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Countdown to retirement

Retirement planning

Adviser Solutions

Introduction

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Often there are two critical inflexion points in preparing for retirement.

Firstly, in the early years of someone's working life, their attention and their resources may be absorbed with buying a home and establishing a degree of financial independence. Perhaps raising a family. This can consume any discretionary income they have. Saving for retirement can feel like an issue for another day. Auto enrolment is a welcome initiative, but may not provide enough for a comfortable retirement.

Over time, priorities can change. The mortgage payments may be less challenging; children less financially dependent. At this point, retirement may not be a distant vision, but a looming reality. People might need to accelerate their savings to achieve their retirement plans. The starting point is to understand their financial position and then propose remedies to address any shortfall.

The second critical stage is the period around 1-2 years from starting the retirement journey. At this point, it may be difficult to add significantly to their savings. The challenge is how to make the most of the assets they have to meet their financial aspirations during retirement. This can present a number of challenges. The FCA's thematic review of the retirement advice market identified several areas for improvement in the advice models used by some advisers.

Our report considers the options available if a shortfall is identified some years out from retirement. The most common options are saving more or retiring later. In the case of the former, which products are most effective? There are also other solutions available which can shore up retirement finances. As retirement draws near, we explore some of the challenges advisers and their clients might grapple with to achieve a comfortable retirement highlighting some of the FCA's concerns.

Everyone deserves a fulfilling retirement at the end of their working life. The role of an adviser should be crucial in contributing to happiness in retirement. Our report sheds light on some of the actions advisers can take to develop effective retirement strategies for their clients.

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Countdown to retirement

Over 12 million people expect to receive the minimum income required to get by in retirement but aren't on track to achieve it.

Marketers often use a concept known as 'itch cycles' to define when to intensify their marketing efforts. It's the point when consumers may be most susceptible to a sales or marketing initiative. For example, commonly people think about buying a new car every three years or moving house every five years.

This concept may have relevance to retirement planning. There is a point when people start to take retirement more seriously. It's no longer a distant vista, but a looming reality. Commonly the motivation is their proximity to retirement coupled with a change in their financial circumstances. As people age, retirement often becomes the focus of their financial concerns. They're less troubled with day-to-day money management. Their salary may be higher, mortgage payments less onerous and children no longer financially dependent. In contrast, early in their working life, people can be consumed by more immediate challenges, like buying a home and raising a family.

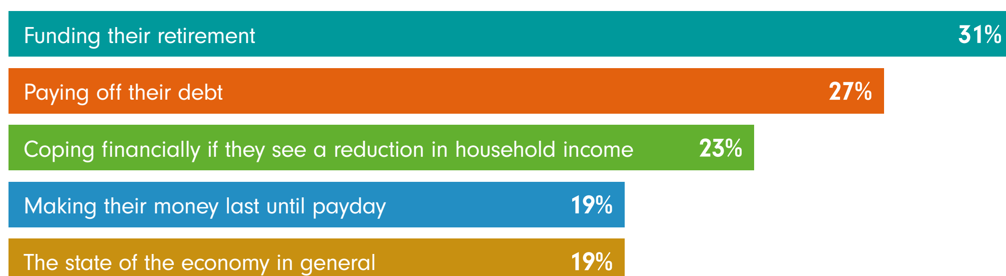
So when does this sea change occur? Research suggests that for baby boomers it starts in the late 40s[1]. This seems consistent with a shift in focus: from buying a home, raising a family and building a career to recognising that retirement is no longer a distant fantasy. The same research suggests that the age at which younger people start to think about retirement is earlier. For Gen Xers it would seem to be late thirties. It's earlier still for Gen Z and Millennials.

This may seem counter intuitive. A possible explanation could be the introduction of auto enrolment. Auto enrolment highlights the need to prepare for retirement, but that may not translate into action (over and above auto enrolment). In other words, people might have greater awareness of retirement, but it's not matched by the capacity to save more. And there is a general recognition that auto enrolment alone may not provide the standard of living many people strive for in retirement.

As such, people could struggle to provide a comfortable retirement unless they act when their finances allow them to go further. A 2023 study revealed that over 12 million people expect to receive the minimum income required to get by in retirement but aren't on track to achieve it[2]. Further research among employees suggests that only one in five said their pension would be enough to retire comfortably[3] (even this could be wishful thinking). What's more, a 2022 Department of Work and Pensions (DWP) study concludes that only around 1 in 4 people have a good idea of how much they need in retirement[4]. All in all, many people seem financially ill-prepared for retirement.

1. Retirement Voice 2023, Standard Life, 2023.
2. Great Expectations: Are people's retirement income expectations adequate and achievable?, Phoenix Insights, September 2022.
3. Aviva Working lives Report 2023, Fit for Future, June 2023.
4. Planning and Preparing for Later Life, DWP, June 2022.

Chart 1: Employees rank funding their retirement as their top money worry



Source: Financial Wellbeing Index 2019, Close Bros.

It's little wonder funding retirement is the top money worry ahead of day-to-day money management for employees or that three in five people feel stressed when they think about their retirement[5]. This issue affects employees physically and mentally. Research carried out in 2022 showed that:

- Planning for retirement is now ranked more stressful than divorce by the 40-44 age group[6].
- Almost one in ten people surveyed have sought medical help for their retirement worries[6].
- 16% have lost sleep worrying about retirement[6].

5. Three in five Brits feel stressed about later life planning, Aviva, November 2022.
6. Retirement anxiety – and how to overcome it, Abrdn, August 2022.

