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A GUIDE TO POST-RETIREMENT INCOME PLANNING AND OPTIONS

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INTRODUCTION - WE ARE LONGER LIVING

The good news is – we are living longer than previous generations both in Ireland and in the rest of the developed world. A man retiring today at age 65 can expect to live to age 83. A woman retiring at age 65 can expect to live until age 86. (Source: CSO statistics 2015- 2017). We also have access to a much greater choice of retirement income options and products than our predecessors.

The bad news is – we now need to make our retirement savings work harder than ever in order to provide retirement income / preserve capital for a longer period. Conventional Defined Benefit pension structures and state pension schemes are under severe pressure to sustain income for life promises going forward. The Pensions Authority review of funded defined benefit schemes to the end 2020 shows only 671 schemes continuing in force. Of these 566 schemes were subject to the Authority's funding standard.

The end result is that more and more individuals now need to take responsibility for and plan their retirement income needs. This means working with their Financial Broker in evaluating retirement options and selecting the financial products best suited to maintain income and capital protection during their retirement years.

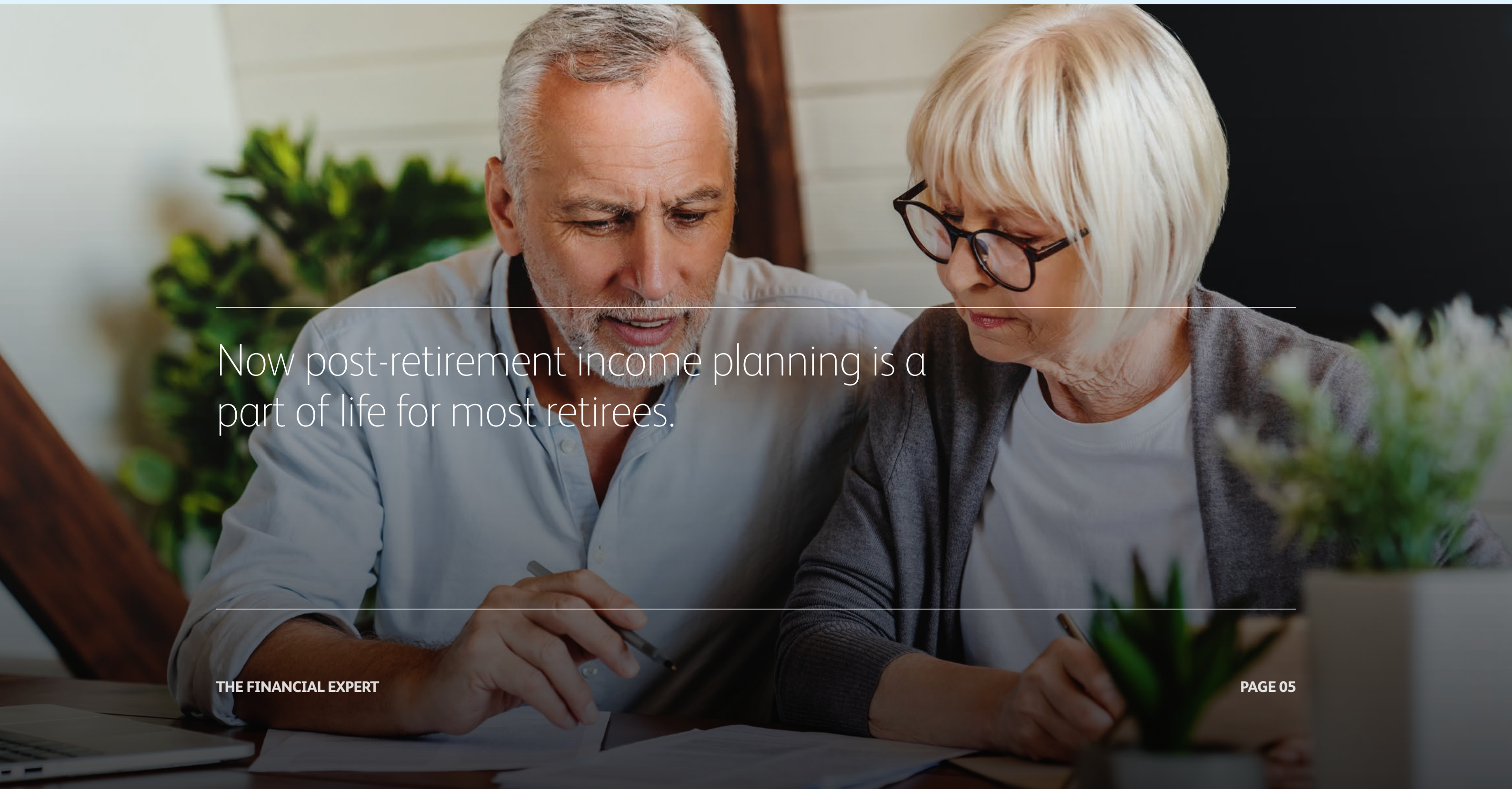
The purpose of this guide to post-retirement income planning is to provide Financial Brokers with an easy to reference document that highlights the considerations to be addressed at this important and very often conclusive stage of financial planning.

