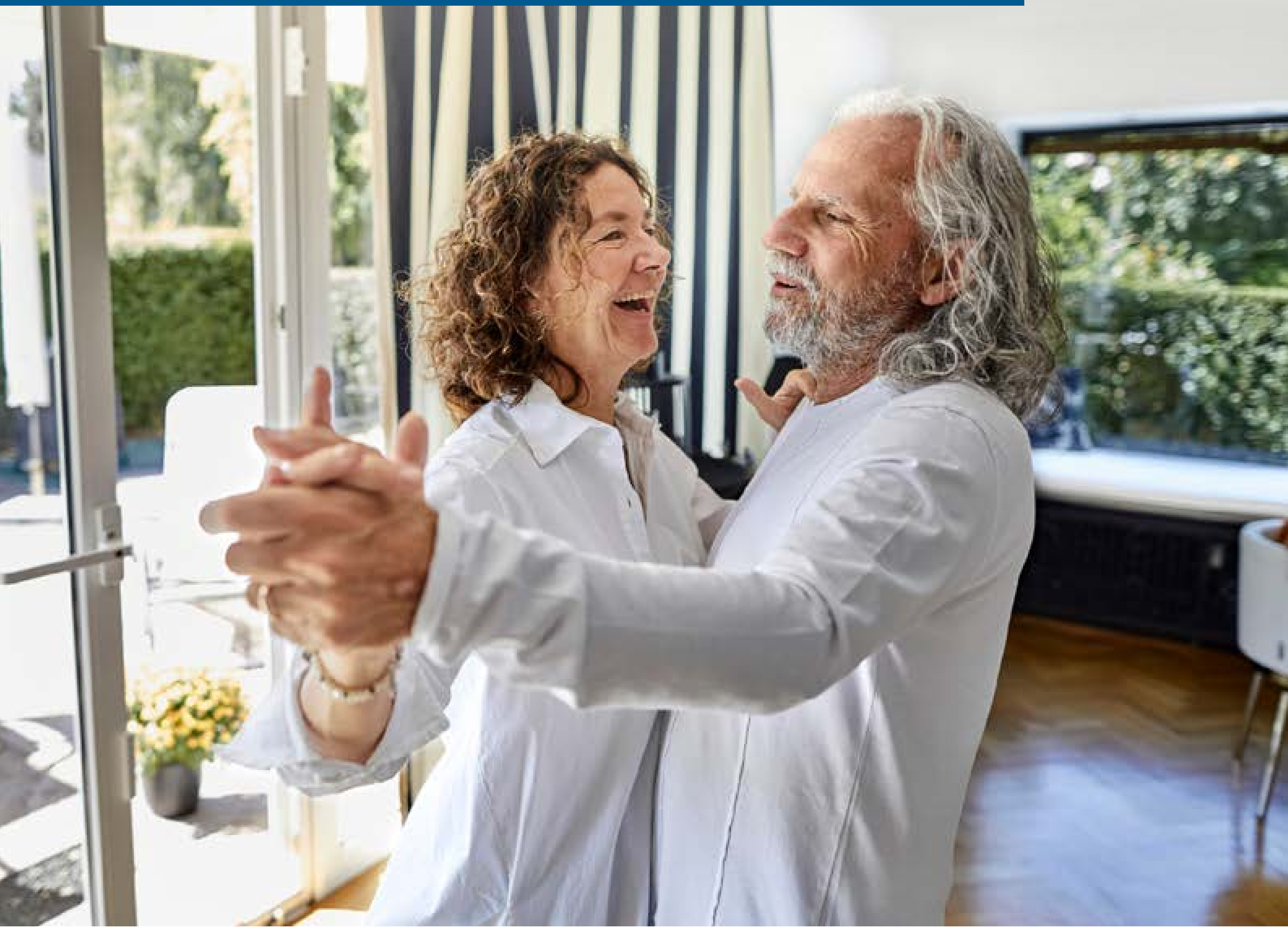
Reinventing retirement

Pension decumulation



Adviser Solutions

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Introduction

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The word 'unretired' has recently entered the financial services lexicon. It's used to describe people who've left the workplace to retire and subsequently decide to return to work. For some it may be a simple matter of finance: They discover they haven't enough for a comfortable retirement and need to supplement their income. Others may miss the opportunities to socialise or perhaps the sense of purpose and fulfilment of a job well done.

Whatever the reason the 'unretired' are just one part of a fluid movement towards a more progressive concept of retirement. Increasingly, people no longer stop work abruptly one day and retire the next. They may transition gradually, perhaps working fewer hours or taking on a less demanding role. Maybe they've always wanted to be their own boss and start a business. The 'unretired' form part of this new, intangible approach to retirement, where it's not always possible to know exactly when work ends and retirement begins.

This creates new challenges for financial advisers. Retirement is no longer a 'one and done' process. Advisers must plan for a series of events that may require different solutions at each inflexion point. This places additional responsibility on advisers as clients move through various stages towards outright retirement. Advisory firms need robust processes to ensure the client's assets are employed efficiently to meet their goals at each stage.

In 'Reinventing retirement', we consider some of the implications of this seminal change in retirement and review the issues advisers should consider in developing solutions. We also look at a practical example to demonstrate how complex retirement planning can become.

The lack of a fixed retirement date has catalysed a new approach to retirement offering people much greater control over how and when they leave the workplace. It's essential that financial advisers have the tools to respond to this fundamental shift. Retirement in the 21 century will bear little comparison with retirement in the last century. We are entering a brave new world of retirement planning.

Contents

Reinventing retirement

The Beatles and the Rolling Stones battled it out for the number one slot. Mary Quant pioneered the mini skirt and a man landed on the moon. The swinging sixties was a period of optimism epitomised by innovation, cultural change and discovery.

Yet retirement remained a much more traditional process. By and large, men retired at 65, women at 60. The state pension started at the same time and there was no option to defer payment. Company pensions were mostly final salary schemes. In 1967, more than eight million employees working for private companies enjoyed a final salary pension, along with four million state workers[1]. Once retired, men could expect to live on average for 12 years to age 77. Women until 80[2]. The process of retiring was simple. Most people had to answer just one simple question: Should they commute part of their pension for a tax-free lump sum?

How times change. These days there is no longer a default retirement age. People can choose when to retire. Generous guaranteed final salary pensions have mostly given way to defined contribution schemes. Only 9% of defined benefit schemes are still open to new entrants, and fewer than 800,000 people still make contributions (out of a total of 9.8 million scheme members)[3]. Average life expectancy at 65 has increased to 85 for men and 88 for women[4]. An increase of more than 50%.

What's more, the risks associated with retirement have been transferred from the employer to the employee and drawdown is becoming the product of choice for most people[5]. This gives rise to a more complex decision making process: Choosing the right product, defining the asset allocation, picking investment funds, selecting the withdrawal rate. And much more.

1. A turbulent history of British pensions, since 1874, Telegraph Media Group Limited, April 2015.
2. Mortality improvements and evolution of life expectancies, Adrian Gallop, UK Government Actuary's Department.
3. Investing in our future: delivering for savers and the economy, The ABI, June 2023.
4. Life expectancy calculator, ONS, March 2025.
5. Retirement income market data, FCA, September 2024.

The new world of retirement

Swinging sixties		21st century
Fixed	**Retirement age**	Variable
Mostly Defined Benefit	**Private pension**	Mostly Defined Contribution
10-15 years	**Average life expectancy at 65**	20-25 years
Simple	**Decision making**	Complex

This combination of less generous pension scheme provision (defined benefits schemes have historically been more generous than defined contribution plans), without guarantees, coupled with the need to provide income for much longer periods, has fuelled a transformation in the nature of retirement.

