic rate tax relief initially and have to reclaim the higher rate relief. Figures based on 2015/16 tax year.

Jelf can help

There are some major decisions to be made about when and how you take your pension benefits, and these are fundamental to your lifestyle and the financial future of you and your family. Once made, some decisions and transactions cannot be undone, so it is important to get it right first time.

If you are certain you want a guaranteed income with your pension plan

This typically means using your pension fund to buy an annuity which provides you with a guaranteed income for life.

Jelf Retirement Income Finder is an impartial service providing information and guidance to help you secure the best income. Jelf Retirement Income Finder searches the market on your behalf to ensure you achieve the best possible income level, as well as helping you understand the various annuity options, such as including a spouse's income and inflation-linking. You'll also be asked all of the relevant health and lifestyle questions to determine if you qualify for enhanced income payments.

If you need financial advice

The guidance guarantee and other information such as this guide can help you understand your situation and the options available to you. You may then be comfortable to take the appropriate action yourself. However you may feel that you would like personal financial advice to help you make the right decisions for your circumstances and to help implement your plans.

Jelf Financial Planning is a Chartered Financial Planning firm and will be happy to help. We can help you understand your circumstances, preferences and objectives, and recommend a suitable financial plan for you in line with the new pension freedoms. As well as retirement planning our service encompasses all aspects of financial planning, and we can provide you with ongoing support and reviews to ensure your plans remain on track.

Not sure when you want to retire?

Retirement is a major change and a very personal decision. Jelf believe that the questions of when to retire and how much income you will have in retirement are interlinked; just because you can take your pension benefits and give up work, it doesn't necessarily mean you should. The important thing is for you to be comfortable with your plans and have the right financial support in place.

Jelf and our specialist subsidiary LaterLife run facilitated workshops covering both the financial and lifestyle aspects of retirement. The workshops are not just about passing on information. The exercises and discussions assist you, and if appropriate your partner, to identify what is important to you personally and to identify the actions you need to take to ensure you enjoy and make the most of your retirement. At the end of the workshop, usually funded by your employer, you will have considered the significant changes you will undergo when you stop working.

Important information

This document is for general information only based on our understanding of Pension Freedom and does not constitute advice.

Although all reasonable efforts have been made to provide accurate information, there can be no guarantee that it is accurate or that it will continue to be accurate in the future. Rates of tax and reliefs may change in the future.

We cannot accept responsibility for any loss as a result of acts or omissions in respect of this document.