Helping people to get in shape for their life after work

There are two critical inflexion points:

- Around 5-15 years from retirement, people start to actively think about their life after work and often have the financial means to do something about it.
- The final 12-24 month period when they need to make decisions about how to move from accumulation to decumulation.

That's not to say that these are the only key interventions. Regular reviews are necessary and each client's need will be different, but as a general rule people begin to focus more closely on their retirement in their late 40s or 50s. And as retirement beckons, they need to develop a personal plan to transition from accumulation to decumulation. In the next section, we'll explore the main actions advisers and their clients can take to get in shape for retirement.

Key points

- Retirement may be a perennial worry for many people, but their capacity to do much about it is often limited early in their life when day-to-day financial pressures dominate.
- At some point, these pressures recede. The mortgage payments may be less onerous, children could be financially independent and career success may increase affluence.
- Coincident with this change is a growing realisation that retirement is on the horizon and the prospect of stopping work, wholly or partly, becomes a reality.
- For many people this period, between having the means to do more and realising the need to do so, often results in playing catch-up for years of under provision.
- Many people don't know how much they need, so there is a challenge to educate and build a better understanding of what constitutes a comfortable retirement.
- As people countdown to retirement, they need to consider the specific decisions and choices they have in the final 12-24 months before they start their retirement journey.

Planning a flight path to retirement

When people are, say, 5-15 years from starting their retirement journey how should they proceed? The start point is to take stock of their position: the value of their current and future retirement savings measured against what they need to retire comfortably. Then a plan can be developed that meets their objectives.

The retirement audit

It's not surprising that many people don't know if they're on track for a comfortable retirement. It's not an easy calculation. Clients usually receive annual statements from their pension scheme, but they may have several pensions from different employers. They need to understand not just what their current savings are worth, but what they could be worth in the future (including the value of ongoing contributions). There's also the State Pension and other non-pension savings that may be used to supplement income in retirement. Then they need to contrast this with the amount required for a comfortable retirement.

It's not surprising that many people don't know if they're on track for a comfortable retirement. It's not an easy calculation.

Fortunately, there are tools that can run these calculations quickly and many financial advisers will have their own version. These tools commonly calculate how much has been put by already in pensions and other savings. Then estimate the value of ongoing pension contributions, and future savings, between now and retirement. The State Pension is usually added, plus any defined benefits income.

Once there is a clear view of the client's financial position a plan can be developed.

The retirement plan

Many people will discover there's a shortfall once they've analysed their current situation. The obvious remedies are to retire later or save more. Often the answer will be a combination of these. There are other actions that can be considered too, which we'll explore later:

Save more

If retirement is still some way off, the option to save more can make a major difference. This begs the question, which savings vehicle to use? The obvious choice is between a pension and an ISA. For most people the answer is likely to be a pension. The attraction of tax-relief, perhaps boosted by an employer matching employee contributions, make this a compelling option. Tax is applied when income is taken, but 25% is tax-free (up to the limit of the new lump sum allowance), and the tax relief on contributions given upfront benefit from tax-free investment growth.

Chart 2 shows how £20,000 invested over 10 years (ignoring investment growth), would grow with tax relief. Compared with the same amount invested in an ISA over this period. The pension contribution would be worth £250,000 for a basic-rate taxpayer, £333,333 for a higher-rate taxpayer and £363,363 for an additional-rate taxpayer.

If retirement is still some way off, the option to save more can make a major difference. This begs the question, which savings vehicle to use?

Chart 2: Pension v ISA – impact of tax relief on contributions

10 years (no growth)	
ISA	£200,000
Pension – basic-rate taxpayer	£250,000
Pension – higher-rate taxpayer	£333,333
Pension – additional-rate taxpayer	£363,363

Source: Pensions – still the first port of call for retirement savings, Fidelity, April 2024.

If the client pays the same rate of tax on the way out as the tax relief received on the way in then, ignoring any investment growth, the amount within the ISA will last 20 years if £10,000 is withdrawn each year. However, if the client is a basic-rate taxpayer, they would still have £14,700 remaining within their pension under the same scenario. A higher-rate taxpayer would still have £47,613 within their pension at the end of the 20-year period while an additional-rate taxpayer would have £61,736 remaining.

There are reasons why an ISA may make more sense. For example, where access to funds before age 55 is required or the tax rate in retirement is higher than the tax relief available on pension contributions or the annual limits on pension contributions have been reached.

The lifetime allowance has been 'abolished', so people no longer need to worry about their retirement funds exceeding the allowance, but the annual limits on contributions still apply. Nevertheless, the ability to accrue further benefits is welcome news for clients with existing Fixed and Enhanced Protection, as at 15 March 2023, who have previously not been able to make further contributions to their pensions. Of course, the lump sum allowance and the lump sum and death benefits allowance may restrict the amount that can be taken tax-free or paid tax-free on death, but the ability to pay more into pensions will still be welcome news for many people.

Some people may be in the fortunate position that they can invest beyond pensions and ISAs. Commonly, the choice will be between a collective investment and offshore or onshore bonds. If the end game is to use these to supplement income in retirement, what's the optimal solution? The short answer is – it depends. Investment returns are generally broken down into three different types of return – capital gains, dividends and interest – and these are potentially all taxed at different rates with potentially different allowances:

- **Onshore bonds.** As a default, some tax will be deducted from the investment as the client goes along and there will be a final tax assessment on the chargeable event to see if additional tax is due.
- **Offshore bonds.** These roll up gross with the gain assessed to tax on a chargeable event.
- **Collectives.** Tax will be due as the client goes along while capital gains will be assessed at the end of the investment.