HISTORICAL POSITION

For previous generations retirement income planning had usually already taken shape by the time of reaching retirement age. Private pension income was either in place or not; and if so there were few choices to be made other than to hope to live a healthy retirement. Broadening of the PRSI coverage classes in 1989 meant that most employees and self-employed persons were now automatically entitled to contributory old age pensions; and therefore private pensions were now more attractive as means testing was confined to eligibility for state non- contributory old age pension benefit.

With this we saw the increased popularity of defined contribution pension schemes and a greater simplification in pension product design via the concept of individual personal and executive pension arrangements followed by standalone AVC products. In 1999 we had the introduction of ARFs. Now self-employed persons and company directors could take control of their pension funds after the point of retirement. Gradually this facility was extended to AVC investors, PRSA holders and from 2011 to the majority of persons with Defined Contribution pensions.

Now post-retirement income planning is a part of life for most retirees.



Now post-retirement income planning is a part of life for most retirees.

2.1 Pillars of retirement income

When addressing financial needs in retirement it is useful to have a starting reference point; and ability to generate income will usually register under one or more of the four recognised pillars of retirement income.

(1) **Old age state contributory or non contributory pensions.** Benefit is currently payable to employees and to the self-employed from age 66. The state pension age was due to increase to age 67 in 2021 and to step up to age 68 by 2028 but the move to 67 has been put on hold. It is now proposed that the qualifying age is increased gradually from 2028 , reaching 67 in 2031 and 68 in 2039 . The state contributory old age pension currently pays a maximum of €12,912 per annum for a single person and is based on qualifying PRSI contributions being paid over a full working lifetime. The pension is set to increase by €5 per week from January 2022.;

(2) **Occupational and personal pension schemes.** Benefits here may be fixed pensions from private or public sector employments and / or consist of occupational or personal pension funds where the individual has some or complete choice as to the manner in which the funds may be accessed. This is a new area of post-retirement income planning, which has been opened up greatly by recent legislation and will now be relevant for the majority of future retirees.

(3) **Part time and full time employment.** Where health and skill sets allow some potential retirees will choose to continue in employment or self-employment well past traditional retirement ages. Such continued participation in the workforce may be in conjunction with retirement income from one or more of the other pillars. Again this means that retirement income drawdown and accumulation issues may need to be considered together now that pension funding opportunities extend to age 75.

(4) **Private assets.** Here we are looking at savings, property, investments etc., which have mainly been accumulated from ‘after tax’ income, asset sales or inheritances. These may need to be balanced out against outstanding mortgages or other debts. Likely capital requirements for lifestyle / family / medical expenses also need to be addressed. Taxation impact on drawdown from these assets may impact upon taxation of income under other pillars.

For the purposes of this guide we will concentrate on the new areas of individual control over retirement assets associated with Pillar 2 above. This is the area where clients will most need the assistance and guidance of their Financial Broker.

2.2 Position pre 1999

Prior to 1999 persons retiring with private pension funds had little choice as to how their benefits were paid out.

Basically choice came down to how much of the fund could be taken as a tax free cash lump sum. Question was whether to take the full tax free cash amount or take less tax free cash in order to increase the residual pension.

Generally pension choices were as follows:

- Public sector scheme: a pension for life from an unfunded government defined benefit scheme paid directly by a government department.

- Private sector defined benefit scheme: a pension for life from the trustees of a privately funded defined benefit scheme paid from the scheme assets.

- Private sector defined contribution scheme or personal pension: a pension for life paid by a life office providing the annuity purchased by the fund at retirement age.

- The position as regards death payments, dependents’ pensions, pension increases etc. were all determined at or before the point of retirement.

Post-retirement there was no choice – there was no post-retirement market.

2.3 Post-retirement market since 1999

- **1999.** Approved retirement funds (ARFs) were introduced in order that persons (predominantly self- employed) who had built up personal and director's pensions could control these assets in retirement. Annuity purchase remained an option but was no longer a requirement. Income and gains on these post- retirement ARF assets were subject to tax as they arose. A small number of these 1999 ARFs remain in force and are known as 'Net ARFs'.

- **2000.** ARF asset taxation was changed from April 2000 with the introduction of gross roll up funds and the operation of PAYE on all drawdowns. ARF options on retirement were extended to all AVC holders in respect of AVCs held under Defined Benefit and Defined Contribution schemes. ARF options were further extended to all company directors with a 5% or more shareholding.

