Making Your Pension Work For You: Income Options Explained

(Without Sending You to Sleep)

WILLOWHURST
FINANCIAL PLANNING

A guide for people with defined contribution pensions over £250,000

💡 **There are three main options for retirement income,** which ones work best for you will depend on things like your tax position, other income, and lifestyle plans:

- 🛡️ **Lifetime Annuity**
- 🎢 **Flexi Access Drawdown**
- ⏳ **Fixed Term Annuity**

You can do all of them or one of them – it's your choice – you just need to make sure they meet your needs.

📝 **Some notes:**

For this guide, I am going to assume your pension is worth **£400,000** – *The reason?* – It makes the maths easier!

📊 ***Some basic facts:**

- 🎂 You can access benefits at **55**, increasing to **57** from 2028.
- ⏰ There is no upper age you must take benefits.
- 💰 You can generally take up to **25%** as tax-free cash *(not necessarily all at once)*.
- 🚫 There is a limit on how much tax-free cash you can take – limits start at **£268,275** – you need to check this.

* Those with protections in place may be eligible for higher amounts or be able to access benefits earlier.

💷 Tax-free cash

Points to consider:

- ❓ What do you need it for?
- 🏦 If you take it out your pension, where will you hold it?
- ⏳ Do you need it all in one go?
- 📏 Are you going to exceed your allowance?

A pension is basically a **savings pot**.

💡 For every **£1** you take as tax-free cash, you have **£3** left to provide you a taxable income (based on 25% tax-free cash allowance).

📈 Depending on what you choose, that £3 may be invested and may go up or down in value – and you don't always need to take all your tax-free cash in one go!

📖 **Over the page, we'll look at the basic pension income options and meet their character.**

🧡 The Lifetime Annuity & Ted

Meet **Ted** – he comes and mows your lawn on the 1st of every month whether you need it or not. Ted is **reliable**, **guaranteed for the rest of your life**, but offers **no flexibility** – he mows it whether it needs it or not.

Ted is your lifetime annuity.

📌 Example

You have a **£400,000** pot:

💷 Take £100,000 as tax-free cash
🏦 Give £300,000 to an annuity provider to provide a guaranteed income for life

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❓ Questions to consider

What happens if you die the next day?
If this is a concern, you need to select options at outset to make sure your £300,000 isn't gone – choosing the wrong options can mean giving up tens of thousands in income or passing less to your family.

Will your partner need an income should you die first?
How much – 50%, 100%, none?

Should your income increase in payment?
Do you want a higher income at the start that doesn't increase or inflation linking, or perhaps a steady 3%? Which is best, when is the breakeven point?

Annuities are inflexible – will you always want this level of income? *(e.g. perhaps you want to reduce it when your state pension starts)*

📊 Annuity Rates & Shopping Around

Your pension provider may have provided an annuity (income) figure on a retirement quote.
⚠ They have no duty to offer the best rate – it most likely **isn't** the best rate. You **must shop around!**

You may get a higher rate because:

- 🏥 You have medical conditions (even minor)
- 🚬 You smoke/smoked
- ⚖ Overweight/underweight
- 💔 Divorced or live alone
- 📍 Live in a slightly less desirable postcode
- 📉 Or simply because your current pension provider pays poor rates

💡 Remember – you accept a lower offer, that's **lower every year for the rest of your life!**
Checking the market properly can make a big difference – even if you're in good health, we still shop around as standard.

🧩 Flexibility with your pot

You **don't** have to use your whole pot:

- Example: Take £50,000 tax-free cash, use £150,000 for an annuity, and leave the other £200,000 for something else *(drawdown, fixed term annuity, another annuity later, or do nothing with it)*. The right split depends on your tax position, other sources of income and how long you need your money to last – this is where the tailored planning really matters.

⚠ **People get caught out here - Once you set up your annuity, you can't cancel it.**
Ted is mowing your lawn for the rest of your life.

🎢 Flexi-Access Drawdown (FAD) & Paul

Meet **Paul** – he mows your lawn when he feels like it.
He is **flexible** with his time, but nothing is guaranteed – you're never sure he will show up, and he may disappear next year.

Paul is your Flexi-Access Drawdown.

📌 Example

Using the same example with your **£400,000** pot:

- 💷 Take £100,000 as tax-free cash
- 📈 Keep £300,000 invested in drawdown
- 💵 Withdraw an income from your drawdown pot as and when you need it

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🔄 Flexibility – and risk

You want more next month than last month? ✅ You can take it.
You want to stop income? ✅ You can do that too.

You are in control – **but unlike an annuity, it can run out** - knowing how much you can withdraw without risking running out is a key planning question!

⚠ Spend too much and you will be left with nothing.
⚠ Don't spend enough and you are left with an unused pension pot on death – too late to enjoy it.

💡 From **April 2027**, this is also set to become subject to **inheritance tax** - There may be steps to take before April 2027 to keep more of your pot outside your estate.

