

for financial advisers only

boosting retirement income

March 2010

For certain clients who have embraced the use of income withdrawals as part of their initial retirement planning, there may be the opportunity to increase the level of annual income they enjoy in retirement. **Adrian Walker** gives details.



The maximum income that can be taken from an unsecured pension fund must be reviewed every five years to ensure the fund is not eroded and can continue to provide an income. Depending on the structure of the underlying registered money purchase pension scheme, there may be other review opportunities available outside of this statutory five year review which could potentially increase (in some cases quite significantly) the maximum level of annual income available.

These additional opportunities for review are dependant on the structures the scheme rules allow and are, therefore, not available through all registered pension schemes. They are:

- member driven annual reviews and
- additional designation for post A-Day income withdrawal arrangements.

These review options operate in slightly different ways, a summary of which is set out in the **table** on the facing page.

how do clients benefit?

The maximum level of income available from income withdrawal arrangements is driven by a number of factors, including:

- The capital value of the income withdrawal fund.
- The underlying gilt yield applicable when benefits were crystallised – this drives the income factor on which the capital was converted to income.
- The client's age at the time of the benefit crystallisation event.

Since the early part of 2009, equity markets have shown a significant increase in value from their low point of March of that year. Coupled with this, gilt yields driving the income factors applying to income withdrawals have remained fairly constant and, albeit with the underlying Government debt, have risen slightly over recent months. Depending on the levels of income that have been taken, and the underlying investment

strategies employed, many client with income withdrawal funds will have seen the capital value of their fund increase.

This, together with the rise in gilt yields and the fact that many clients will be a year older, could deliver increased levels of retirement income from this source for very little or no cost. How this works in practice is detailed in the example to the right.

It's important to regularly review income levels and creating a higher annual income entitlement can give your client the opportunity to review the overall retirement planning position. For instance, it may allow the client to delay the surrendering of other assets to meet any income shortfall. Or it may allow the client to lock-in increased income entitlements for future use while investment conditions remain favourable to do so – planning that could prove to be particularly prudent as uncertainties remain in investment markets. •

The table below shows the movement in gilt yields since the beginning of 2009.

	Gilt yield 2009	Gilt yield 2010
January	4.00	4.25
February	3.75	4.25
March	4.00	4.50
April	3.25	
May	3.75	
June	4.00	
July	4.00	
August	4.00	
September	4.00	
October	3.75	
November	3.75	
December	4.00	

example

– beneficial use of additional designation to provide an increased level of income for little additional cost.

A male client aged 60 in March 2009 crystallised a pension fund of £200,000, taking a pension commencement lump sum of £50,000. The balance of the fund then moved into income withdrawal creating a maximum annual income of £10,800.

At that time the client had no need for income and since crystallisation the overall fund value has increased to £180,000.

The client then added a further £200 of uncrystallised funds to the arrangement for further designation.

Effect:

- He receives a pension commencement lump sum of £50.
- His income withdrawal fund is now £180,150.
- The maximum annual income would, if designated in March 2010, increase to £13,835.52, an increase of 28.10%.
- The client is now 61 and therefore the maximum income increases to £14,051.70, an increase of 30.10%.

What if the client has no existing uncrystallised pension rights available for additional designation?

- Clients who have fully retired are able to contribute up to £3,600 a year as a relievable contribution.
- They can contribute up to 100% of any ongoing relevant earnings in a tax year or, where caught by the relevant income threshold limit, to the special annual allowance of £20,000.
- If clients have not used their annual income withdrawal entitlement they can take income from their income withdrawal fund and regenerate this as a new contribution. The tax paid on the income will be recaptured by the tax relief entitlement from the new contribution.

Any of the above solutions can create new uncrystallised rights that can be immediately designated to create a rebased annual income.

reviewing existing income withdrawal arrangements

Review issue	Member driven annual reviews	Additional designation
Can this option apply to all existing income withdrawal arrangements?	Yes. An annual review can apply to both pre and post A-Day income withdrawal arrangements.	No. Additional designation is rarely available when linked with pre A-Day income withdrawal arrangements.
Is the option available at any time?	No. The option can only be used at the scheme income year anniversary or within 60 days of the anniversary if the scheme rules allow.	Yes. Available at any time in a scheme income year where uncrystallised rights are added to a post A-Day income withdrawal arrangement.
What happens to the five-year income review date?	Where a member accepts the income level created by an annual review the next five-year review date is applied from the scheme income year at which the review takes effect.	The existing five-year income review date remains in force. Any increased annual income will apply for the current scheme year and any year up to the current five-year review date.
Is additional funding required to create the income review?	No. The maximum annual income is reviewed on the existing income withdrawal fund.	Yes. New uncrystallised rights will need to be added to the existing post A-Day income withdrawal fund before the annual income is re-based.
Do all schemes offer this facility?	No. When this was introduced by the Finance Act 2007 it was up to individual schemes as to whether their rules would allow it. It is not currently available under the Skandia registered pension schemes.	No. It depends on the arrangement structure and the minimum designation permitted by the registered pension scheme concerned. It is available through the Skandia Investment Solutions Collective Retirement Account and the Skandia Life Personal Pension Scheme where PP5 and PP6 contracts hold uncrystallised pension rights.

This document is based on Skandia's interpretation of the law and HM Revenue & Customs practice as at February 2010. We believe this interpretation is correct, but cannot guarantee it. Tax relief and the tax treatment of investment funds may change.

Increasing withdrawals may not be sustainable in the long term and may affect the capital value of the Plan.

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