Aided by improvements in health, and the abandonment of a fixed retirement date, retirement has become a more nebulous, indistinct concept. It's not always obvious where work ends and retirement begins. This new approach has led to retirement being characterised as a 'journey', rather than a single event. The desire to transition gradually to retirement may be motivated by a need to boost savings, but it can be symptomatic of other issues. It could be to maintain the social benefits that work can bring and stave off loneliness. It may be a desire to stay active mentally and/or physically. Perhaps it's to maintain the status and self-esteem work often confers. And of course, there are people who simply enjoy their job so much they are reluctant to retire completely.

The signal that retirement has begun in some shape or another is usually triggered by a significant change in our working lives. This can take many forms. It may start with a reduction in working hours to flexible or part time work or a change in role to something less stressful. It could be a switch from employment to self-employment or starting a new company. According to Age UK, the number of self-employed people aged 65 and over has more than doubled in the past five years[6]. ONS statistics show from April to June 2022, the number of people aged 65 years and over in employment increased by a record 173,000 on the quarter to 1.468 million, which was also a record level. This increase was driven by a rise in part-time work[7].

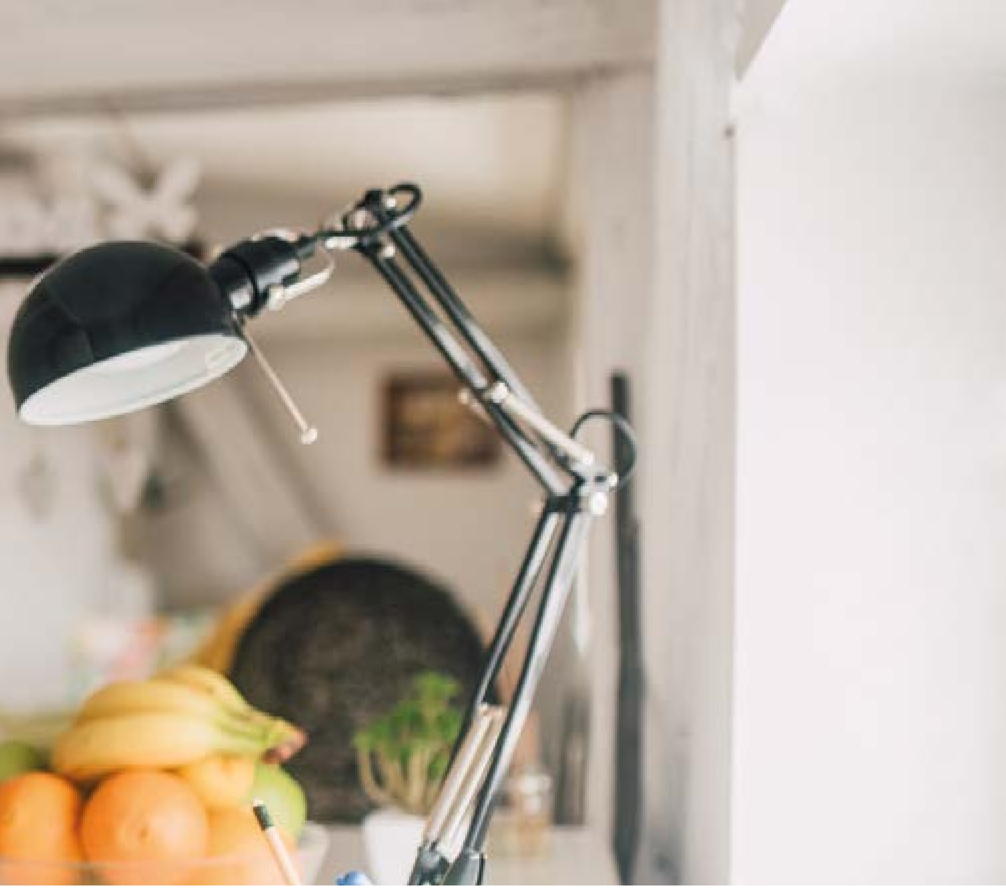
A poll of 2,400 people in the UK, conducted by Fidelity International, found that while most workers planned to retire from their primary job at the age of 66, 52 per cent expected they would continue to work at least part time in their retirement. The survey also found 45 per cent expected to work past the age of 70, and nearly one in 10 (9 per cent) planned to keep working into their 80s[8].

This new flexible approach to retirement can take a variety forms:

- Working full time beyond State Pension age.
- Moving to part time work or a less well paid role.
- Leaving full time employment to become self employed.
- Setting up a company.
- Retiring outright, then returning to the workplace.

"According to Age UK, the number of self-employed people aged 65 and over has more than doubled in the past five years.

6. Be your own boss, Age UK, February 2025.
7. People aged 65 years and over in employment, UK: January to March 2022 to April to June 2022, ONS, September 2022.
8. People Management, Jessica Brown, November 2019.



It could be argued that people starting a business or becoming self-employed haven't retired or even begun the transition to retirement. They could still be working long hours. But when someone chooses this route later in life, it's often a sign. A change made possible because they can access pension savings, if necessary, and often have fewer financial commitments. In other words, they can take control. This degree of financial independence creates the opportunity to make the break. To do something they may have always wanted to do. In this sense, it signals the end of an era where the burden of work to earn money and discharge responsibilities dominated and the beginning of a journey characterised by self-fulfilment, a better work/life balance and greater control of one's destiny. Ultimately, this will usually lead to outright retirement at some point and so can legitimately be considered the beginning of a transition towards retirement.

Key points

- With the demise of defined benefits, risk has been transferred from the employer to the employee and the decisions around retirement are much more complex.
- The process of retirement as a single event is less relevant as more people transition gradually to retirement – it's not always clear when work ends and retirement begins.
- There are many reasons why people continue working as part of their retirement: Generate income, social benefits, self-esteem and sometimes the sheer pleasure of work.
- Various options exist from continuing to work indefinitely, reducing hours or taking a less demanding role, becoming self-employed or starting a small business.
- In some cases, people retire then subsequently return to the workplace.

How do I retire?
‘Let me count the ways’

There are so many ways to retire these days, let’s look at the more common options and consider some of the issues raised by different approaches:

Continuing to work beyond State Pension age

There is no longer a default retirement age. Nevertheless, the evidence suggests that most people still retire around age 65[9]. Let’s consider someone who wants to continue to work in their current role beyond State Pension Age without reducing their working hours. In this case, here are some of the issues to consider:

- **State Pension.** Should the State Pension be deferred? As the State Pension is taxable it could push someone into a higher tax bracket. If this isn’t the case, it could be used to boost income further, used to help fund further pension contributions or deferred to provide a higher income later. Bear in mind, National Insurance contributions are no longer payable after State Pension age, so net income should increase anyway. Also, the benefits of deferring the State Pension are less generous under the new flat rate scheme.
- **Ongoing pension contributions.** Anyone under age 75, who hasn’t taken more than the tax-free lump sum from their pension or other benefits that would not trigger the MPAA, can continue to make pension contributions up to the annual allowance of £60,000 (2025/26). Even if benefits have been taken that trigger the MPAA, up to £10,000 can be paid each year (though the carry forward provisions can’t be used to fund more than £10,000).
- **Sustainable withdrawal rates.** The later someone leaves it to start taking an income from their pension savings the more they could withdraw when they eventually decide to take benefits. A Morningstar study suggests that for a 30 year term, a 90% probability of success and a 40/60 equity bond split, 3.7% is a safe withdrawal rate. This would take the average 65 year old retiree to age 95. Someone retiring at 70 could take 4.3% with a 90% probability of success over a 25 year period or 5.2% from age 75[10].
- **Lifetime annuities.** At a certain age, the income from an annuity is difficult to match from other investments because of the impact of mortality credit. For example, a 75 year old can currently achieve an income of over £9,500 each year for a £100,000 purchase price[11].

There is no longer a default retirement age. Nevertheless, the evidence suggests that most people still retire around age 65.

9. Retirement age in the UK: When can you retire and get your state pension?, Moneyfarm, December 2022.
10. The state of retirement income: 2024, Morningstar, December 2024.
11. Hargreaves Lansdown, single life, level income, no guaranteed period, March 2025.

