

Just because it's legal: some of the risks of Flexible and Capped Drawdown

Just because something is legal, it doesn't mean it's a good idea.

Drawdown is a case in point, and with an embracingly permissive budget the ability to do harm has increased.

Changes to both Capped and Flexible Drawdown mean that from next Thursday an individual can:

1. take 25% more from their pension plan under Capped Drawdown
2. potentially elect for Flexible Drawdown if they have £12,000p.a. guaranteed from Annuity, State Pension or Final Salary benefits

Both of these two cases greatly increase the level of withdrawals a pensioner can take from their fund, and also increase number of pensioners who can withdraw up to their total fund value.

But a pension needs to last a long time; life expectancies continue to increase, and many individuals under-estimate both their likely lifespan, and also the level of activity they will enjoy throughout their retired life.

Implications on Capped Drawdown

The new rules mean that based on the current prevailing withdrawal rates, and the rules applying from next Thursday, 27th March 2014, the following could be withdrawn each year:

- 55 – 7.20%
- 60 – 7.95%
- 65 – 8.85%
- 70 – 10.35%
- 75 – 12.45%
- Above 75 – 12.45% (as current rules age 75 limit applies above age 75)

These are big numbers, in order to support these withdrawals in **real money terms** a level of growth of this level above inflation needs to be achieved. Assuming inflation drifts between 2-3% (and it may be higher in actual terms for pensioners) then in all cases returns need to be well into double digits. Not realistic and an accident waiting to happen for those without advice!

There is an argument that the fund can affordably be depleted to an extent, as clearly the year before death one doesn't need the full value of the fund, but when a couple are reliant on one fund it's very difficult to assess just how long that fund is needed – caution is needed!

Implications on Flexible Drawdown

Of course the same warnings apply for Flexible Drawdown, but with big withdrawals the spectre of tax also applies. In the **current** year (2013-14) individuals broadly experience the following tax rates:

Bottom of Band	Top of Band	Tax Rate
£0	£9,440	0%
£9,440	£42,450	20%
£42,450	£100,000	40%
£100,000	£118,880	60% – as high as it goes!
£118,880	£150,000	40%
£150,000+		45%

And worse still if you do not spend the funds, then the inheritance tax 40% rate can apply in addition this could be a 64% rate ($100\% - (60\% \times 60\%)$) !

Summary

Seek advice. The above is a simplification, and may not apply in all situations. Drawdown is a complex area, and choices made now can impact throughout life.