A COMPARISON OF PENSION INCOME CONTRACTS

(EXCLUDING SCHEME PENSIONS)

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Choosing **when** and **how** to access your pension funds can be complex. This note gives a **side-by-side summary comparison** of the main features of the different pension income options available. It should be read in conjunction with the Research Notes on each type of pension income for fuller details.

clarity

	Lifetime Traditional Annuity	Flexi-Access Drawdown Pension	Phased Retirement	Uncrystallised Funds Pension Lump Sum
The Main Points	The insurance company invests the pension fund (usually gilts and fixed interest securities) and pays a guaranteed income for life. The rates depend on age, mortality experience, long term gilt yields, and the structure of the annuity.	The pension fund remains invested. Regular or one-off withdrawals of any amount can be made at any time.	A slice of the pension fund is vested periodically (e.g. annually). This provides a tax-free sum and the balance of the pension buys an annuity/drawdown pension. The cash sum and annuity/drawdown added together provide income for that year. A further slice is vested in the next period, and so on.	A lump sum of any amount (within scheme rules) can be taken from a pension fund, of which 25% is deemed to be tax free cash (max. Lump Sum Allowance of £268,275 unless protection applies) and 75% is subject to income tax. Residual pension fund remains uncrystallised.
Income				
a) Guaranteed income?	Provides certainty of income, payable for life. Annuities can be guaranteed (i.e. payment continues for longer of the annuitant's life or the guarantee period).	No guarantees. If too high an income is taken, or investment performance is worse than expected, there is risk of depleting pension fund.	Guarantee and level of income depends on the amount of pension vested and whether an annuity or drawdown is chosen. Continuing investment risk for the unvested portion.	N/a – lump sum taken. Remaining fund continues to be subject to investment risk.

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b) Income flexibility?	Usually no flexibility of income. Once annuity bought it cannot be changed.	Entirely flexible, income limited only by fund value.	Each year's income depends on the amount of fund encashed subject to annuities/drawdown pension already purchased.	Any amount of lump sum can be taken. In addition, a series of UFPLS could be taken to meet income requirements if needed, in the same manner as for phased drawdown.
c) Inflation and escalation?	Annuity can increase either by fixed escalation, e.g. 3% or 5%, or in line with RPI/CPI.	Levels of escalation are limited only by future fund growth. RPI increases cannot be guaranteed.	Phased annuities can be bought with escalation. Phased drawdown escalation limited by future growth as for drawdown.	N/a – lump sum only taken.
Age	Best suited to over 60's (rates probably unattractive for lower ages).	Best suited to younger ages because longer-term investment strategies can be considered. For older ages, the additional costs involved, and mortality drag, increase the required return to maintain annuity purchasing power and therefore becomes more risky.	Best suited to younger ages because longer-term investment strategies can be considered. For older ages, the additional costs involved, and mortality drag, increase the required return to maintain annuity purchasing power and therefore becomes more risky.	Suitable for any age where the lump sum is required immediately, and further significant pension contributions will not be made. For older ages, the remaining uncrystallised funds remain subject to mortality drag.

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Investment Risk	No investment risk for traditional annuities – guaranteed income. Unit-linked and with-profit annuities are not guaranteed and fluctuate depending on fund performance.	Pension fund is still invested so investment risk remains. This can be reduced by adopting an appropriate investment strategy and/or by using guaranteed funds. Temporary annuities also available.	The unvested funds carry the same investment risk as drawdown, but more sensitive to volatility as units may have to be sold when price low (although this risk can be managed).	Balance of uncrystallised funds remain invested and subject to investment risk.
Death Benefits	Annuities can be guaranteed five or ten years, or longer periods. Joint life annuities pay out at either full or reduced rate until death of spouse. If the annuitant dies under age 75, spouse's pension paid income tax free; otherwise subject to income tax). Capital protected annuities available (at a cost, with a return of the unpaid fund), otherwise no return of fund on death.	Three options available for bene-ficiaries (subject to scheme rules): i) Return of fund ii) Remaining fund buys lifetime annuity for beneficiary iii) Continuing drawdown pension fund for beneficiary If the drawdown holder dies before age 75, the beneficiary can take the income free from income tax, or a lump sum free from income tax if within the LSDBA. If the lump sum is over the LSDBA the beneficiary will pay income tax. If over 75, the beneficiary will pay income tax in all cases. From Apr27 IHT will also apply to all pension death benefits.	Options and tax on death for unvested fund same as for drawdown.	Remaining uncrystallised investment funds are subject to the same options and tax on death as for drawdown.

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Health	Annuity potentially offers good value for those with better than average longevity expectations. Those with certain health conditions can buy impaired life annuities, which can offer good value.	Potentially a good option for those in poor health as death benefits may be better.	Potentially a good option for those in poor health as death benefits may be better. Impaired life annuities can be bought if needed.	Potentially a good option for those in poor health as death benefits for remaining uncrystallised funds may be better.
Tax	All annuities subject to Income Tax. Voluntary purchase annuities (i.e. non-pension) have a special tax treatment.	Income fully taxable.	Can reduce marginal tax rate by taking part income in the form of tax-free cash.	Up to 25% of the lump sum is tax free (where within the maximum tax free cash allowable). Remaining 75% is taxable at the highest marginal income tax rate. For large lump sums, tax effect can be managed by splitting lump sum over more than one tax year.
Further Pension Funding	Must establish a new pension arrangement. Money Purchase Annual Allowance does not apply.	Additional fund designation is possible. Once income has been taken, the Money Purchase Annual Allowance applies.	Can make additional payments into unvested segments. Once income has been taken from the drawdown pot, the Money Purchase Annual Allowance applies.	Can make additional payments into pension. After the first UFPLS has been taken, the Money Purchase Annual Allowance applies.

Please note that this is intended to be a summary of the main points only. Professional advice should be taken before making your decision.

Important information: Our views are based upon our understanding of current legislation in England, unless stated otherwise. Levels and bases of, and reliefs from, taxation are subject to change and their value to you will depend upon your personal circumstances.

Risk Warning: The past is not necessarily a guide to future performance. The value of your investment and the income from it can fall as well as rise and is not guaranteed. You may not get back the full amount invested. This document is provided for information only and does not constitute advice. You should not act on any of the information without seeking professional advice.