Moving to part time work or a less well-paid role

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:

- **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.
  - Defined benefit pensions usually apply an actuarial reduction if income is taken early.
- **Other savings and investments.** An alternative source of income to top up any shortfall could be other savings and investments, particularly those which are tax advantaged like ISAs or the tax deferred status of investment bonds. Utilising the CGT allowance, dividend allowance and personal saving allowance may also create additional income tax free. More radical solutions could include downsizing or equity release (though these are unlikely to be the first port of call for most people).

Whenever a tax-free solution is used, the amount required will be less than if it's drawn from a taxable source.

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

Becoming self-employed

More and more people are beginning their retirement journey be moving from full time employment to self-employment. In 2023, there were nearly 1m self employed people aged 60 or over of which 223,086 were aged over 70[12]. The key risk is a shortfall in income, but unlike employees who reduce their working hours or take less well paid roles, their income requirements are likely to be variable. This has implications for anyone looking to supplement any shortfall in income:

- **State pension.** The State Pension can't be varied. This means in good years it may be more than is needed and could push someone into a higher tax bracket (though the previous comments about the less generous terms on deferral and the potential to fund further pension contributions should be considered).
- **Topping up from private pensions.** It could make sense to top up any shortfall from private pensions but, as with part time work or a less well paid role, similar considerations apply:
  - Leaving aside the tax-free cash element, private pensions are taxable, so this could push someone into a higher tax bracket.
  - Taking income could trigger a reduction in the annual allowance. The MPAA has recently been increased to £10,000. Nevertheless, a reduced allowance may inhibit flexibility and carry forward can't be used to fund contributions above the MPAA limit.
  - Tax-free cash could top up income tax efficiently and would not trigger the MPAA. Likewise income from a lifetime annuity or a defined benefit scheme, but both provide a fixed or increasing income, which may not be suitable.
- **Other savings and investments.** An alternative source of tax-free income to top up any shortfall could include other savings and investments like ISAs, the tax deferred status of investment bonds or utilising the CGT allowance.

"There are almost 1m self-employed people between 55-65 and more than 400,000 people over 65 who are self-employed.

12. UK has record 991,000 self-employed workers aged 60 or over, The Guardian, August 2024.

Starting a company

Some people may choose to do their own thing by starting a Limited company rather than becoming self-employed. This introduces additional considerations. In particular, the interplay between income and dividends:

- There is a dividend allowance of £500 (2025/26). Dividend payments in excess of this are treated as the top slice of income and taxed at 8.75% for basic rate taxpayers, 33.75% for people paying higher rate tax payer or 39.35% for anyone paying the additional rate. It will usually make sense to take advantage of the dividend allowance and the reduced rate for dividends, particularly the 8.75% basic rate.
- The personal allowance of £12,570 is still available so, someone who has reached State Pension age, could set the State Pension or other taxable income against their personal allowance.
- Other tax advantaged savings and investments could be deployed to make up any income requirements above the basic rate, without undermining the preferential tax regime for dividends.

The right course of action will depend on each client's personal circumstances, but the availability of dividend payments can introduce additional considerations for people who start a limited company after retiring from their main employment.

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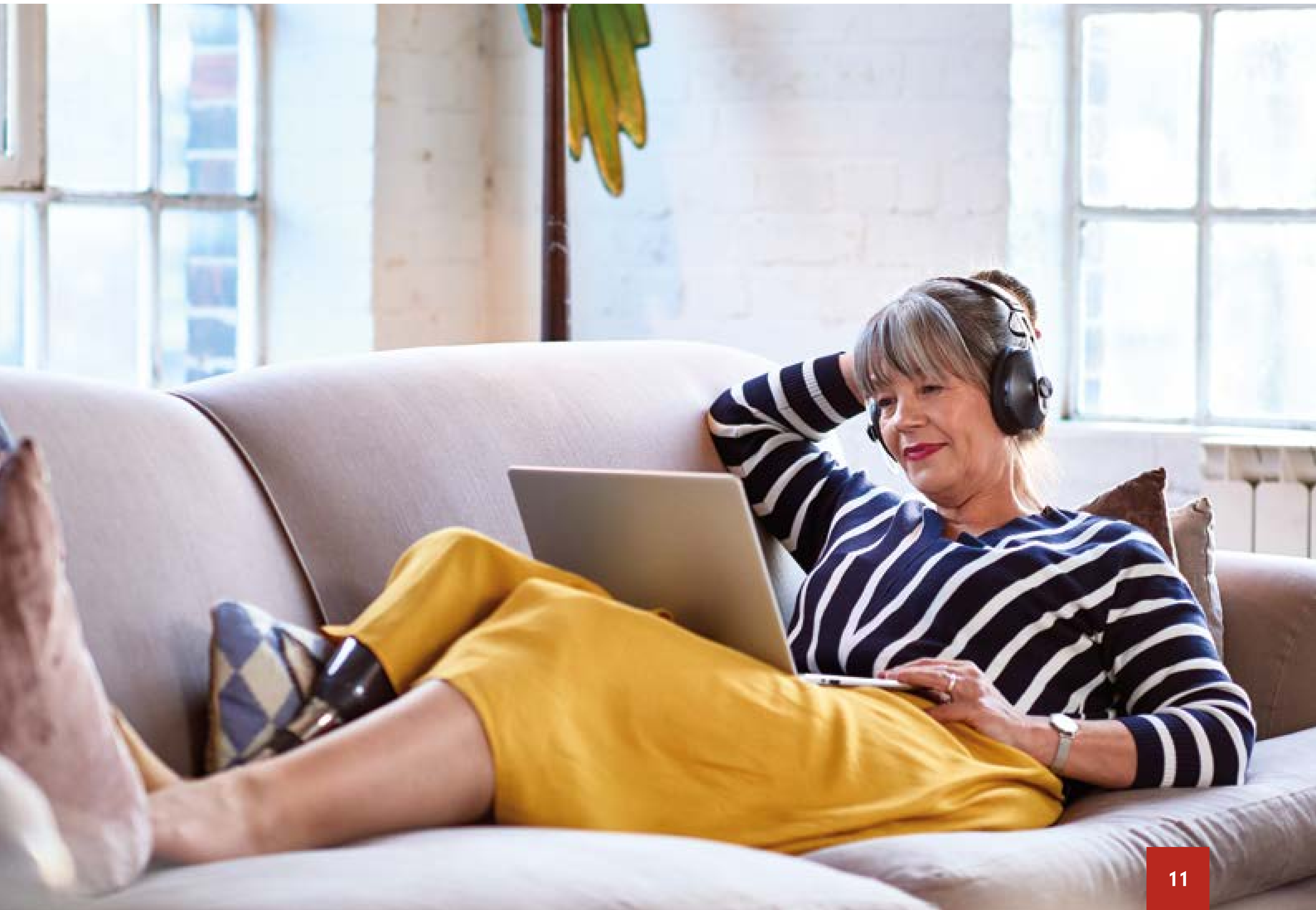


Returning to work after retirement

Increasingly, people may retire and then return to work in some capacity. They may have chosen to take a few years out, akin to an extended sabbatical or they may be disillusioned with retirement – doing nothing can seem desirable, but boredom can set in. For some people, the main reason is the most obvious: The realisation that they don't have enough money to enjoy a satisfying retirement. For anyone who has retired and decided to return to the workplace, there are a number of issues to consider:

- **Auto enrolment.** Anyone returning to the workplace who is below the State Pension age and earning above £10,000 should automatically be enrolled into a workplace pension scheme. People over State Pension age won't automatically be enrolled, but should be given the option of joining a workplace pension scheme.
- **Workplace pension.** If benefits, other than the tax-free lump sum, income from a lifetime annuity or benefits from a defined benefit scheme, have or are being taken the MPAA will apply.
- **State pension.** Even if the State Pension is already being paid it can be stopped if someone returns to the workplace. This will boost their State Pension when it is reinstated. This can only be done once and it is necessary to contact DWP. The date to stop payment cannot be a date in the past or more than four weeks into the future. Someone returning to work under State Pension age can choose to defer payment of their State Pension age when it becomes due.
- **Private pensions.** Someone returning to the workplace may want to reduce or stop any income they receive from their private pensions. This should allow them to take a higher income when they eventually retire outright. Of course, they may not have this option. Benefits received from a defined benefit scheme can't usually be stopped nor can the income from a lifetime annuity (though in the case of the latter, the income doesn't have to be taken if it's established as an asset of a drawdown fund).