The lifetime allowance has been 'abolished', so people no longer need to worry about their retirement funds exceeding the allowance, but the annual limits on contributions still apply

The chart below shows the best solution for the three different investment options assuming 5% withdrawals are made. The investment sum is shown on the vertical axis while the client's rate of tax during the investment and at the end of the investment is shown on the horizontal axis. The total annual return is assumed to be 6% made up of 2.5% capital growth, 2% dividends and 1.5% interest each year.

Chart 3: Comparison assuming 5% income withdrawal

Ongoing	ADRT	ADRT	HRT	ADRT	HRT	BRT	ADRT	HRT	BRT
Withdrawal	ADRT	HRT	HRT	BRT	BRT	BRT	NT	NT	NT
£500k	Collective 34.95%	Onshore 33.47%	Collective 30.76%	Onshore 16.84%	Onshore 16.84%	Collective 12.28%	Offshore 0.00%	Offshore 0.00%	Offshore 0.00%
£400k	Collective 34.28%	Collective 34.28% Onshore 33.47%	Collective 29.92%	Onshore 16.84%	Onshore 16.84%	Collective 11.80%	Offshore 0.00%	Offshore 0.00%	Offshore 0.00%
£300k	Collective 33.17%	Collective 33.17%	Collective 28.54%	Onshore 16.84%	Onshore 16.84%	Collective 10.99%	Offshore 0.00%	Offshore 0.00%	Offshore 0.00%
£200k	Collective 30.97%	Collective 30.97%	Collective 25.77%	Onshore 16.84%	Onshore 16.84%	Collective 9.38%	Offshore 0.00%	Offshore 0.00%	Offshore 0.00%
£100k	Collective 26.03%	Collective 26.03%	Collective 19.02%	Onshore 16.84%	Onshore 16.84%	Collective 5.18%	Offshore 0.00%	Offshore 0.00%	Offshore 0.00%
£50k	Collective 22.20%	Collective 22.20%	Collective 11.77%	Onshore 16.84%	Collective 11.77%	Collective 0.20%	Offshore 0.00%	Offshore 0.00%	Collective 0.20% Offshore 0.00%

Source: Investing beyond pensions and ISAs, April 2024.

The offshore bond works well for anyone who will be a non-taxpayer on encashment though these people may be few and far between. For taxpayers paying the same rate of tax on investing and encashment the collective works well. For people paying higher or additional-rate tax on investment and basic rate tax on encashment the onshore bond performs well in a number of instances.

The total annual return is assumed to be 6% each year, but actual returns are likely to be inconsistent. This favours an Investment Account because clients sitting on gains can use their capital gains allowance.

Retire later

There are a number of benefits to putting back the date of retirement:

- More time to save (whether in a pension, ISA or some other vehicle).
- More time for savings to grow (though investment growth isn't guaranteed).
- The State Pension increases if deferred beyond State Pension age (see chart 4).
- NI contributions are no longer payable after State Pension age on any earnings.
- Annuity rates are usually higher. At 65 a single life, level annuity would pay £7,432 p.a. compared with £8,236[7] at 70 (per £100,000 purchase price).
- Drawdown rates improve with age too. For example, at 65 the recommended withdrawal rate to age 95 is 4% compared with 4.5% at age 70[8].

But there are pitfalls: for example, DB benefits can't usually be deferred and this could plunge someone into a higher tax bracket when added to income from employment.

Chart 4: Impact of deferring State Pension

Weekly State Pension	Years State Pension deferred for	Amount of State Pension given up	Extra State Pension amount (gross)		Total amount of State Pension paid (gross)	
			Per week	Per year	After 5 years	After 10 years
£221.20	1	£11,502.00	£12.78	£664.57	£3,322.87	£6,645.74
	2	£23,004.00	£25.56	£1,329.17	£6,645.83	£13,291.66
	3	£34,506.00	£38.34	£1,993.75	£9,968.73	£19,937.45
	4	£46,008.00	£51.12	£2,658.33	£13,291.66	£26,583.31
	5	£57,510.00	£63.90	£3,322.91	£16,614.53	£33,229.05
	6	£69,012.00	£76.68	£3,987.49	£19,937.45	£39,874.91
	7	£80,514.00	£89.46	£4,652.08	£23,260.41	£46,520.81
	8	£92,016.00	£102.24	£5,316.66	£26,583.31	£53,166.62
	9	£103,518.00	£115.02	£5,981.25	£29,906.24	£59,812.48
	10	£115,020.00	£127.80	£6,645.82	£33,229.11	£66,458.22

Source: The State Pension: a technical guide, Fidelity Adviser Solutions, 2024. The figures in this table are for illustration purposes only. The amounts actually payable and received by individuals may differ and will depend on the actual number of weeks deferred and the rates of inflation applicable during the term of deferral. Income figures have been prepared without taking into account yearly inflationary increases under the triple lock. The income figures shown are the potential amounts after the period of deferral has ended.

7. Hargreaves Lansdown, single life, level annuity, guaranteed 5 years, February 2024.
8. The State of Retirement Income: 2023, Morningstar, November 2023.

