

Simplified Guide to SIPP Retirement Benefits

Introduction

One of the advantages of having a Self Invested Personal Pension (SIPP) is the flexibility it offers when you want to start taking the benefits you've been saving for throughout your working life. When there is so much choice it can be confusing, therefore we have prepared this brief guide on the main types of benefits you can take, when you can take them and some of the advantages and disadvantages of each.

This guide should be read in conjunction with our more detailed retirement Fact Sheets and our Key Features Document which can be found at the Technical Centre on our website at www.sippsolutions.com. In preparing this guide, Pointon York SIPP Solutions Limited (PYSS) is not giving you any financial or investment advice. We strongly recommend that you seek appropriate advice from a professional financial adviser due to the very complicated nature of retirement benefits. The information provided is based on our understanding of UK pension legislation at the date of this guide.

Taking Benefits...

Once you reach age 50 (or 55 from 6th April 2010) you will normally be able to take up to 25% of your pension fund as a tax-free one off payment. This is known as your Pension Commencement Lump Sum (PCLS). The remaining 75% MUST be used to provide an income for you for the remainder of your life. If your fund includes Protected Rights pension savings the remaining 75% must be used to provide an income for you and any surviving spouse on your death. This income will be taxed as if you had earned it, so will be subject to income tax at your highest marginal rate.

There are two basic ways in which you may take income benefits from your SIPP; Annuity and Income Withdrawal.

Annuity

Purchasing an annuity is effectively "buying" an annual income with all or part of your pension fund, usually from an insurance company. If you are purchasing an annuity with Protected Rights then the whole of the fund must be used. Your PCLS is paid out before the annuity is purchased.

The income you receive depends on your age at the time of purchase, your state of health, whether you smoke or not, current interest rates and even where you live. The insurance company will work out how much income they are prepared to pay you based on these factors and what optional "extras" you choose, such as a spouse's pension, an increasing pension or a guarantee period.

The income will be payable for the rest of your life and will usually stop when you die. Exceptions to this are when you choose to purchase a spouses pension at outset or choose to reduce your annual income in exchange for a guarantee period. A guarantee period is where the payments are guaranteed to be paid out for either 5 or 10 years after purchase (but not beyond age 75), regardless of whether you die during that period. For instance, you opt for a 5 year guarantee and take your pension monthly. Death occurs 3 years after the annuity is

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purchased, 36 months pension have already been paid out. The insurance company would therefore pay a further 24 months worth of pension to your estate as a lump sum.

The payments will remain the same every year unless you choose an index linked or increasing pension. Again, as this will cost the Insurance Company more to pay you, it will reduce your annual income.

PYSS does not provide annuities so you will have to find a suitable annuity provider to suit your needs. A financial adviser will be able to help you with this.

Advantages of buying an annuity:

- Your income is guaranteed until your death.
- There is no investment risk to you. Your income does not depend on how your investments are performing.
- You can ensure that your spouse and/or dependants are provided for by purchasing a pension for them on your death.

Disadvantages of buying an annuity:

- You lose control of your pension fund which is paid to the annuity provider in exchange for the annuity.
- You have to decide at outset if you want to purchase optional extras such as a spouse's pension or a guarantee, and these cannot be changed if your personal circumstances change in the future.
- You have no further benefit from a good investment return.
- You may purchase during a period when annuity rates are low and get locked into a low income.
- Once you have purchased an annuity with an annuity provider you cannot switch to another provider at a later date.

Income Withdrawal

If you decide not to purchase an annuity immediately you have the option of income withdrawal, sometimes referred to as drawdown. This is when you take your pension benefits directly from your SIPP rather than buying an annuity. For this option it is important to note what you are permitted by HMRC to take as an income, your death benefits and taxation treatment are all very different depending on whether you are aged under or over 75.

Unsecured Pension

If you have not yet reached your 75th birthday you may take an Unsecured Pension (USP). As the name suggests, the income you get is not secured (or guaranteed) as it would be with an annuity. This is because you are not committing a fixed amount of your pension fund to an insurance company in exchange for an annual income for life.

You can decide, within limits set by the Inland Revenue, how much you take from your SIPP every year. You may increase your income, decrease it, stop taking it altogether or choose to purchase an annuity at any time. You may choose to take the whole or part of your fund into drawdown. Leaving some segments "unvested" changes the taxation of any benefits should

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you die or purchase an annuity before age 75.

Your income is calculated using the Government Actuary Department (GAD) set standard annuity rates based on your age, and investment gilt yields at the time you take your benefits – PYSS use these as an equivalent to the annuity rates the insurance company would use. PYSS then calculate an annual income, based on the amount of fund vested to provide benefits, and you may choose to take between 0% and 120% of this amount every year as a pension.

The annual income level is set for the next 5 years. You may choose to review it more often, but you don't have to.