"For some people, the main reason is the most obvious: The realisation that they don't have enough money to enjoy a satisfying retirement.

Key points

- Continuing to work full time after retirement raises the question of whether to take or defer State Pension.
- Part time work or lesser paid work invariably leads to a gap in earnings. There are several ways in which any shortfall can be made up.
- Becoming self-employed may also lead a reduction in income, but any shortfall may differ from year to year. This has implications for how best to replace any income.
- Starting a small business by setting up a limited company introduces the option of taking dividend income.
- Returning to the workplace after retirement raises a series of questions: For example, should the State Pension be stopped or deferred if not yet payable?

Overview of different types of flexible retirement

State Pension	Private pensions	Savings and investments	Other considerations
Continuing to work beyond State Pension age			
■ Consider deferring State Pension assuming income unchanged or use it to fund further savings or pension contributions. ■ No NICs payable so net income increases anyway.	■ Membership should be unaffected. ■ DB pensions may not continue to grow past State Pension Age.		■ Automatic enrolment doesn't apply to workers aged 75 or over and tax relief is no longer available. ■ Sustainable withdrawal rate and annuity rates should both improve if continuing to work.
Moving to part time work or a less well-paid role			
■ If eligible, State Pension can make up any shortfall, but 100% must be taken which could be more than required. ■ No NICs payable if beyond State Pension Age.	■ Any shortfall could be covered by pension income, but this could trigger MPAA. ■ Tax-free cash could be used to avoid MPAA. ■ A lifetime annuity or any defined benefit income would also mean MPAA not triggered.	■ Tax-free savings and investments like ISAs could be used to gap fill. ■ Tax-free status means less income needed.	■ Increase in MPAA to £10,000 may mean fewer people affected. Carry forward provisions can't be used to fund more than the MPAA. ■ Taking benefits from a DB scheme before the selected retirement date will often result in an actuarial reduction being applied.
Becoming self-employed			
■ Income from self employment can be variable. If top up required State Pension may be too much or too little. ■ Class 2 NICs have been abolished for self employed individuals with profits over the small profit threshold. ■ Voluntary class 2 NICs can still be paid where profits are less than the small profits threshold up to State Pension Age.	■ Pensions savings could be used, but same considerations as per people working part time or in a lower paid role apply. ■ A lifetime annuity or DB income might not be ideal as income cannot be varied and an actuarial reduction may apply if DB benefits taken early.	■ Same considerations as per people working part time or in a lower paid role.	
Starting a company			
■ If State Pension Age reached, the State Pension can be set against the personal allowance or stopped if in payment. ■ If the State Pension isn't payable yet, it can be deferred when State Pension Age is reached. ■ No NICs payable after State Pension Age.	■ Treatment of dividend income requires careful tax planning. It may make sense to take income over personal allowance as dividend income if possible. ■ Tax-free cash could be used to top up any shortfall in income and would not trigger MPAA.	■ Tax-free savings and investments could be used to gap fill without reducing the advantageous treatment of dividend income. ■ Tax-free status means less income needed.	■ There is a dividend allowance of £500 (2024/25). Dividend payments in excess of this are treated as the top slice of income and taxed at 8.75% for basic rate taxpayers, 33.75% for people paying higher rate tax payer or 39.35% for anyone paying the additional rate tax payer.
Returning to work after retirement			
■ The State Pension can be stopped if someone returns to the workplace. This can only be done once. ■ Someone returning to the workplace under State Pension Age can defer payment of their State Pension when it is due.	■ Income received from private pensions can be reduced or stopped (this is not possible for income from DB scheme or lifetime annuity). ■ Anyone below State Pension Age earning above £10k should automatically be enrolled into a workplace pension. People over State Pension Age should be given the option of joining a workplace pension to age 74.	■ Tax-free savings and investments could be used, if required, to make up any shortfall in income if this is more advantageous.	■ If benefits have or are being taken the MPAA will apply, unless these are exempt. For example, tax-free lump sum, lifetime annuity, benefits from a defined benefit scheme.

The role of a centralised retirement proposition

In its thematic review of retirement income advice, the FCA expressed concern that not all firms recognised the different needs of customers in decumulation. A CRP is a step towards acknowedging the differences that exist[13].

Research by Wealthtime and Copia Capital suggests that the nunmber of firms using a Centralised Retirement Proposition (CPD) has increased significantly in the wake of the FCA's thematic review[14].

This is good news. More and more advisers are becoming aware of the benefits of a CRP. The antecedent of the CRP is the Centralised Investment Proposition (CIP). CIPs focus on the accumulation phase, but there are significant differences between accumulation and decumulation as shown below.

Accumulation is very different from decumulation

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

13. Retirement income advice thematic review, FCA, March 2024.
14. Advisers change retirement propositions in wake of FCA review, FT Adviser, November 2024.

Investment risk

During the accumulation phase, the goal is to build capital and the adage to 'start early and save as much as possible' is usually sound advice. The general rule of thumb is that a diversified portfolio, weighted towards higher risk assets like equities, makes sense. Over the longer term, equities will tend to outperform more conservative asset classes and market volatility is less of a problem, particularly in the early years. Market falls can be ridden out and the impact is lessened because money isn't being withdrawn.

Traditionally, most people bought an annuity with their defined contribution savings. In this environment, pension savings would be gradually moved to less riskier assets as the timing of the annuity purchase draws near. These days, drawdown sales are more than three times the level of annuity sales[15]. With retirement lasting 20-30 years it's important to have continued exposure to higher risk asset classes, but it is a careful, balancing act. Sequencing risk needs to be considered and strategies devised to combat this. This may include keeping a cash bucket to fund income over two or three years and ride out any volatility or using smoothed funds which avoid the highs and lows of investing in equities.

There are other considerations too. Some apply during the accumulation phase, but require review for the decumulation phase:

- **Attitude to risk.** It's not necessarily the case that attitude to risk is similar during the accumulation and decumulation phase. There is evidence to suggest that as we age attitude to risk changes. A 2020 study concluded that 'risk aversion concerning financial decisions increases in older cohorts'[16]. The act of retirement may also have an influence[17]. People no longer have the cushion of a regular salary. Instead, they are drawing on savings that are finite. This can be unsettling.
- **Capacity for loss.** Defined as 'The customer's ability to absorb falls in the value of their investment', capacity for loss is a critical element of any CRP. It requires a deep understanding of the client's resources and their expenditure to be able to stress test how much risk clients can take without exposing themselves to peril.

The FCA thematic review also referenced the need to adapt attitude to risk and capacity for loss questionnaires for the decumulation phase[18].

> **These days, drawdown sales are nearly three times the level of annuity sales.**

15. Retirement income market data 2023/24, FCA, September 2024.
16. Mónika Kuti – Zoltán Schepp, Aging Society and Attitude to Risk, Public Finance Quarterly, 2020/4.
17. Wang Hui, Hanna Sherman – Does Risk Tolerance Decrease with Age?, Financial Counseling and Planning, Vol 8(2).
18. Retirement income advice thematic review, FCA, March 2024.

Longevity risk

In the accumulation phase generally the time horizon is known. Most people have an idea of when they plan to retire and work towards that goal. Of course, things don't always turn out the way they'd like, but deviation isn't usually too far from the original plan and the consequences are often inconsequential.