Saving more or delaying retirement are probably the most common solutions for most people some years from retirement, but there are other ways to potentially boost retirement income. These include:

- **Assume higher income withdrawals.** The general rule is that a 4% withdrawal rate has a 90% probability of the money lasting 30 years (based on a 40% equity weighting)[9]. Using a higher withdrawal rate could help people towards a comfortable retirement. Of course, this carries the risk that money may not last a lifetime, but it may make sense in the right circumstances.
- **Boost NI record.** If the client doesn't have a full 35 year NI contribution record, now is a good time to check. It's usually only possible to fill gaps in the previous six years. However, there are special arrangements for people who reach State Pension age on or after 6 April 2016. They have until 5 April 2025 to pay voluntary contributions to make up gaps between April 2006 and April 2017.
- **Review investment strategy.** Moving to a more aggressive investment strategy could boost retirement pots. Of course, this is a double-edged sword. There is no guarantee that investment growth will be positive (though over long periods this is a reasonable assumption). A high equity allocation during the decumulation period can also be beneficial (though care should be taken to guard against sequencing risk).

Moving to a more aggressive investment strategy could boost retirement pots. Of course, this is a double-edged sword. There is no guarantee that investment growth will be positive.

9. The State of Retirement Income: 2023, Morningstar, November 2023.

- **Leverage all assets (including property).** Increasingly, people are using all of their assets to fund their retirement plans, but there may be reluctance to do this. Often home equity is notionally allocated to provide a legacy for children. Yet children may be in their 50s or even 60s when parents die. At this stage, they're often financially settled. Releasing equity could boost retirement income, while part could be gifted to help children. Perhaps to help with a housing deposit.
- **Working during retirement.** Continuing to work in some capacity during retirement can help people achieve the lifestyle they want and also help in other ways. Combating loneliness, for example. This could also be combined with deferring State Pension, which will boost the amount eventually paid.

A final option, if clients are struggling to achieve a comfortable retirement, is to adjust spending plans and retire on a lower income than anticipated. This may seem defeatist, but for some people the attraction of retirement, and a life without work, outweighs any reduction in living standards.

In the next section, we'll look at the period immediately prior to starting the retirement journey.

Key points

- Often the point at which people have both the motivation and the resources to act to secure a comfortable retirement is in their late 40s or 50s.
- The starting point for many is to take stock of whether they are on track to retire comfortably, but this is not always a simple exercise.
- These are difficult calculations for individuals, but many advisers will have tools to help their clients understand their expected position at retirement.
- If they are likely to fall short of what they need to live comfortably, they might consider whether they can save more or retire later – sometimes a combination of the two.
- Other measures could include a more adventurous investment strategy, leveraging all of their assets (including property equity), taking a higher income or continuing to work.
- For some the answer may simply be to accept a reduced standard of living as a trade-off to otherwise meet their retirement needs.

Five steps to a better retirement

Retirement is increasingly a transition rather than a single event. Nevertheless, there is usually a point where fundamental decisions are made that signal the start of the retirement journey, even if working in some capacity is still involved.

Here are the main steps clients and their advisers will consider when providing their clients with the means to enjoy a comfortable retirement:

- Organise State Pension.
- Deploy private pensions.
- Use non-pension savings and investments.
- Leverage equity in the home.
- Consider working during retirement.

Some people may have other concerns beyond providing a comfortable retirement. If they're well placed to provide their desired standard of living, they may focus on maximizing their legacy. In these instances, the conversation will be different. This section is focused primarily on securing a comfortable retirement.

The FCA's thematic review of the retirement income advice market suggests a mixed picture with several areas identified for improvement. Some of the key concerns include:

- Some firms have not adapted their advice model to accommodate the needs of those in decumulation.
- Firms were not always collecting enough information to deliver suitable advice in areas like clients' wider financial circumstances, for example.
- Risk profiling methods were not sufficiently rigorous for decumulation. For example, failing to use capacity for loss as well as attitude to risk tools.
- An imperfect approach to sustainability of withdrawal rates. This could be a blanket approach to withdrawal rates that does not allow for individual circumstances.

These concerns should be borne in mind as advisers develop or refine their advice models for decumulation. What follows is an overview of the key steps, and some of the issues advisers should consider, as they help their clients to a better retirement.

Retirement is increasingly a transition rather than a single event.

Step 1: Organise State Pension

The State Pension is still the bedrock of retirement income for many people. Indeed, it's now almost £1,000 per month for those with a full qualifying NI record and is paid gross (though liable to tax). Some people may receive more than this by virtue of their membership of the state schemes that existed before the introduction of the flat rate scheme in April 2016.

There are a number of actions to take in connection with the State Pension:

The State Pension is still the bedrock of retirement income for many people.

Request a State Pension estimate

A State Pension estimate can reveal whether someone has a full NI contribution record. If not, they should consider buying added years (see below). There are different ways to get an estimate:

- Complete form BR19.
- Telephone 0800 731 0175 (Monday to Friday 8am to 6pm).
- Apply online for a State Pension statement.

Buy added years if necessary

As previously mentioned, it's usually only possible to fill gaps in the previous six years. However, there are special arrangements for people who reached State Pension age on or after 6 April 2016. They have until 5 April 2025 to pay voluntary contributions to make up gaps between April 2006 and April 2017. Bear in mind that, anyone with less than 10 years NI contributions or credits isn't entitled to any State Pension and it's not possible to buy added years for any period where someone was 'contracted out'.