❓ Key questions

- Do you know what you need?
- Do you know how long it will last?

📉 **Anyone seen Paul lately?** *The lawn is now a meadow – the drawdown pot has run out!*

🧩 Mixing your options

You don't need to fully commit to drawdown:

- Example: Take £10,000 as tax-free cash, then use £30,000 to provide income while the remaining £360,000 stays invested for another day.

If you have enough of **Pau**l (FAD) – and still have money left – you can switch to **Ted** (annuity).

⚠ You **can't** switch from Ted to Paul.

⚠ You generally can't split your drawdown pot and move just part of it elsewhere — you'd need to transfer the whole amount, unless you're buying a lifetime annuity or going through a divorce.

⚠ Knowing which product you can switch to and from is an important detail!

⏳ Fixed Term Annuity (FTA) & Mike

You may not be sure if you want Ted or Paul – so you choose **Mike**.

He will do as you tell him for a set period, perhaps 3 years or maybe 10.

He'll mow the lawn monthly, annually, or not at all.

Mike is your Fixed-Term Annuity (FTA).

ℹ Note

Although it has the word *"annuity"* in the name, you **don't have to take an income**.

💡 You need to decide whether to take your tax-free cash **before** setting up a fixed term annuity – after that, it is gone.
Again, you may decide to do this with only part of your pot.

⚙ How it works

You can:

- ✅ Get the FTA to pay a regular income **or** no income
- ✅ Arrange for a guaranteed maturity value at the end - *If the maturity value isn't guaranteed, you could end up with less than you expect!*

📌 Example

You:

- 💷 Take £25,000 tax-free cash
- 🏦 Hold £75,000 in an FTA for 3 years
- 💵 Take an income (or not)
- 📅 Get a maturity value back at the end of the term

🔄 After the term ends

You can then use the maturity value for:

- 🛡 **Annuity** (Ted)
- 🎢 **Drawdown** (Paul)
- ⏳ **Another Fixed Term Annuity** (Mike)

⚠ In most cases, you’ll need to use the full amount for one option. The only exception is if you want to use part of it to buy a lifetime annuity (Ted).

🎬 Other Options (The TV Extras with No Names)

You could withdraw your whole pension in one go – **two major points:**

- ❓ What are you going to do with it?
- ⚠ You will likely pay a huge amount of tax doing so.

💵 UFPLS

Like drawdown – but rather than take an income, you withdraw as a **lump sum**.
Example: Use **£100,000** → £25,000 tax-free cash + £75,000 taxable lump sum.

⚠ This approach can work, but without careful timing it can push you into higher tax brackets unnecessarily.

📋 Other considerations

There are other things to think about too – PSA, LSDBA, small pots, MPAA, protected tax-free cash to name a few– but these are beyond this short guide!

This is an overview guide to assist thinking about your plans and does not cover all scenarios.
⚠ You need to be aware:

- Some products are **irreversible**
- Taking income can impact any **future amounts** you pay into a pension

❓ What should you do next?

Before you think about what you should be using, you really need to understand what you want.

Key questions to ask yourself:

- 📅 When will I stop working?
- 🌓 Will I stop fully or have a phased retirement?
- 💷 Do I want the same level of income throughout retirement?
- 🎉 Will I need more in my earlier years whilst I can have fun?
- ⚖️ What risks do I want to manage in retirement?
- 🏁 What will I have left – and should I spend more?

💬 Your Story Comes First

You might only have started thinking about retirement planning recently — I've been helping people navigate it for almost twenty years.

Everyone's situation is unique, so I'll start by listening.

If you'd like to talk things through, email me at **James@willowhurst.co.uk** and we'll arrange a Zoom or Teams call. You can share what's on your mind and take your time deciding whether my approach is the right fit for you.

- This guide is for information purposes and does not constitute financial advice, which should be based on your individual circumstances.
- The value of pensions and any income from them can fall as well as rise. You may not get back the full amount invested.
- Levels and bases of, and reliefs from, taxation are subject to change and their value will depend upon personal circumstances. Taxation and pension legislation may change in the future.
- Drawdown pension plans (unsecured income) are complex and are not suitable for everyone. Pension decisions can affect your income for the rest of your life (and that of any partner and other dependants). Where benefits are accessed on a flexible basis, these are not fixed or safeguarded for life. If security of income is important to you then you should consider purchasing an annuity or taking a scheme pension to provide a secured level of income.
- Your pension income could also be affected by the interest rates at the time you take your benefits. The tax implications of pension withdrawals will be based on your individual circumstances, tax legislation and regulation which are subject to change in the future.
- With a Lifetime annuity: *Once set up, your decision is irreversible and you can't change or access the money — payments are fixed unless increases are chosen. For a* Fixed-term annuity: *You can't usually access the money during the term — the maturity value is only available at the end.*