If someone works beyond the date they anticipated this can give them the opportunity to save.

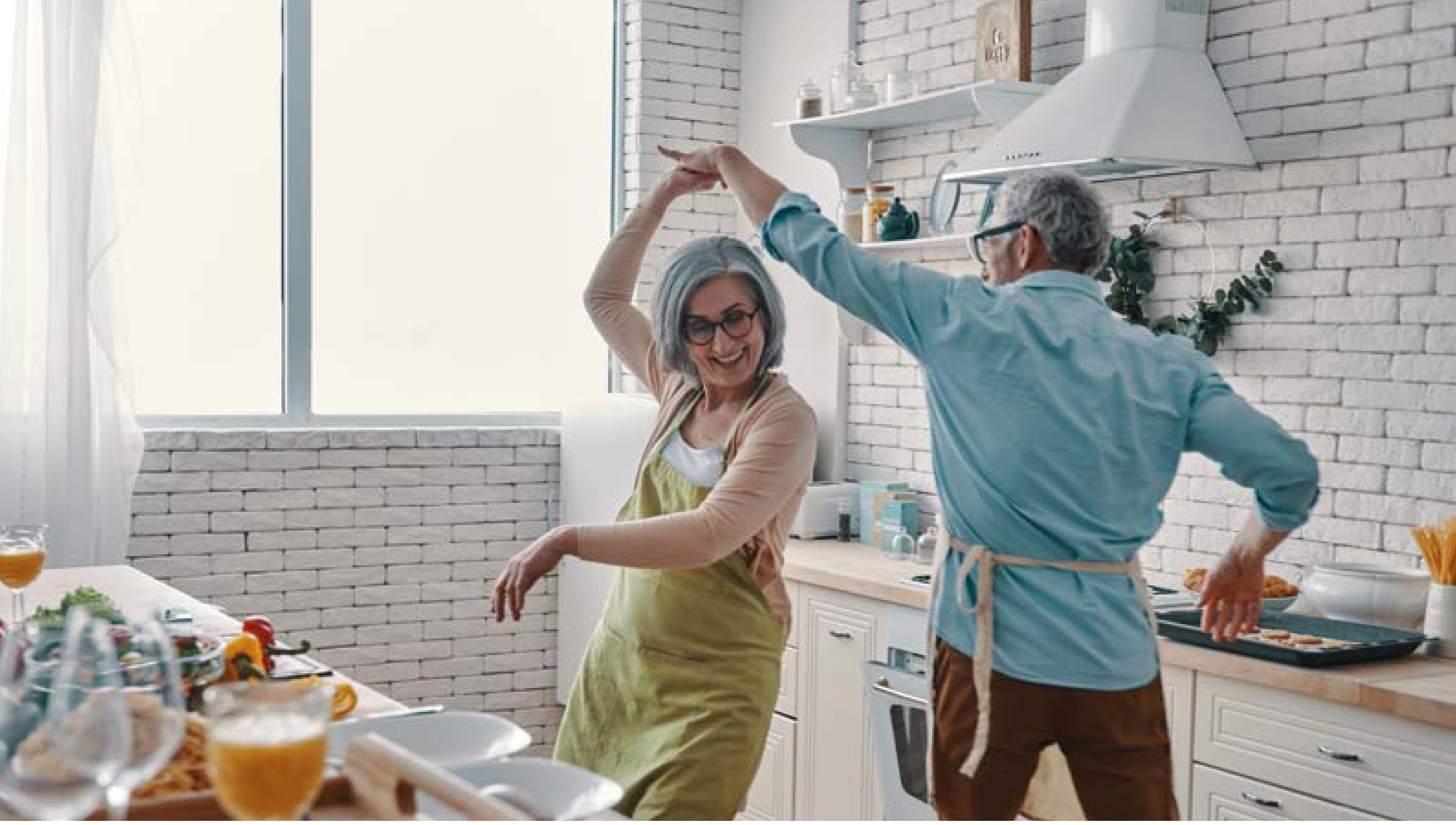
Taking benefits sooner than anticipated can be more problematic, particularly if it's enforced through ill health or redundancy. In these cases, it may be necessary to adjust expenditure to align with savings but, by and large in the accumulation phase, the time horizon is fixed or flexed within narrow parameters.

Contrast this with the decumulation phase. Not only is the time horizon unknown, but the consequences of getting it wrong can be substantial. For example, average life expectancy is a useful way to track improvements across the population as a whole, but it's less effective in forecasting individual life expectancy. Probabilities are a better lens through which to build a more helpful understanding of mortality, but can produce wide variations. A 65 year old man has an average life expectancy to 85, but a 1 in 4 chance of living to 92 and a 1 in 10 chance of living to 96[19]. He could even join the more than 15,000 people in the UK over 100[20].

It's little wonder that many advisers suggest planning to live to 100. This is a safe option to avoid clients running out of money, but can throw up a separate set of issues. The safe withdrawal rate for a 65 year old over a 35 year period has been estimated at 3.4% based on a 90% probability of success and a balanced portfolio[21]. For many people, it will be challenging to live comfortably on the income this produces. Someone with £500k pension savings may consider they're comfortably off, but 3.4% delivers a yearly income of less than £20,000. State Pension and other assets can boost this figure, but many retirees might be disappointed with the outcome. The calculation of the safe withdrawal rate suggests that money might run out beyond this period, but in many instances it won't. William P Bengen, calculated that for US retirees 4% is a safe withdrawal rate over 30 years, but separate analysis of US data over a 140 year period revealed that retirees withdrawing 4%, would have only a 10% likelihood of ending up with less than their initial capital after 30 years and a 10% chance they would have 6 times their original capital[22].

"It's little wonder that many advisers suggest planning to live to 100. This is a safe option to avoid clients running out of money, but can throw up a separate set of issues.

19. ONS, Life expectancy calculator, March 2025.
20. Estimates of the very old, including centenarians, UK: 2002 to 2020, ONS, January 2024.
21. The State of Retirement Income: 2024, Morningstar, December 2024.
22. The Extraordinary Upside Potential Of Sequence Of Return Risk In Retirement, Michael Kitces, February 2019.



