

**RETIREMENT  
 - THE THIRD WAY**

The traditional belief is that there are two distinct phases in pension planning – the accumulation phase when the fund is building up, and the de-cumulation phase when the benefits are being drawn down.

However, for all but the fortunate minority with final salary pensions, increasing longevity has made it difficult to ensure that pension savings will be sufficient to meet retirement needs, and the problem has been exacerbated by the low levels of return currently available from annuities.

It is against this background that the simplified tax regime for pensions introduced by the Government in 2006 provided opportunities which assist retirees to manage the transition from accumulation to de-cumulation, by treating retirement as a process rather than an event.

The Government provided the precedent by announcing its plan to increase the State retirement age and to reward those who delay drawing their State pension. In the same way, it makes sense for a number of reasons for holders of private pension funds to delay committing their funds to annuity purchase for as long as possible.

One way of doing this is phased retirement, whereby instead of committing the whole of a personal pension fund to annuity purchase, the fund is realised progressively over a period of years. 75% of each segment is applied to purchase an annuity and 25% is drawn in the form of tax-free cash, to supplement the annuity income.

This enables the pension holder to take advantage of any improvements in annuity rates which may result from increases in interest rates. In addition, the longer the annuity decision is deferred, the clearer it becomes whether expensive options such a

guaranteed minimum payment periods and spouses' benefits are required.

Phased retirement, however, has not proved popular, and a simpler approach is to convert the pension plan to Unsecured Pension ('USP'), which enables the holder after the age of 50 (increasing in 2010 to 55) to draw the permitted 25% of the then value of the plan in the form of tax-free cash to cover income needs, while maintaining the remainder of the value of the plan as an on-going tax-efficient savings medium.

The decision to purchase an annuity can be staved-off until the age of 75, when the Government insists that personal pension funds must either be applied to purchase an annuity or be converted to a variant of USP known as Alternatively Secured Pension ('ASP').

Both USP and ASP permit income to be drawn from the fund, within limits which are higher for USP than ASP. However, the main differences relate to death benefits. Under USP, a lump sum death benefit is available on the death of the pension owner, but under ASP the benefits must be applied to provide pension benefits for dependants; and if there are no dependants, payments from the plan (except payments to charities) are subject to both Inheritance Tax and 'unauthorised payment' and other charges, resulting in a total tax bill of 82%!

There are, therefore, two clear courses open to pension investors at age 75:

- Those with smaller pension funds and those whose primary concern is security of income for themselves and their spouses or civil partners and who wish to minimise risk are likely to elect to purchase one or more annuities at age 75.
- Those for whom security of income is not paramount and who feel comfortable with the riskier and administratively more

complicated option of ASP may choose this option in order to be able to defer annuity purchase until rates might improve or personal circumstances might change, while also enjoying the benefit of being able to vary the income withdrawals and possibly also improve on the benefits available from annuities through superior investment performance. One ASP variant is what the Americans call '5 for life' products, which mimic annuities by guaranteeing that income levels will be maintained (up to the prescribed limit) even if capital values should fall.

These options could of course be combined, with part of an individual's pension assets being applied to annuity purchase and the remainder to ASP; and a decision to opt for ASP could be reversed at any time and the funds applied to annuity purchase.

**NUMBERS TO  
 CONJURE WITH**

On the question of accumulating pension assets, Financial Adviser columnist offered the following illustration of the benefit of tax relief on pension savings:

*"Start by putting £780 into a SIPP, or any other pension you choose. Uncle Gordon tops it up to £1,000 and I get further tax relief, cutting my investment to £600. I leave it invested for 10 years by which time, at 7 per cent growth, it will hopefully be worth around £2,000. I then take out my £500 tax free cash, cutting my investment to £100 and leaving £1,500 to buy an income.*

*I know, I know. There is inflation to consider and all sorts of other things. But there is something comforting about sums like these when you are lying in bed at night, contemplating a drooping stock market and wondering whether you will ever be able to retire".*

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