CAMPBELL & McCONNACHIE

chartered financial planners

Drawdown

Flexibly accessing your pension through income drawdown.

After years working hard to build up your pension pot, you'll naturally want to make the most of it when it's time to retire.

There are several options on the market, and since the government's introduction of pension freedoms in 2015, you have even more choice about how you access your retirement savings.

Along with purchasing an annuity or withdrawing funds directly from your pension pot, one of your options is to take income drawdown.

The flexibility of drawdown arrangements has attracted more take-up in recent years.

According to the Financial Conduct Authority, twice as many people chose to move their pension pots into drawdown rather than annuities since 2015.

The way you manage your pension will determine your retirement lifestyle, and is certainly not something to rush into.

Drawdown is complex, so it's important to fully understand the advantages and disadvantages before committing to it.

What is drawdown?

Drawdown is a feature offered by some personal pensions, which allows you to draw a post-retirement income from the assets held in your pension. These could be cash, funds, equities or other eligible investments.

This offers the potential for investment growth, and your income can vary depending on your investments' performance. However, it also means your investments can fall in value as well as rise.

Unlike an annuity, there is no guarantee that your income drawdown can last for life.

You should be careful when planning how much income to take through drawdown, to avoid running out of money.

It's also important to regularly review your investments and monitor their performance. A financial adviser can help you with this.

How does it work?

You can usually take up to 25% of your pension pot as a tax-free lump sum, before moving the rest into investments. You can also choose to take phased drawdown, where each withdrawal is part tax-free cash and part income.

You can receive an income either on a regular or ad hoc basis as required.

The money you take through drawdown after your tax-free cash is liable for income tax. If you withdraw a large amount it could put you in a higher tax band, so keep this in mind when deciding how much to take out.

There are two main types of drawdown: flexi-access or capped.

Flexi-access drawdown

Flexi-access drawdown was introduced in April 2015, replacing flexible drawdown as part of the pension freedoms.

Where flexible drawdown required a guaranteed lifetime income of £12,000 a year, flexi-access is available to anyone.

With flexi-access, there is no limit on the amount of income you can receive. You can take withdrawals as a regular income stream, or as several lump sums – whichever option you prefer.

However, when you withdraw from a flexi-access fund, your annual allowance for pension contributions drops to a reduced rate called the money purchase annual allowance (MPAA).

This allowance was reduced from £10,000 to £4,000 a year in April 2017.

Harbour House 1 Shore Street Lossiemouth
Moray IV31 6PD
01343 814000 david@campbell-mcconnachie.co.uk

www.campbell-mcconnachie.co.uk

Drawdown

Capped drawdown

Capped drawdown closed to new applicants on 6 April 2015. If you already use this type of drawdown fund you can convert it to flexi-access, or keep it under its existing rules.

With capped drawdown, the amount you can take as income is limited to 150% of the income a healthy person of the same age could get from a lifetime annuity.

This cap is reviewed every three years if you're under 75 and is assessed yearly afterwards.

The main benefit of staying in capped drawdown is that as long as your income withdrawals stay within the drawdown cap, the MPAA won't apply – meaning you may be able to save up to the annual allowance of £40,000 tax-free.

If you exceed the cap, you'll be converted to flexi-access drawdown, and your tax relief on pension savings will be reduced to the level of MPAA.

It is not possible to switch a flexi-access pension back to a capped one.

Death benefits

If you die before the age of 75 and have a flexi-access or capped drawdown arrangement, any money left in your pension passes on to your nominated beneficiary, either as a lump sum or as income. This is tax-free if it is paid within two years of your death.

If you die after 75 and have either type of drawdown, the money passed to your beneficiary will also be subject to tax.

Additionally, different rules apply if your pension savings are worth more than £1 million.

Dealing with instability

Your investments may not always perform well, and it's best to have a strategy in place in the event that they don't.

This is something a financial adviser will be able to help you with, by monitoring and reviewing your investments and arranging them in a way that minimises negative impacts on your income.

You can also look at changing the amount you withdraw and how often, to keep it at a sustainable level.

Having an alternative income outside of your investments could also provide a valuable safety net – one way to do this is to use your drawdown investments to purchase another product with guaranteed income, such as an annuity.

The income amount for annuities can't usually be changed, so if you're in a capped drawdown arrangement, you'll need to ensure your annuity payments don't exceed your maximum income cap.

Things to consider

Taking cash out of your pension pot while you continue working could push you into a higher tax bracket, making you less tax-efficient. It would also trigger the MPAA, and any pension contributions resulting from your work could be affected.

As well as earnings from work, your state pension, taxable benefits, and any other income you might receive all count as income for the purposes of tax.

Keeping your drawdown income tax-efficient takes careful planning, so it's wise to speak to a financial adviser for assistance.

Is drawdown right for me?

Whether or not drawdown is the most suitable option for you will depend on your circumstances, and it's worth considering the pros and cons before you speak to an expert.

Advantages

You have the freedom to **control your investments**. You can choose them based on your target income, and your attitude to risk.

You can **vary the income you receive** according to your requirements, instead of being restricted to fixed sums at set intervals.

There is **potential for growth**, unlike fixed arrangements such as annuities.

There are **flexible options** for how your remaining pension is passed to a beneficiary when you die.

Disadvantages

Your income is **not secure**, as the value of your pension investments can fall. Because it's not guaranteed for life, it's possible you could run out of income if you live for a long time and your investments perform badly.

Drawdown is a **complex** pension arrangement and **requires more monitoring** than some other options.

It's possible that an annuity will offer a greater total income over your lifetime.

Get advice

It's a good idea to spend some time comparing different pension products and providers to assess which is best suited to your personal circumstances. Help from an expert is valuable at every step of this process.

We can advise on whether drawdown suits your circumstances, help you compare the pension products that are available, and review your investments when you're in a drawdown arrangement.

Contact us to discuss your options at retirement.

Important information

The way in which tax charges (or tax relief, as appropriate) are applied depends on individual circumstances and may be subject to change in the future. Pension eligibility depends on individual circumstances.

This document is solely for information purposes and nothing in it is intended to constitute advice or a recommendation. You should not make any investment or retirement decisions based on its content.

While considerable care has been taken to ensure the information contained in this document is accurate and up-to-date, no warranty is given as to the accuracy or completeness of any information.

Campbell & McConnachie is authorised and regulated by the Financial Conduct Authority. FCA No : 187211