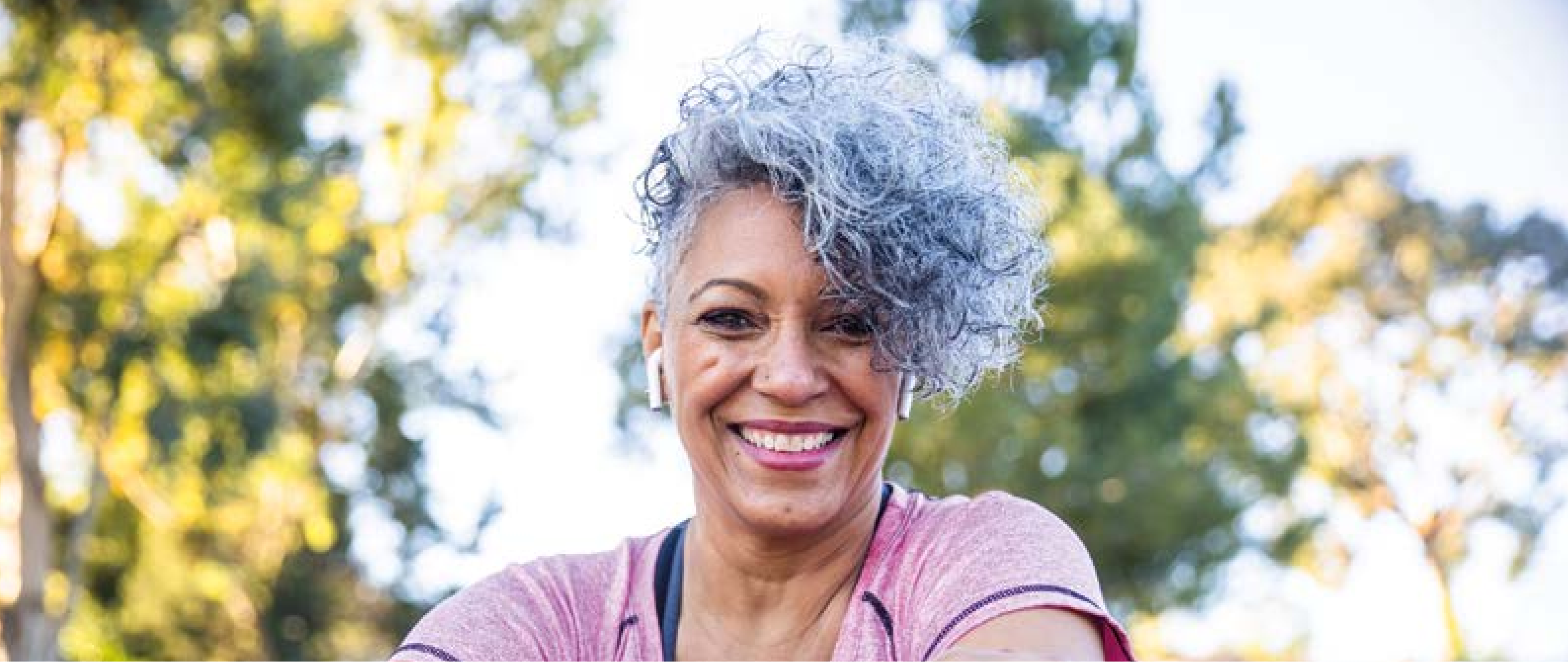
Withdrawal rate risk

This brings us to the question of how to manage withdrawal rates. There are a number of issues that this raises:

- **Proportion of guaranteed income.** There is a view that it can make sense to cover essential expenditure with a guaranteed income stream:
  - State Pensions and any defined benefits can contribute to this with any balance provided by a lifetime annuity.
  - What constitutes essential expenditure is a matter of conjecture. Intuitively, this covers the basic requirements of food, shelter and clothing, but should advisers protect expenditure beyond this? Expenditure that, whilst not essential, makes a valuable contribution to quality of life? In other words, if playing golf is an important requirement for an enjoyable retirement shouldn't this be included?
  - There is a growing body of evidence that including annuities in a drawdown portfolio can boost the likelihood of income lasting a lifetime and even increase death benefits over the long-term too[23, 24, 25].

> **Essential expenditure is a matter of conjecture. Intuitively, this covers the basic requirements of food, shelter and clothing, but should advisers protect expenditure beyond this?**

23. Can we help consumers avoid running out of money in retirement?, Institute and Faculty of Actuaries, March 2018.
24. Annuities reinvented: Are annuities the missing asset class for sustainable drawdown solutions?, Milliman, October 2018.
25. More recently, Abraham Okusanya, Timeline CEO, substituted half of the bond element in a 60/40 drawdown portfolio for an annuity, resulting in a 60/20/20 split. The results showed that introducing the annuity element boosted the fund value over the long term.



- **Sustainable withdrawal rates.** Another key aspect of any CRP will be the selection and monitoring of withdrawal rate risk from any part of the clients' portfolio that isn't guaranteed:
  - Income needs. Some clients may not need to take the maximum they could. Limiting withdrawals can reduce tax and avoid exposure to higher tax rates. It can also preserve the amount that can be distributed on death without tax if death occurs before age 75. Even after 75, it may still be advantageous, relative to other alternatives. The government has announced that pension savings on death will be liable to Inheritance Tax from April 2027. This is likely to impact on the benefit of using pension savings to pass on wealth in this way.
  - Age and health. The older someone is the more income they can take. Their health will also play an important part. If they suffer from an illness likely to shorten life expectancy, this can impact how much they could withdraw, but care is needed. The prognosis for many illnesses is variable. For example, mortality rates for lung cancer are high compared with many cancers. Nevertheless, 10% of people diagnosed with lung cancer in England will survive for more than 10 years[26]. What's more, across all types of cancer death rates are nearly 60% higher for people living in the most deprived areas of the UK compared with the least deprived[27].
  - Total assets and probability of success. Most assessments of safe withdrawal rates are based on a 90% probability of success over a 30 year period but, as previously discussed, the result may be overly conservative. If the client has access to other assets, accepting a lower probability of success could make sense. For example, Morningstar estimate that for a balanced portfolio, a 3.7% withdrawal rate over a 30 year period has a 90% probability of success. In contrast, the safe withdrawal rate for a portfolio with a 70% equity weighting and a 70% probability of success over 30 years is 4.7%[28].

> **Most assessments of safe withdrawal rates are based on a 90% probability of success over a 30 year period but the result may be overly conservative.**

26. Cancer Research UK, 2022.
27. Cancer death rates almost 60% higher in UK's most deprived areas, Cancer Research, February 2025.
28. The state of retirement income: 2024, Morningstar, December 2024.

- **Structuring income.** A further issue for decumulation is how to structure income? The old adage, 'don't let the tax tail wag the investment dog', may have merit in the accumulation phase, but is arguably less relevant when considering how to decumulate efficiently. Using the right assets in the right way can avoid being pushed into a higher tax bracket or maximise any potential legacy. This could matter more now that both the personal allowance and the higher rate threshold have been frozen until 2028 and the threshold for the additional tax rate of 45% has been lowered to £125,140. If leaving a legacy is a major goal, the inheritance tax allowances have also been frozen until 2028 and the impact is being felt. Inheritance Tax receipts for April 2024 to February 2025 were £7.6 billion, which is £0.8 billion higher than the same period last year[29].

The process of managing decumulation is further complicated when retirement occurs gradually over several years giving rise to different considerations at each stage of the transition. For all these reasons, it's difficult to adapt a CIP to accommodate the contrasting characteristics of the decumulation phase. It will generally make sense for advisers to develop a CRP focused on the complexities of managing the challenges of retirement in the 21st century.

> **Using the right assets in the right way can avoid being pushed into a higher tax bracket or alternatively maximise any potential legacy.**

Key points

- More advisers are developing Centralised Retirement Propositions to meet the contrasting characteristics of decumulation compared with accumulation.
- Managing investment risk is a relatively straightforward process during the accumulation phase, but is much more challenging during the decumulation phase.
- The unknown time horizon during decumulation means advisers have to regularly review assumptions and balance a number of often disparate influences.
- Hybrid models which include a degree of annuitisation within an overall portfolio to protect important expenditure can provide better outcomes.
- Tax issues play a more prominent role in decumulation to structure income in the most efficient way to mitigate tax either on income or any legacy.

29. HMRC tax receipts and National Insurance contributions for the UK (monthly bulletin), HMRC, March 2025.

Case study

Jenny's background

- **Age:** 62
- **Occupation:** Publishing executive
- **Current salary:** £100,000 (reducing to £60,000 during transition)
- **Status:** Single, two adult children
- **Total DC pensions:** £900,000
- **Mortgage:** Outstanding mortgage £195,000

Jenny's objectives

Jenny is 62 and plans to start the transition to retirement now by beginning to work 3 days each week. Her objectives are to:

- Retire completely at 67 when the State Pension will be paid.
- Pay off her outstanding mortgage of £195,000 using the tax-free lump sum.
- Boost her reduced income by a further £20,000 to maintain her current standard of living.
- Enjoy a comfortable standing of living when she retires outright.
- Continue to pay maximum pension contributions to her employer's DC scheme.

Jenny's story

Jenny plans to take her tax-free cash of £225,000 to pay off an interest only mortgage of £195,000 and pay the balance of £30,000 into a cash ISA over two tax years. She could have decided to use the tax-free cash to provide the additional income required, but her fixed rate mortgage expires soon and she is worried about the rise in interest rates. Despite earning £100,000 she has brought up two children as a single parent and has had to rely on commercial child care. As such, she hasn't amassed much by way of other savings and investments, so the £30,000 ISA investment will make up part of the shortfall in earnings during the transitional period.