Consider deferring the State Pension

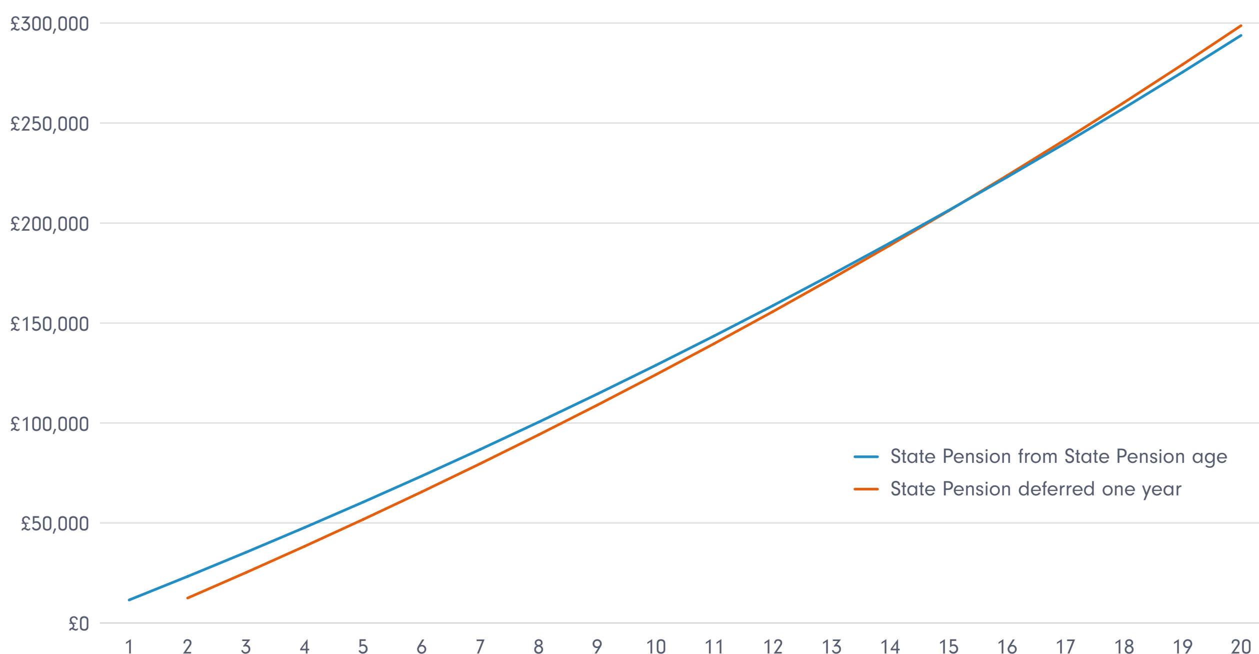
Delaying the State Pension means it will increase by 1% for every 9 weeks it's delayed. Broadly, just under 5.8% over the course of a year. You can see the impact this could have on the amount payable in Chart 4 (see previous section). However, this doesn't show whether it's worthwhile delaying payment. Chart 6 looks at the impact of delaying the State Pension for one year assuming that the State Pension increases by 2.5% each year. The chart shows that the crossover point is around 16 years. This is where the total payments are higher as a result of deferring the State Pension for one year. There are a few points to bear in mind:

- The case for deferment becomes more attractive over longer periods. For example, after 30 years the total payments (including increases of 2.5% p.a.) would be £505,000 compared with £522,000 for those who deferred payment for one year.
- If the income given up in the first year by deferring payment is invested, the investment income earned could push the crossover point out further.
- It's not possible to take part of the State Pension, so someone who continues to work after retirement could find that the State Pension pushes them into a higher tax bracket, which may make deferment an attractive option.

Note that State Pension in deferment won't increase during any period where benefits are being claimed. For example, Pension Credit, Universal Credit, Carer's Allowance, Unemployment Supplement and Widow's Pension.

Delaying the State Pension means it will increase by 1% for every 9 weeks it's delayed.

Chart 5: Cumulative impact of delaying State Pension for one year



Source: Making Sense of Retirement Ltd, 2024.

Applying for the State Pension

The State Pension isn't usually paid automatically. Your clients should receive a letter no later than 2 months before State Pension age. If they haven't received the letter, they can apply for their State Pension. There are three routes:

- Complete a State Pension Claim Form.
- Telephone 0800 731 7898 (Monday to Friday 8am to 6pm).
- Apply online – applying for State Pension online.

Step 2: Deploying private pensions

How to apply pension savings to generate an income during retirement is one of the key elements of retirement planning. The process will involve an analysis of the client's goals and objectives, their attitude to risk and capacity for loss, budgetary requirements and more. Increasingly it will also involve a series of 'what if' cash flow analyses to stress-test strategies.

Rather than defining the advice process, which will differ from firm to firm, what follows is an overview of the key actions highlighting some of the challenges advisers and their clients face in arriving at a strategy. Here's a reminder of how different the decumulation phase is compared with the period of accumulation.

How to apply pension savings to generate an income during retirement is one of the key elements of retirement planning.

Chart 6: Accumulation is different from the decumulation phase

Accumulation	Decumulation
Converting income into capital	Converting capital into income
Fixed-term horizon	Unknown time horizon
Investing for growth	Investing for income
Increasing capital	Reducing capital
Pound cost averaging	Pound cost ravaging

Source: Making Sense of Retirement Ltd, 2024.

