TelfordMann
Pensions & Investments

Pensions Guide

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Financial Planners
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Introduction

The Past
– Inflexible Fixed Income

In years gone by, pension holders didn't have much choice when it came to deciding how to draw their benefits in retirement. In most cases, that choice was simply about deciding whether to take your entire pension as a fixed income or a reduced fixed income with a tax-free lump sum. monetary needs and helps you allocate your financial resources efficiently and profitably.

The Present
– Flexible Income Drawdown

On the 6th of April 2015 a new pensions regime came in to force allowing individuals significant new freedoms when it comes to drawing income in retirement. The ability to draw a tax-free lump sum remains, but as I will explain later, the requirement to take a fixed income has been abolished, that is provided that you have the right type of pension (e.g. a self invested personal pension or SIPP). It is also now possible to pass your pension on to your spouse, children, grandchildren or indeed anyone you wish, after your death.

The Future
– Making Flexible Drawdown Sustainable

The flexibility to draw as much income as you like, whenever you like, comes with consequences unfortunately. The more you draw out, the more tax you will pay and if you draw out too much, too quickly, you will soon exhaust your pension fund. The ideal solution is to find the right balance of income withdrawal versus ongoing investment returns to provide sustainability throughout retirement.

This guide has been designed by Telford Mann to provide a step-by-step explanation of how to structure your pension arrangements, flexibly, tax efficiently and sustainably.

Step 1

Choosing the right pension scheme

Step 2

Choosing an investment strategy

Step 3

Choosing how to draw benefits

Step 4

Choosing and maintaining sustainable income

Step 1

Choosing the right pension scheme

Most traditional pension arrangements have not been designed to allow flexible access. Generally they fall into one of the following categories; defined benefit or defined contribution company pension schemes and personal, stakeholder or workplace pensions. The primary purpose of these pensions is to provide a regular fixed income in retirement; or with the option to take a tax-free lump sum with a reduced fixed income.

Some of these traditional schemes are allowing pension holders to partially use the new pension freedom rules, but usually this means having to draw the entire pension as one transaction with the consequence of losing 40% or even 45% of the fund in tax.

A Self Invested Personal Pension (SIPP) will allow pension holders to take advantage of the new rules. Tax-free lump sums can be withdrawn from a SIPP without any requirement to draw taxable income and it is possible to vary the level of income you draw down to suit your needs. You can take a minimum of zero to a maximum of 100% of your fund value or anything in between.

The ability to vary income levels is highly valuable, particularly if you are retiring early and need to fund an income shortfall before reaching state pension age or the age when a company pension is due to pay out.

A SIPP will allow you to draw out what you need, when you need it and switch the income off again when you don't.

Self Invested Personal Pensions also provide you with access to discretionary investment management. This is a special ongoing service under which you appoint an investment professional whose job it is to try to maximise investment returns whilst minimising risk in line with a strategy that has been agreed and approved by you. This can be very useful in times of volatility when action needs to be taken, swiftly and without delay.

Step 2

Choosing an investment strategy

Getting the investment strategy right is very important. If you want your pension fund to provide you with many years of income, then you need to make sure that your funds are invested properly. This isn't something that you can afford to get wrong since the consequence of failure could mean a pension fund that is eroded by hefty losses or poor returns. An investment strategy that is too risky could result in losses that cannot be recouped. Conversely, if you choose a strategy that is too safe, it might mean that you won't be able to generate sufficient investment returns to maintain the real value of your pension.

So how do you find a strategy that will deliver sustainable long term returns with an acceptable level of risk? A good starting point is to remember the old adage about not keeping all your eggs in one basket. A well diversified investment portfolio which is spread geographically and across different types of assets will reduce risk and is likely to perform differently under different markets conditions. Employing a discretionary investment manager to manage your pension fund professionally will bring a number of advantages.
The manager can use their expertise and research capabilities to identify the best places to invest and use their discretion to change the strategy whenever economic conditions dictate. In times of crisis, a discretionary manager can take action immediately in order to protect your investments, rather than have to wait for signed instructions.