Jenny estimates she'll need £80,000 to maintain her standard of living after the mortgage is paid off, so she has a £20,000 shortfall. She also plans to continue to make pension contributions during this period. Her employer operates a generous 'matching' contribution scheme where contributions up to 10% are matched by the employer – Jenny intends to take full advantage of this, but this could trigger the reduced MPAA of £10,000.

Jenny's options

The 5 year transitional period (62-67)

Jenny's financial adviser has suggested the following course of action to make up the shortfall:

- Jenny can use the £30,000 she has paid into a cash ISA to take an income of £6,000 pa which would equate to a gross income of nearly £10,500 given that Jenny is a higher rate taxpayer and wouldn't be liable for NI contributions on the ISA withdrawals.
- This still leaves a shortfall of roughly £9,500. Jenny's adviser suggests a lifetime annuity for a number of reasons:
  - Although annuity rates improve with age, and Jenny is relatively young, they are currently higher than they have been for many years.
  - Jenny could use the lifetime annuity to cover essential or important expenditure along with the State Pension payable from 67.
  - There is a growing body of evidence that partial annuitisation can provide a better outcomes for drawdown clients[30].
  - A lifetime annuity will not trigger the MPAA of £10,000 so she can pay £6,000 in pension contributions from her reduced salary, matched by her employer, to contribute £12,000 each year.

If Jenny uses £150,000 to purchase an annuity she would receive more than £10,803 each year payable for life[31]. Together with the ISA income, this will make up the shortfall of £20,000.

Outright retirement (67 onwards)

When Jenny decides to retire outright, she believes she can maintain her lifestyle with a lower income. She'll no longer have to make pension contributions nor pay NI contributions. She also anticipates that her living expenses will reduce. This is in line with DWP analysis that suggests income replacement rates during retirement for high earners, like Jenny, should be around 50% of pre-retirement earnings[32].

Her adviser estimates her pension fund, which reduced to £525,000 (after the tax-free lump sum and the cost of the annuity purchase), will be boosted by the ongoing contributions of £12,000 each year and produce investment returns of 5% pa compound, after charges, over this period. This will give Jenny nearly £745,000. At a withdrawal rate of 3.7%, added to the income from the lifetime annuity and her State Pension, this will provide an annual income of £49,868. This is broadly consistent with the DWP estimate of 50% of her pre-retirement earnings of £100,000 (before she paid off the mortgage and her income reduced to £80,000).

An overview of Jenny's situation is shown on the next page.

30. Can we help consumers avoid running out of money in retirement?, Institute and Faculty of Actuaries, March 2018. Annuities reinvented: Are annuities the missing asset class for sustainable drawdown solutions?, Milliman, October 2018. More recently, Abraham Okusanya, Timeline CEO, showed that introducing the annuity element to partially replace the bond holding in a portfolio boosted the fund value over the long term.
31. Moneyhelper, annuity calculator, January 2024 (based on single life, level pension, guaranteed 5 years with no health issues.
32. Estimates of the number of people facing inadequate retirement incomes, DWP, July 2012.

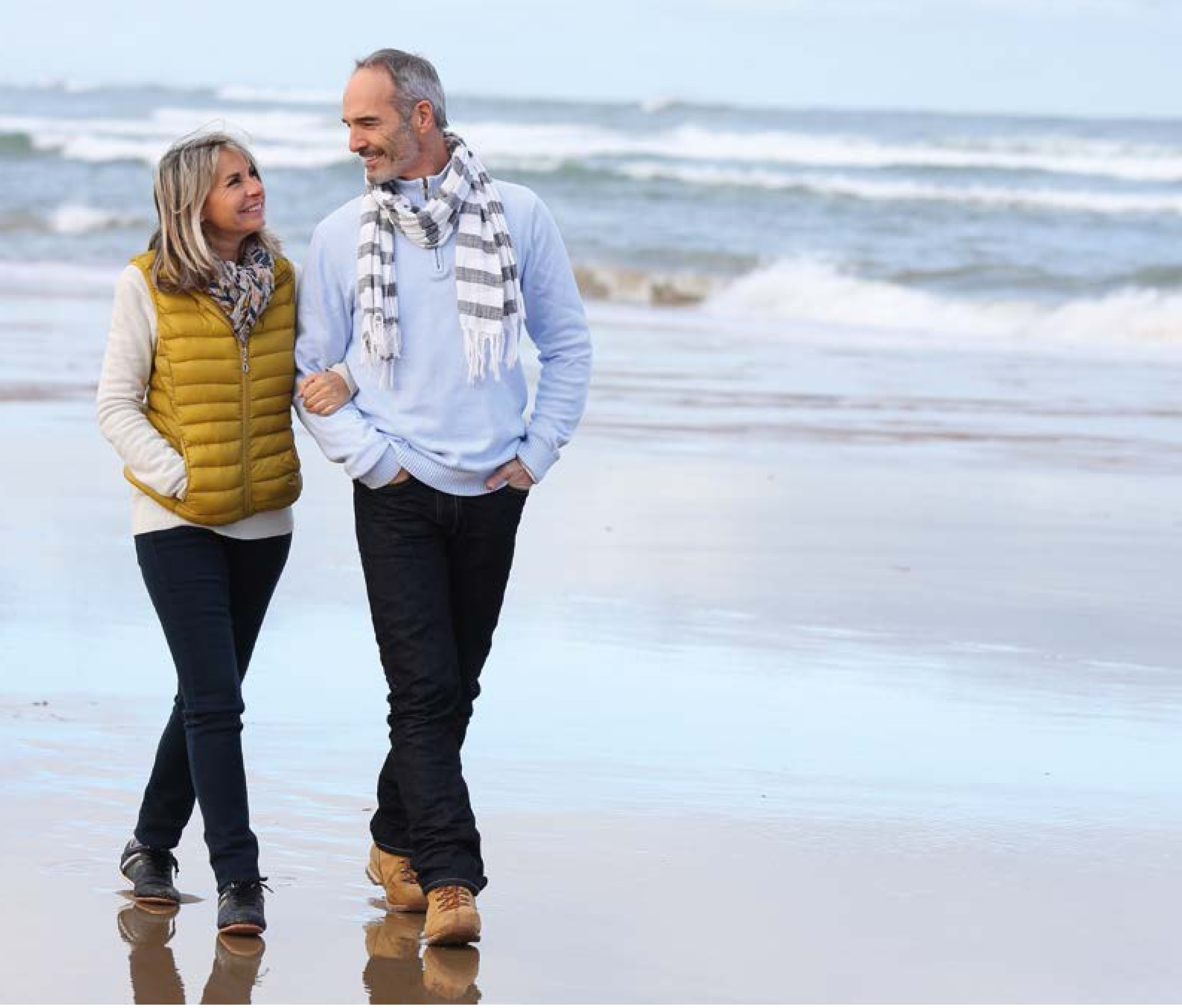
An overview of Jenny's plans

While this example is relatively straightforward, it still demonstrates the added complexity a flexible approach to retirement can introduce. In Jenny's case, she simply works reduced hours for five years then retires outright. Many examples will be more complicated than this perhaps gradually winding down over several years or dealing with fluctuating earnings. This emphasises the need for a robust retirement process that can accommodate a range of possible situations. And can adapt to change. In Jenny's case, it's conceivable that she subsequently chooses not to retire outright or does so, then decides to return to the workplace. Advisers need to make sure they have retirement propositions that can adapt to changes throughout retirement.

Pension savings – £900,000

Jenny is 62 and plans to start the transition to retirement now by working only 3 days per week. Her salary is £100,000 and she will be paid £60,000 for the reduced hours. She takes tax-free cash to pay off her mortgage and estimates she'll need around £80,000 to maintain her standard of living during the transitional period.

