Top Ten Tips

Get the best from pensions

Changes to pension rules in recent years have given rise to an increasing number of ways in which you can take your pension benefits. Mark Christie, a director at Edinburgh-based Carbon Financial Partners, shares his top tips for getting cash out of your pension pot:

1 TAX-FREE CASH

The first choice to make when deciding how to draw your retirement income is the amount of tax-free cash you take, if any. Many people take the maximum permitted 25 per cent, often spending it on things like home improvements, luxury holidays, paying off their mortgage or simply giving themselves the flexibility to enjoy their retirement. If you plan to phase in your retirement over a period of time, tax-free cash can also provide a useful top-up to this income stream.

2 TRADITIONAL ANNUITIES

These provide a guaranteed income for life in exchange for your pension pot. The rate received is based on your age and, in many cases now, your postcode. Rising life expectancy is helping drive down annuity rates and this is unlikely to change in the future.

Other factors to consider are whether to include a widow's pension for your spouse on your death, and "inflation proofing" so your pension maintains its value in real terms. You can also include a guaranteed period so your family can recoup some of the purchase price should you die early. If you decide to go down the traditional annuity route, use the open market option: this allows you to shop around for the best annuity rate and can add 10 per cent-20 per cent to your retirement income.

Smokers are able to get enhanced annuity rates

3 ENHANCED ANNUITIES

This is like a traditional annuity, but the rate received is higher, either because of ill health or the fact that you smoke. As many as 65 per cent of retired people would qualify for an enhanced annuity, but last year only 12 per cent of annuities bought included an enhanced rate.

4 TEMPORARY ANNUITIES

This provides a fixed income for a fixed term with a guaranteed capital amount at the end. It provides more flexibility than traditional annuities, but you could get lower annuity rates in the future when you come to renew for a further fixed term.

5 GUARANTEED ANNUITY RATES

Many older pension policies still have guaranteed annuity rates attached to them. These can be very valuable, especially when compared to today's annuity rates. Guaranteed annuity rates are typically 10 per cent to 12 per cent, against the current rate of 6.8 per cent for a 65-year-old non-smoking man of average health. The main drawback is that guaranteed rates are usually on a single life basis only, with the rate either removed completely or vastly reduced if taken on any other basis.

6 INVESTMENT-BACKED ANNUITIES

These offer the same basic options as a traditional annuity, with the exception that the income is not guaranteed and will fluctuate from year to year. The income received is based on your chosen investment strategy. These types of schemes can be very useful in helping beat the effects of inflation by providing a rising level of income, but unlike traditional annuities they involve an element of investment risk and income can fall.

7 INCOME DRAWDOWN

Here, your pension pot remains fully invested, so you need to think carefully about investment risk and volatility. This approach provides a high level of flexibility, but should be reviewed on a regular basis – every three years if you're under 75 and every year if you're over. On death, the pension pot can be passed to your spouse, who can continue to draw a retirement income or buy an annuity.

8 PHASED DRAWDOWN

This is like income drawdown, but you phase in the taking of benefits as you need them – ideal for someone who wants to top up other income, from part-time working, for example, while they gradually move into retirement. The main advantages are tax-efficient income and greater death benefits for funds not yet moved across to drawdown.

9 FLEXIBLE DRAWDOWN

This option has resulted from pension legislation that came into force in April. To choose this – which gives greater flexibility in the amount you can withdraw each year – you must have pension income of at least £20,000 a year from other sources, such as state pension, savings or annuities.

10 FINAL SALARY

Final salary pension schemes (at least outside of the public sector) are a dying breed. Think about sacrificing some of your pension to increase your lump sum. The main drawbacks are loss of widow's pension and inflation-proofing on the sacrificed pension.