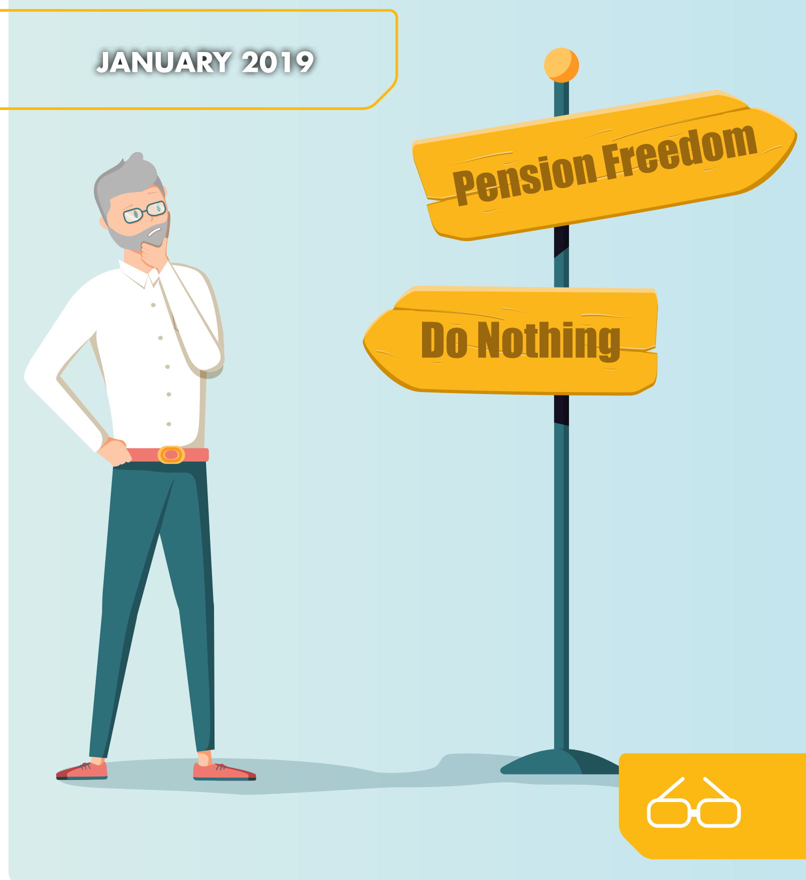

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Pension options for over-55s

What alternatives do you have at retirement?

Raiding your pension before retirement remains a popular option, with more than 1.3 million savers taking flexible payments from their pensions in the three years since 2015.

While the premise of withdrawing 25% of your pension pot tax-free is nothing new, the options you have when you reach the age of 55 have increased.

Before pension freedoms came into force in 2015/16, it was possible to withdraw a quarter of your pension pot tax-free and the choice was simple: buy an annuity or a drawdown product.

Now, retirement savers are spoilt for choice with several options proving popular for accessing pensions before retirement.

If you're considering taking money out of your pension pot, you've got lots to weigh up, but first of all you need to know what type of pension you have.

Pension types

Pensions usually fall into two different types: **occupational** or **private** schemes.

Private pensions, such as a stakeholder pension, personal pension or self-invested personal pension (SIPP), are money purchase schemes.

Occupational pension schemes are further divided into defined contribution and defined benefit schemes – but pension freedoms only apply to defined contribution pensions.

Defined benefit pensions – also known as final salary pensions – are seen as the Rolls Royce of pensions as what you receive depends on your earnings when you retire and is not dependent upon investment performance and growth.

They are set up by your employer and provide you with a percentage of your final salary at retirement.

While final salary pensions do not qualify for pension freedoms, it is possible to convert them into a pot of cash – but beware this is area targeted by scammers and is a high-risk strategy as you will be giving up valuable guarantees.

Pension freedoms also do not apply to your state pension.

Options at 55

Leave it untouched

Continuing to save into your pension until the time comes to retire is the default position for most retirement savers in the UK.

You can contribute up to £40,000 of your annual earnings towards your pension pot in 2018/19 without paying tax, subject to taper rules which may apply to high earners and which reduce the annual allowance. This cap remains in place for 2019/20 at the time of writing.