62		67	Ongoing
Tax-free lump sum £225,000	**Mortgage:** £195,000 **ISA:** £30,000	**Drawdown** £745,000	**£27,565 pa** Assumes 4% withdrawn plus inflation
Lifetime annuity £150,000	**£10,803 pa payable for life**		
ISA £6,000	**£6,000 pa** Equals around £10,500 gross	**State Pension** £11,500	**£11,500 pa** Increasing each year by triple lock
Earnings £60,000	**£60,000 pa**		
Total income	**£81,178 pa**	– Employment ceases – State pension payable – Lifetime annuity starts – DB pension commences	**£49,868 pa**



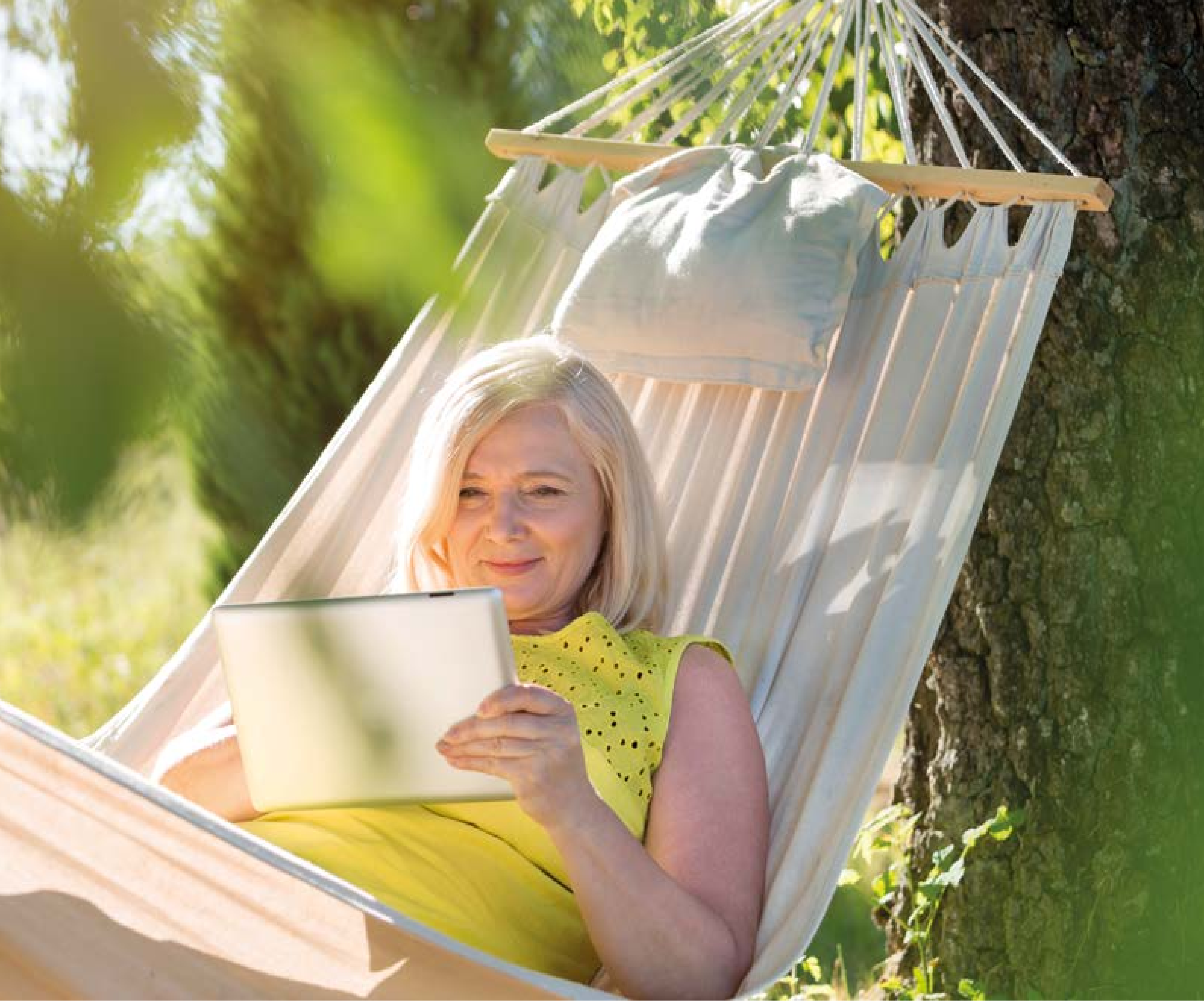
Further points to bear in mind...

- Though Jenny has taken her tax-free lump sum and is continuing to make contributions this should not meet the conditions set for assessing tax-free lump sum recycling, so should not incur extra charges.
- The lifetime annuity isn't inflation linked, but the State Pension is subject to the triple lock and the drawdown income is intended to be inflation linked.
- Morningstar research suggests that withdrawals of 3.7% will provide an inflation linked income for 30 years with a 90% probability of success based on a balanced portfolio[33].

33. The state of retirement income: 2024, Morningstar, November 2023.

Summary

- The idea of retirement as a single event is rapidly becoming redundant for many people as a more fluid, nebulous concept of retirement takes over. Indeed, it's not always clear when work ends and retirement begins, though there is usually a change in someone's work pattern that signals the start of a transition towards retirement.
- People often continue to work for any number of reasons. For some it's entirely practical – they need more income. For others, it can be to stave off loneliness, provide a sense of purpose and fulfilment or to maintain the status that accompanies a successful career.
- The range of scenarios is endless. Reduced working hours or taking on a less demanding role, a move to self-employment or starting a company. Some people will retire and then return to the workplace – possibly missing the emotional benefits work can bring or because they need to supplement their retirement income.
- Flexible retirement raises a number of issues. Whether to take, defer or stop payment of the State Pension (depending on circumstances), how to make up any shortfall in income, which can be a fixed or variable amount, and how or when to start taking benefits from pension savings. These are just some of the issues advisers and their clients face.
- Structuring income during the transition to outright retirement requires defining the optimal mix of income from employment earnings, pension savings, savings and investments and the State Pension. This can be challenging and the solution may be influenced by tax considerations.



- Decumulation is markedly different to the accumulation phase and advisers should develop specialist Centralised Retirement Propositions to reflect the specific characteristics of decumulation. Even where there appears a degree of commonality between the two phases, attitude to risk for example, there may be significant differences in each phase.
- It's important to identify the right product mix. Historically, this has been a largely binary decision between annuities and drawdown. There is increasing evidence to suggest that a hybrid approach can often provide a better outcome. Uncrystallised funds pension lump sum are also increasing in popularity.
- Flexible retirement requires advisers to adopt a fluid approach to retirement planning, rather than a 'one and done' solution at a fixed point in time. It's also important for advisers to monitor performance throughout any transition and beyond and change course whenever necessary.

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Notes

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.

The value of investments and the income from them, can go down as well as up, so clients may get back less than they invest.

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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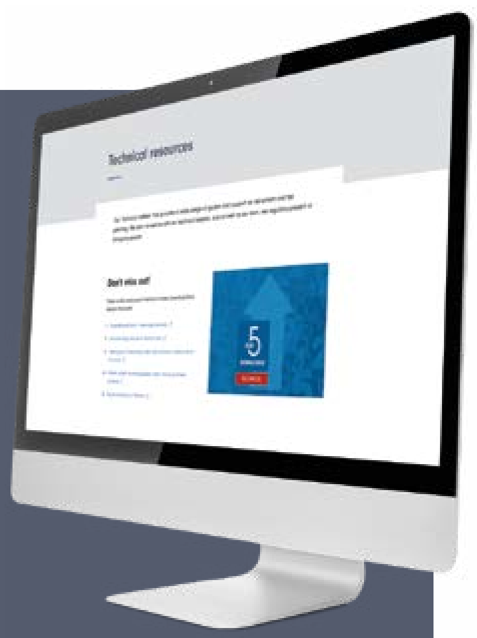

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