Advantages of Unsecured Pension:

- No need to set a level of income now – you have flexibility to increase or decrease as your personal circumstances change.
- You can use some of your fund to provide an income and leave the rest invested in a tax free environment. This is especially useful if you are going to move into retirement gradually and don't need a full pension yet.
- You retain control over the SIPP investments.
- You have control over when or if you purchase an annuity, not being forced to purchase when rates are low.
- More choice in how death benefits can be paid, including under some circumstances a lump sum taxed at 35% or even tax-free if some segments remain unvested.

Disadvantages of Unsecured Pension:

- You retain the whole of the investment risk, if your investments do badly it could affect your income.
- As you stay in your SIPP you will continue to pay the SIPP charges, in addition to charges for administering the drawdown and the reviews.
- You don't have the security of a guaranteed income.
- Annuity rates may worsen in future.
- The higher the level of pension you take from your fund, the better the rest of the fund must perform to ensure your pension benefits are not eroded away in the future.
- You have to have a formal review of the pension every 5 years and this may mean that your benefits could reduce.

Alternatively Secured Pension

Once you reach your 75th birthday you have to secure your pension. You do not have to purchase an annuity, you can choose to take an Alternatively Secured Pension (ASP). This works in a similar way to USP although there are important differences.

The important thing to note is that you must take any PCLS before you reach age 75 or you lose the ability to take a tax free lump sum.

As for USP, PYSS use a GAD annuity rate and the amount of fund used, to calculate an annual income of which you have to take at least 55% but no more than 90% as an income. The GAD rate we have to use is based on you being aged 75, even if you are older.

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The death benefits that are paid out under a USP and an ASP are very different, and will have Inheritance Tax implications. A more detailed explanation can be found in our Fact Sheet on our website at www.sippsolutions.com. **PYSS recommends strongly that you do not enter into ASP without professional advice.**

Advantages of Alternatively Secured Pension:

- Most of the same advantages as under Unsecured Pension.
- You may leave any unused fund on death to a nominated charity, tax-free.
- If your spouse is aged under 75 when you die then their pension would be treated as Unsecured Pension NOT Alternatively Secured Pension and so may benefit from the much more flexible death benefits.

Disadvantages of Alternatively Secured Pension:

- All the same disadvantages as under Unsecured Pension.
- You must have your pension reviewed annually which will increase your administration costs.
- Under a SIPP, as you are the only member, you do not benefit from *cross subsidy*. This is where an insurance company calculate what annuity they would pay you using an average lifespan for someone of your age, health and lifestyle. Some people may live longer than this and would get back more in annuity payments than they originally paid to the insurance company, and some people will die earlier and will lose out as they got back less than they paid to the insurance company. This is a risk that you take in exchange for a guaranteed income for the rest of your life and a risk the insurance company take in exchange for a lump sum payment from you.
- As you do not benefit from cross subsidy you are affected by *mortality drag*. Mortality drag simply means that as you are the only member of the SIPP, in order to take an income under ASP that would be comparable to what you would get from an annuity, it will cost you more. Your investments therefore need to work harder to keep up with the amount of income you take every year.
- The investment return needed to offset mortality drags can mean that more risk may need to be taken at a time in your life when attitude to risk is usually very low.
- GAD rates stop at age 75 so although you are growing older, your annuity rates are not getting any better.
- You **MUST** draw a minimum pension of at least 55% of the GAD pension.
- Much stricter death benefit rules. Where survived by a spouse/financial dependant a pension benefit must be provided. Otherwise it must be paid to a nominated charity. It is possible to pass on to family members but there would be a large tax penalty incurred of 82%. Because of this PYSS will not allow this option.
- ASP comes into play at a time in your life where you may wish to simplify your finances rather than complicate matters. ASP is a complicated and confusing way of taking pension benefits so may not suit your attitude or circumstances.

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Quick reference of differences between the different ways of taking benefits

	Annuity	USP	ASP
Minimum age to commence	50 (55 from 6/4/10)	50 (55 from 6/4/10)	75
Maximum age	None*	75	None
PCLS available	Yes	Yes	No
Maximum Income	Set by annuity provider	120% GAD	90% GAD
Minimum Income	Set by annuity provider	0%	55% GAD
Ongoing fees	None	Yes	Yes

* Whilst you are able to purchase an annuity after age 75 some companies do not allow this so you may have a vastly restricted choice of insurers.

Further help?

PYSS know that planning your retirement is important but can be a very complicated matter and we hope that this has given you a better understanding of your options.

Here is a list of further places you can go for more information:

The Financial Services Authority

Consumer helpline: 0845 606 1234
Minicom/Textphone: 0845 730 0104
www.moneymadeclear.fsa.gov.uk

The Pensions Advisory Service

Telephone: 0845 601 2923
www.pensionsadvisoryservice.org.uk

The Pension Service

Telephone: 0845 606 0265
www.thepensionsservice.gov.uk

Further information can also be found on our website at www.sippsolutions.com or by telephoning our office on 01858 419300. You may request a copy of our Fact Sheets by emailing enquiries@sippsolutions.com

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