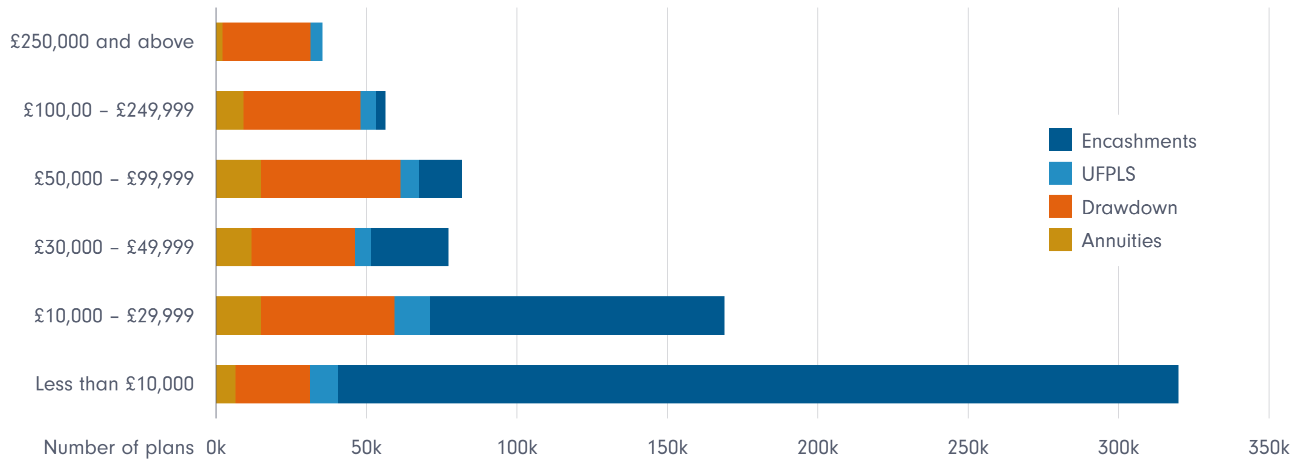
What are the key steps in helping clients to plan for a comfortable retirement?

- **Finding past pensions.** Few people these days work for the same company throughout their working life. If clients have lost the contact details of a past pension scheme or a previous employer with a defined benefit scheme has become insolvent, help is at hand:
  - The Pension Tracing Service can help you contact previous employers.
  - The Pension Protection Fund protects the defined benefit pensions of millions of people.
- **Consolidation.** Consolidation can make sense. For example, greater convenience and possibly lower charges, but advisers will be aware of the pitfalls: potential penalties and loss of valuable guarantees. And it rarely makes sense to transfer defined benefits. Nevertheless, under the right circumstances, it can be a good idea to consolidate past pensions.
- **Taking benefits from defined benefit schemes.** There are a number of points worth bearing in mind:
  - The commutation rate is a critical piece of information for members of DB schemes to assess how much tax-free cash to take.
  - While it's usually not advisable to transfer from a DB scheme there are instances where it might be worthwhile.
  - The income from DB schemes is guaranteed and, together with State Pensions, can be used to provide cover for essential expenditure.
  - If benefits have been taken before 6 April 2024 from a DB scheme consider whether a transitional tax-free certificate could be beneficial.
  - Benefits from a DB scheme can't usually be deferred so if clients are continuing to work when DB benefits start this could have tax implications.
- **Deploying defined contribution plans.** The main choices, after any tax-free cash lump sum has been taken, are:
  - Buying an annuity.
  - Investing in drawdown.
  - Using uncrystallised funds pension lump sum.
  - Taking all of the fund as cash.

The fears around people taking their pension fund and buying expensive sports cars haven't materialised. Most funds that are encashed in their entirety are small pots. There is little evidence that larger pension funds are being used in this way to any degree. Uncrystallised funds pension lump sums are also used less than the two main options: buying an annuity or using flexi-access drawdown. These remain the most popular choices, so we have focused on these (see chart 7).

Consolidation can make sense. For example, greater convenience and possibly lower charges, but advisers will be aware of the pitfalls: potential penalties and loss of valuable guarantees.

Chart 7: Pension plans accessed by pot size and method of access



Retirement income market data 2022/23, FCA, April 2024.

- **Annuities.** Some of the issues to consider in the context of choosing annuities include:
  - Annuity sales have suffered since the introduction of pension freedoms, but there has been a recent resurgence. ABI data suggests that the volume of annuity contracts increased by around a third last year over 2022[10]. The FCA thematic review did highlight the need to consider annuitisation as part of any decumulation process.
  - Annuities now provide much more flexibility on death. Guaranteed periods up to 30 years, value protection up to 100% of the original purchase price (less payments to the date of death) and beneficiaries' pensions. What's more, beneficiaries' pensions are not included in the lump sum and death benefit allowance.
  - Statements like George Osborne's 'No one will have to buy an annuity' are often used by people to make snap judgements. Combat rash judgements with data or visualisation: ask clients how they feel when their investments fall as an entry point to discussing annuities.
  - In choosing between a level and an escalating annuity, our report 'The impact of inflation on retirement planning' has data on the crossover points between level and escalating annuities.

10. 2023 sets new post-pension freedoms record for annuity sales, ABI, February 2024.

- **Drawdown.** Some of the issues to consider in the context of choosing drawdown include:
  - Morningstar suggests 4% is a sustainable withdrawal rate for a 65 year old over 30 years with a 90% probability of success[11]. The FCA raised concerns about the use of a blanket approach to withdrawal rates and the need to recognise the client's financial requirements in retirement.
  - For many, a 4% withdrawal rate won't be enough. People can reduce the probability of success to take a higher income. A 60% probability of success would increase the rate to 5%. Where there is a backstop, like property equity or the prospect of an inheritance, this can make sense. Partially inflation linking income during retirement can also help raise withdrawal rates. People at older ages could also take more than 4%. These issues are explored in more detail in our report 'Help your clients survive retirement'.
  - There is a realisation that it can make sense to cover essential expenditure with a guaranteed income stream. But is this enough? For affluent social groups, retirement isn't just about surviving. These people may have ambitious goals for retirement, which can carry extra cost. For example, golf club fees, overseas travel or expensive new hobbies. Though not essential, these are important expenses for affluent clients. Therefore, it can make sense to cover these expenses with a guaranteed income stream too.
  - Investment strategy is key during retirement. An overly conservative approach means money may run out too soon; too much invested in high risk investments can expose clients to sequencing risk. There are various strategies that can mitigate the latter and these are reviewed in 'Help your clients survive retirement'.