Step 3

Choosing how to draw benefits

Under the new pension freedoms introduced in April 2015, pension holders have complete freedom to draw whatever they like from their pensions, as little as none, or as much as all, of their pension fund. You have to be aged at least 55, but essentially the new rules mean that there are no rules. At face value this may seem that the process of drawing your pension has now been hugely simplified. Unfortunately things are not quite as straightforward as they might appear. For example; if you draw out too much, too quickly, you run the risk of exhausting your fund early in your retirement.

For many pension holders reliant on a guaranteed income for life, purchasing an annuity will remain an appropriate solution that will give them the security they desire. A decision will need to be made as to the basis of the annuity and it is important to take advice at this stage and to consider the 'Open Market Option'.

For individuals requiring greater flexibility, with the ability to take advantage of the new pension freedoms, utilising drawdown may be a more appropriate choice. Allowing them to vary their income to suit their needs whilst also giving them the opportunity to incorporate their retirement savings into their overall financial planning, as described above.

Tax is another issue. Although you are able to draw up to 25% of your pension fund tax free, you have to draw the rest as taxable income. Ideally, you wont pay tax at more than 20%, but drawing too much might mean you end up paying tax at 40% or even 45%.

There has however been a positive change in the tax rules when it comes to the treatment of any money that is left in your pension fund after your death. Prior to April 2015, a pension pot left to any beneficiary (other than a spouse) would suffer an inheritance tax (IHT) charge of 55%.
Not any more though since the new rules also abolished inheritance tax on pension funds. This creates a dilemma for anyone with a pension fund who also has an IHT problem. Their home, savings, investments and other assets will all form part of their estate whilst their pension will be exempt and can be passed on to the next generation free of IHT. What this means is that some individuals might want to consider spending other assets before their pension fund in order to reduce any liability.

Step 4

Choosing and maintaining sustainable income

When choosing how to draw your pension benefits and at what rate, it is important to consider how long you may need your pension to work for you. In olden times living until you were '3 score years and ten' (i.e. until age 70) was considered the limit. These days, anyone in their 50s or 60s is highly likely to live until at least age 85 and possibly longer given the continued advances in medical science and technology.

The consequence of longer lifetimes mean that you may need to rely upon your pension fund to support you for 20 years or more, if you retire when you are 65, or for at least 30 years, if you retire at 55.

The point being that 20 to 30 years is a very long time and you will need to avoid the risk of running out of money too quickly.

If you are using income drawdown as your retirement income strategy, you need to make sure that the rate at which you are drawing income is in balance with the returns that you are achieving on your pension fund's investment portfolio.

In an ideal world we would all know exactly how long we are likely to live and exactly what rate of investment return we will achieve each year. Unfortunately in the real world things are much less certain. We may live much longer or shorter than we expect and returns may vary from our expectations.

Maintaining sustainable income is very much an ongoing process. In our view, holding regular meetings with your financial planner in order to review your changing circumstances, needs and requirements, is the best way to make sure that your pension will last as long as it needs to.

Whilst your pension scheme may be your most significant investment asset, it is important to look at your circumstances as a whole, and take into account any other income, savings, investments or assets that you may have.

In our opinion, making the most of your pensions can be best be achieved by:

1. Getting the right advice on how to set up your pensions
2. Choosing a solution that is as flexible as you need it to be
3. Having an investment strategy that can deliver the returns you need
4. Choosing the right income vehicle to suit your needs, with the ability to increase or decrease your drawings if required
5. Regularly reviewing your plans to make sure they are working

Telford Mann offer all potential clients an initial meeting without charge to understand your needs and requirements and to explain how we can help and what we charge for providing our services.

To arrange a meeting send an email to **enquiry@telfordmann.co.uk** or phone us on **01536 462700**

Corby

Oakley House
Headway Business Park
3 Saxon Way West
Corby
NN18 9EZ

T 01536 462700
E enquiry@telfordmann.co.uk

Peterborough

Rutland House
Minerva Business Park
Lynch Wood
Peterborough
PE2 6PZ

T 01733 397300
E enquiry@telfordmann.co.uk

Northampton

Newton House
Kings Park Road
Moulton Park
Northampton
NN3 6LG

T 01604 419350
E enquiry@telfordmann.co.uk

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