Pension freedom pitfalls and how to avoid them

The new pension freedoms are a great opportunity for most retirees, as they will have much more scope to use their retirement savings in a way that is right for them. However, the greater choice and flexibility also creates a number of pitfalls that could stop people enjoying their retirement. Even before they get to that stage, there are questions they might need help with such as can they afford to retire? Should they bring all their pension pots together? How much will their State Pension be?

The following is a list of some of the pitfalls that need to be avoided

1. Exit Charges
In the first three months post April, approximately 200,000 people chose to take advantage of the new ‘Pension Freedoms’ – with the majority choosing to access their policies through either Drawdown or an Uncrystallised Lump Sum.

Nevertheless recent research, based upon data collected from 23 Life Insurance and Pension Providers, has found that 16% of over-55’s wishing to take advantage of the new retirement flexibilities would be hit with an exit charge of some kind were they to attempt a transfer.

Findings by the Financial Conduct Authority has also found that most retirees, specifically those interested in Drawdown, would need to transfer their entire pension fund to be able to access the full range of ‘Pension Freedoms’, so for some clients the aforementioned charges would at first appear to be unavoidable.
Of those wanting to take advantage of the new Freedoms to access their funds, many have found themselves forced to switch into a new contract, even with their existing provider, subject to paying a penalty on the old contract.

**AM&A may be able to assist you avoid an exit charge on a pension transfer**

**2. Running out of money**
People are we’re told living longer. If they swap their pension fund for an annuity, they are guaranteed to receive an income for the rest of their life but they will enjoy none of the flexibilities of the new pensions freedoms. Of course, through drawdown, their income will only last as long as they have money left in their pension pot to take out. Rather like a savings account, if people take too much out too quickly, they could run out of money and if they take money out when prices are low, they could suffer ‘pound cost ravaging’ making it difficult to recover the value of their fund. This creates a real challenge for retirees – they **could benefit from expert advice to help them determine the appropriate level of any withdrawals and manage the remaining assets.**

**3. Paying more tax than necessary**
Any amount a person takes from their pension in excess of their tax-free cash sum will be taxed at their marginal rate. The taxable amount they take from their pension is added to their income from other sources in that same tax year to determine how much tax they pay. It may not be possible to work out the tax due exactly, as providers do not have access to HMRC’s records, and so people who take a taxable lump sum may be taxed on a higher emergency tax code to begin with. The extra tax will need to be claimed back from HMRC. **Careful planning could help retirees minimise their tax exposure - an adviser can make a real difference.**
4. Losing a right to enhanced benefits
Some people who have been saving in a pension scheme for some time might have a right to a higher level of tax-free cash when they retire. Their pension scheme provider should be able to tell them if this applies. If an individual does not take all of their tax-free cash sum at the same time, or if they transfer to another pension scheme, they could lose this entitlement and end up paying more tax than they need to. We can explain how you can protect any enhanced entitlement.

Similarly, the Money Purchase Annual Allowance was introduced by the Government to stop people withdrawing significant sums of money and then recycling it back into a pension for a second round of tax relief. This means when someone takes a flexi-access drawdown payment or an Uncrystallised Funds Pension Lump Sum, their annual allowance will be cut from £40,000 to just £10,000. For those looking at accessing a portion of their savings before retirement, this could be a decision that requires significant support from their adviser.

5. Failing to make the best use of savings
With more options to choose from, and the freedom to combine them in whatever way a retiree wants, it could be easy for some people to become overwhelmed – and potentially make poor decisions. In particular, they may not realise that they do not have to make all their choices in one go. There is the scope for them to tailor their income to their changing needs. For example, annuities may not appeal to those people who have just entered retirement but are happy to continue managing their assets. However, as they get older, they may want the security of a guaranteed income to cover their day-to-day expenses. They could then choose to buy an annuity with a portion of their remaining funds. The support of a financial adviser could play a pivotal role in helping navigate the options and make the most of their pension fund.
6. Becoming the victim of fraud
Over 55s may become very attractive to those who are looking to promote ‘too good to be true’ investment schemes. Many people in this age group will have access to thousands of pounds of hard earned savings in a pension scheme, which they could lose if they fall victim to fraud. Even if a person has never taken financial advice before, this is probably the time to do it – **and from someone they can trust.**

Pensions are complicated - we want to help

We can assist you in helping to help identify:

- what you can do with your pension funds
- the different ways of taking your pension and providing income in retirement
- what is tax-free and what is not and importantly what is the most tax efficient

**AM&A can help you avoid making expensive and potentially life changing mistakes.**