11. The State of Retirement Income: 2023, Morningstar, November 2023.

- **Annuity and drawdown hybrid solutions.** Some of the issues to consider in the context of choosing a hybrid solution include:
  - Covering essential and important expenditure with a guaranteed income can provide valuable peace of mind. State Pension and final salary benefits can be used and any shortfall provided by an annuity within a drawdown fund.
  - The Institute and Faculty of Actuaries modelled a range of strategies involving drawdown and annuitisation and concluded that by adopting an integrated strategy 'consumers can potentially generate a larger overall income from their pension pot'[12].
  - Global actuarial firm, Milliman, explored displacing the bond proportion of a portfolio with an annuity and found not only did this strategy improve the sustainable withdrawal rate, but death benefits over the long term were often higher[13].
  - Research undertaken by Demos suggests that people who have annuitised, in particular those on lower incomes, are less likely to suffer from depression or feel sad compared with those who choose drawdown[14]. Combining an annuity within drawdown provides both certainty with flexibility – highly valued by many people.
  - Over time, the impact of mortality credit in annuity rates means it is difficult for drawdown to match the effective return from an annuity without taking significant risks, so a phased approach to annuitisation can bring significant benefits.

Over time, the impact of mortality credit in annuity rates means it is difficult for drawdown to match the effective return from an annuity without taking significant risks.

12. Can we help consumers avoid running out of money in retirement?, Institute and Faculty of Actuaries, March 2018.
13. Annuities reinvented: Are annuities the missing asset class for sustainable drawdown solutions?, Milliman, October 2018.
14. The retirement income riddle, Demos, November 2018.

Step 3: Use other savings and investments

There are a range of different savings and investments available that can be used to supplement income that are tax advantaged:

- **Personal Savings Allowance.** Basic-rate taxpayers can earn up to £1,000 interest a year without paying tax on savings accounts with banks, building societies or other savings institutions. Higher-rate taxpayers can earn up to £500 interest. The allowance does not apply to people paying the additional rate of income tax. For people on low incomes there is also the starting rate for savings.
- **ISAs.** There is no additional income tax or capital gains tax payable under a stocks and shares ISA, so income can be taken tax-free (though there is a 10% tax credit on dividend income applied that cannot be reclaimed).
- **Investment bonds.** Up to 5% of the original investment can be taken each year without creating a chargeable event. If the tax-deferred allowance is not taken each year, any unused amount can be carried forward for future use. There are differences between how onshore and offshore bonds are taxed. This is explored in the previous section. Using the starting rate for savings, someone could potentially have a chargeable gain on an offshore bond of £17,570 (depending on their total taxable income) without any liability to tax, increasing to £18,570 if the Personal Savings Allowance is used.
- **Unit trusts, investment trusts and OEICs.** The first £500 of dividend income is covered by the dividend allowance which is tax-free. Dividends above this amount will be taxable at 8.75% for basic-rate taxpayers, 33.75% for higher-rate taxpayers or 39.35% for an additional-rate taxpayer. There is also the capital gains allowance of £3,000.

Someone could potentially have a chargeable gain on an offshore bond of £17,570...without any liability to tax.

Step 4: Leverage equity in the home

There are a number of ways to generate a tax-free income from the home:

- **Rent a room.** This is not about leveraging property equity, but is included here for completeness. Renting a furnished room in the client's main residence can generate a tax-free income of up to £7,500 per year.
- **Downsizing.** At some point, it may make sense to downsize. The house may be too big after the children have left home and the upkeep of the home could be challenging.
- **Equity release.** Many people are reluctant to sell the family home. For these reasons, equity release is becoming more popular than ever before. It can be a valuable way to release money tax-free.

Equity can be used to supplement income or act as a backstop if other funds run dry. Alternatively, it can be used to pass on wealth to the next generation or to cover any major ad hoc expenditure during retirement. Equity release products have benefited from the low interest rate environment, but more recent increases have impacted sales of these products. Home reversion plans have largely been superseded by lifetime mortgages. More recently, retirement interest only mortgages have emerged. These products meet different needs. A comparison is shown below:

Chart 8: Lifetime mortgages v retirement interest only mortgages

Retirement interest only mortgage	Lifetime mortgage
Borrowing limit based on affordability	Borrowing limit based on age and property value
Interest payments are required monthly	No compulsion to make regular payments
Interest rate fixed for defined period	Interest rate fixed for life
Any shortfall payable on death or maturity	Never owe more than the value of the property
Property can be repossessed if monthly payments in arrears	Right to remain in the home for life or until moved permanently into long-term care

The FCA has said that 'generally, firms approached lifetime lending as a distinct and separate area of advice, only tending to bring this into consideration as a last resort for relevant customers.' Equity in the home can become a pillar of retirement planning and considered whenever there is a shortfall in the income the client needs or wants to provide their desired standard of living in retirement.