The first time you take any part of your pension benefits, you then become subject to the £4,000 money purchase annual allowance instead of the full annual allowance, and your ability to make pension contributions and claim tax relief is much reduced.

Doing nothing is usually the best option unless you need the money for something in particular, whether that's to pay off your mortgage or help your grown-up child get on to the property ladder.

Withdraw everything

One former pensions minister expressed fears savers would withdraw all of their pension pot and splurge it on Lamborghini supercars when the freedoms came in.

If you did take this extreme step, the first 25% of your retirement savings would be free from tax and the remaining 75% would be taxed at your marginal rate of income tax.

This is still the case in 2018/19 – but be aware that doing so could nudge you into a higher income tax band and see you paying 40% as a higher-rate taxpayer or 45% as an additional-rate taxpayer.

Pension options for over-55s

This may be a suitable option if you have no major overheads and already have enough cash saved in other ways to maintain the same quality of life you enjoy at the moment.

Take several lump sums

Another option is to take 25% of your pension pot tax-free and leave the other 75% exactly where it is, continuing to grow as an investment in your existing pensions.

For example, let's imagine you have a pension pot of £200,000, withdraw £50,000 without paying tax, and leave the rest (£150,000) in your various pensions.

Whether you pay income tax on taking several lump sums depends on your total annual income in any financial year and the personal allowance.

You could withdraw up to £11,850 from your pension pot in 2018/19 without paying income tax on your withdrawals so long as you have received no other income in the tax year.

Any amount over this threshold will be taxed at your marginal rate of income tax.

This may be useful if you want to stagger your withdrawals over a period of time, such as to the point at which you retire.

Lump sum and drawdown

You could opt to take 25% tax-free after reaching the age of 55, and use the rest to buy a flexible income drawdown product.

This would buy investments such as shares, corporate bonds, gilts, funds and more, giving you an investment portfolio which you can dip in and out of.

As this is an investment, you should be aware the value of your product can rise and fall at any time and you should accept the element of risk involved.

Check in regularly with your fund manager to see if it's performing as you wish. In the meantime, any income supplied through drawdown is usually paid out on a monthly basis.

The money you make from drawdown will count as income and will be taxed at your marginal rate of income tax if you exceed the personal allowance.

Lump sum and an annuity

Buying an annuity works in a similar way to buying a flexible income drawdown product in that you can withdraw 25% of your pension pot without paying tax and purchase an annuity with the rest.

The concept of buying an annuity is sound as they usually pay you a fixed annual income up until you die, but they have fallen out of favour with retirement savers in recent years.

Annuity rates have offered poor returns since pension freedoms were introduced, and due to low rates of inflation which affect the rates of income you receive.

But data from Moneyfacts showed average income earned from annuities in the six months to June 2018 rose between 1.4% and 4.8%.

Annuity rates continue to improve since hitting all-time lows after the Brexit vote in 2016, with the average annual income in the first half of 2018 just 1.2% behind when freedoms were brought in.

If the idea of having a fixed annual income for the rest of your life appeals to you, be sure to shop around for the best annuity rates.

Mix and match

It's possible to consider mixing and matching your pension options, such as using some of your pension pot to buy a flexible income drawdown product and some to purchase an annuity.

Various other combinations are available but be sure to seek professional advice before doing so as this is by far the most complex option.

Seek help with your decision

When the time comes to retire, what you do with your pension savings is one of the most important decisions you will make as it will affect the rest of your life.

The Government offers free guidance for over-50s through its Pension Wise initiative, which was introduced after the pension freedoms were brought in.

However, the guidance merely outlines your options in a similar way to this brief guide and you should speak to our experts for tailor-made advice to suit your situation.

Professional advice is also compulsory if you want to transfer defined benefit or safeguarded benefits worth £30,000 or more.

Speak to us about your retirement plans

Important information

The way in which tax charges (or tax relief, as appropriate) are applied depends on individual circumstances and may be subject to future change. Pension eligibility depends on individual circumstances and you cannot usually take pension benefit until age 55.

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 decisions based on its content. The value of pensions can fall as well as rise and you may not get back the amount you originally invested.

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