

What you need to know about...

UNSECURED PENSIONS

Unsecured pension has now replaced income drawdown, or pension fund withdrawal. This is an alternative to taking a traditional pension annuity when a person comes to retire from a pension scheme. The main benefit of an unsecured pension is to allow a pension income to be paid directly from the fund, thus allowing the fund to remain invested. This allows greater flexibility, but comes with higher risk.

What usually happens at retirement?

Most people choose to buy a pension annuity at retirement. They take the value of their fund, and buy a lifetime income with the lump sum. Usually, this income will be guaranteed for life, so this option comes with a level of security.

There are many options to choose from with an annuity, so this decision should be taken carefully (see our leaflet on this subject).

Most annuities pay either pay a level income, which never changes, or increase each year in line with an index, such as inflation. However, once they start, this cannot be changed. This can mean that they are seen as inflexible.

If you decide that you do not like this once-only decision, you can defer an annuity by taking an unsecured pension using income withdrawal.

What is an unsecured pension?

This is a scheme that allows you to draw an income from your pension funds, usually by using income withdrawal, or possibly by taking a short-term annuity.

What is income withdrawal?

This allows you to keep your money invested within your pension, but to withdraw an income within certain limits. The upper limit is 120% of the amount that you would get from a level single life annuity. There is now no minimum level of income, so this could be zero.

You are permitted to switch to a standard pension annuity at any time, and must make a decision whether to do this at age 75, or to switch to an alternatively secured pension, which works on different rules.

Which schemes can use this facility?

Usually, income withdrawal applies to personal pension schemes, although some occupational schemes will offer the facility. You can always transfer your benefits to a personal pension. Most providers do not offer the facility to use protected rights money, although this is possible. This leaflet does not deal with this type.

Who might consider income withdrawal?

These are complicated issues, and so usually should be taken with advice.

Continued overleaf...

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The plans are more risky than annuities as the money remains invested, and so is not guaranteed. Also, the charges tend to be higher as the contracts are more complex. Therefore, these plans are usually only suitable for more experienced investors, with larger funds (say over £50,000). As with all things, this depends on how much risk you are prepared to take.

How does it work in practice?

You would start by taking up to 25% of your fund as tax-free cash. If you do not take this at the outset, you will lose the right to this facility. As you can then elect to take zero income, some people use this simply to get at the tax-free cash. However, this should only be done with caution, and if you understand the risks.

The fund continues to be invested in a largely tax-free environment, and you can choose from a wide range of investments and funds. Of course, this means that your funds could rise as well as fall. In the medium to long term this could mean that your fund could eventually run out if your fund performs badly, or you take too much income. This is why many people prefer the security of annuities. The maximum level of income will be reviewed every 5 years, which could affect the income you are able to receive in future, especially if your fund had dropped in value. Realistically, you should review the income taken annually.

Flexibility

- The plan allows you to switch to an annuity at any time.

- You can choose to vary the level of income you receive, especially if you have income from other sources. This can be very helpful with tax planning for higher rate tax payers.
- You can choose to phase your retirement by leaving some of your pension invested, and drawing an income from the rest.
- As you get older, annuity rates should rise (although this may not be the case). By delaying the purchase of an annuity you could generate greater income.

Death before age 75

One of the main benefits of an unsecured pension is that you can leave the remaining fund to your partner or dependants, minus a 35% tax charge. This is far better than under an annuity, where the fund would be lost if you die, unless you have purchased guaranteed elements.

Your partner or dependants could also choose to carry on with the income withdrawal, or to buy an annuity.

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