Step 5: Consider working after retirement

More and more people are transitioning to retirement by gradually reducing the hours they work or moving to a less demanding role. The key issue for these people is that earnings are generally lower so there may be a need to top up. In calculating any shortfall, remember that NI contributions are no longer payable over State Pension age and some costs, commuting perhaps, could reduce, so the gap may be less than the difference in earnings. Nevertheless, if a gap does exist, there are ways to deal with this:

More and more people are transitioning to retirement by gradually reducing the hours they work or moving to a less demanding role.

State Pension

Someone who has reached State Pension age could simply take their State Pension to top up any shortfall in earnings. However, it's not possible to take part of the State Pension, which means the State Pension could push someone into a higher tax bracket. At best, it may simply provide more income than the client needs (though it could be used to fund further pension contributions under the right circumstances).

Top up from private pensions

It could make sense to top up any shortfall from private pensions. If so, the following should be borne in mind:

- Leaving aside the tax-free cash element, income from private pensions is taxable so this approach could push someone into a higher tax bracket.
- Taking income could trigger the MPAA. This may be less relevant now the MPAA has been increased to £10,000 (though carry forward can't be used to fund contributions to a DC pension plan above the MPAA limit).
- Using the tax-free cash sum to top up income would not trigger any reduction in the MPAA or lead to an increase in tax payable. Also, less income would need to be withdrawn because of the tax-free status.
- Income from a lifetime annuity or any defined benefit income would not trigger the MPAA, but would be taxable. If the retirement journey begins at a relatively young age, annuity rates may not be that attractive.
- DB pensions usually apply an actuarial reduction if income is taken early.

An alternative source of income to top up any shortfall could be other savings and investments, particularly those which are tax advantaged. When a tax-free solution is used, the amount required will be less than if it's drawn from a taxable source. Making up any shortfall from sources other than pensions also preserves the favourable tax status on death of funds held in pensions before age 75.

Key points

- Advisers should take a holistic view across all of a clients' assets including State Pensions, private pensions, non-pensions savings and home equity.
- Working after retirement, and a gradual transition to a life without work, is becoming increasingly popular.
- State Pensions are important. An estimate should be obtained, added years bought if appropriate, deferment considered and an application made when payment should start.
- Drawdown remains the most popular choice among retirees, despite increased annuity sales (there is a case for hybrid solutions including an annuity within drawdown).
- Other savings and investments are often used and can usually provide a tax-efficient income to supplement other income or preserve pension pots for inheritance purposes.
- Property equity is often notionally earmarked as a legacy to pass on, but can play a valuable role in retirement planning.

Summary

- There are two important trigger points when people are preparing for retirement. Firstly, around 5-15 years before retirement when people have the motivation to increase their retirement savings and the means to act on it. Earlier in their life, other financial issues often dominate and retirement can seem a long way off. Secondly, the period immediately prior to the start of their retirement journey when critical decisions need to be made about how to deploy their retirement savings.
- When people are 5-15 years away from retirement, they may not understand how much they need for a comfortable retirement nor how close they are to achieving it. This is unsurprising. These calculations should take stock of the value of savings to date and the value of future savings plus state benefits, any defined benefits and other savings and investments. Many advisers will have software that can assess the position.
- Where there's a shortfall there are a number of ways people can address this. Commonly, they may choose to save more or retire later. Perhaps even a combination of the two. Other options could include a more adventurous investment strategy, using assets perhaps earmarked for other purposes, taking more than the recommended withdrawal rate or continuing to work during retirement.
- Where clients are keen and able to save more, this begs the question of which savings vehicle to use? This is usually framed as a choice between pensions and ISAs. There are valid reasons why an ISA may be the answer, but in purely financial terms the pension will be the solution in most cases. Beyond this, other tax advantaged products like onshore and offshore bonds and collective investments are often considered. The right choice between these products is less obvious and will depend on individual circumstances.
- As retirement draws near there are important options to consider, decisions to be made and actions to take. Advisers should take a holistic view of all the assets a client can use to create a comfortable retirement. This will include State Pensions, private pensions, other savings and investments and property equity. It should also extend to income from work during retirement as more people gradually transition to retirement over several years.

- A significant area of focus for advisers and their clients will be how to use pension savings. There is little evidence that people are taking all of their pensions funds as cash (small funds aside), so the main choices are an annuity or drawdown. Advisers should also consider hybrid solutions. There is a growing body of evidence that in certain circumstances a combination could be the optimal strategy.
- The FCAs thematic review of the retirement income advice market suggests a mixed picture with several areas identified for improvement. The concerns raised in the review should be borne in mind as advisers develop or refine their advice models for decumulation to ensure that as many people as possible enjoy the retirement they've worked to provide.

Important information

This document provides information and is only intended to provide an overview of the current law in this area and does not constitute financial advice, tax advice or legal advice, or provide any recommendations. The value of benefits depends on individual circumstances. The minimum age clients can normally access their pension savings is currently 55, and is due to rise to 57 on 6 April 2028, unless they have a lower protected pension age. Different options may have different effects for tax purposes, different implications for pension provision and different impacts on other assets and financial planning.

Past performance is not a guide to future returns. The value of the fund and the income from it can go down as well as up so you may get back less than you invested.

More insights on tax and pensions

We're committed to providing you with technical support to help you keep pace with the latest rules and legislation. Our range of practitioner material is designed to help you keep on top of all aspects of retirement planning. Themes covered include death benefits, pensions and divorce, the State Pension, pension withdrawals taxation and much more.

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