- **2003** saw the introduction of Personal Retirement Savings Plans (PRSAs). This was a flexible pension plan which was open to all workers, both employed and self-employed, and to which employers could also contribute. All PRSA holders became entitled to access ARF options on retirement either by transfer to a separate ARF contract or by retaining control of funds in the PRSA after retirement in what is then called a 'vested PRSA'.

- **2006.** Imputed drawdown provisions were introduced. ARFs were becoming increasingly popular, particularly for large fund holders who spotted the opportunity to retain the funds in a tax exempt environment with little need to take taxable withdrawals. A requirement was introduced to take a minimum annual withdrawal each year starting at 1% and increasing to 3% over three years. If minimum withdrawal was not taken then imputed tax would be deducted by the QFM in any event. In this event the ARF investor would suffer the income tax due on the minimum withdrawal but would forfeit the benefit of the net after tax withdrawal. As such every encouragement is provided to take the minimum withdrawal amount each year..

- **2010.** The imputed drawdown requirement was increased from 3% to 5% per annum. Also the standard fund threshold for pre-retirement funds was reduced to €2.3m, which had the effect of limiting new ARF funds in size going forward.

- **2011.** ARF options were extended to all new Defined Contribution schemes, and all existing schemes that made suitable rule amendments. Now ARF options were effectively available to all DC pension members. On the negative side the specified income level for ARF entry was increased from €12,700 to €18,000 per annum with a corresponding AMRF / vested PRSA requirement to set aside funds of €119,800 until age 75. 2011 also saw the introduction of Ireland's first lifelong income ARF based on the US variable annuity model.

- **2012.** The imputed drawdown tax regime was extended to vested PRSAs and the drawdown requirement was increased from 5% to 6% for aggregate ARFs / vested PRSAs over €2m. This change triggered a decline in usage of vested PRSAs.

- **2013.** Specified income level for ARF entry was reduced back to €12,700 per annum and AMRF set aside amount was reduced back to €63,500.

- **2014** The standard fund threshold was decreased from €2.3m to €2m. Commutation factors for pensions changed from a fixed rate of 20 to a scaled rate of 37-22 depending on the age at retirement (applies to post 2014 accrued benefits). A new/extension levy of 0.15% was introduced on pre-retirement pension funds for 2014/15.

- **2015** New drawdown options were introduced for AMRF investors. Now a single optional taxable drawdown of up to 4% of value of AMRF funds is permitted each year. The new provision replaces the previous income / growth only drawdown rule and applies irrespective of the AMRF value.

  Also the 5% minimum ARF imputed drawdown rule was reduced to 4% pa for ARF and vested PRSA investors aged under 71 throughout the year. Where ARF / vested PRSA assets exceed €2M the imputed drawdown requirement remains at 6% pa.

- **2016.** Transfers from DB schemes to a PRB could avail of the ARF option at retirement. The Finance Act 2016 introduced a rule which meant that if an individual had not drawn down benefits from a PRSA or personal pension they would no longer be able to, effectively putting their pension fund in lockdown.A PRSA would be subject to imputed distribution and the benefits from either the PRSA or personal pension would only become payable on death where the proceeds would be treated as an ARF.

- **2020.** The Interdepartmental Pensions Reform and Taxation Group (IDPRTG) published its findings from their 2018 consultation with the aim of simplifying the current private pension system. The recommendations, when / if implemented will have far reaching changes to the pension landscape.In the post retirement world this will include

  A) A new "whole of life" PRSA which allow policyholders to retain funds in the same product post retirement and the restrictions that apply to a PRSA at 75 removed.

  B) 55 would be the new earliest draw down date and would apply to all pension types (other than ill health) and 75 would be the latest date

  C) The retirement lump sum to be considered further with a view to standardizing it although it was acknowledged that this was a challenge to achieve

  D) **The replacement of the current ARF product and the removal of the need for an AMRF***

  E) In addition to the whole of life PRSA , consideration to be given to in-scheme drawdown for retirees

  F) The removal of the compulsory purchase of an annuity

* The Finance Bill 2021 proposes the abolition of the AMRF and the "conversion" of existing AMRFs to ARFs.

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ARFs- NEW CONCEPT OF ONGOING POST-RETIREMENT INCOME PLANNING

A lot changed in 1999 to open up a new market in terms of post-retirement planning. A lot has happened since then in terms of increased access to this market and changes in product design and taxation implications. No doubt further changes will take place as more and more individuals become actively involved in planning their retirement income needs. Experience to date suggests the following questions should be addressed as part of any fact finding discussion.

3.1 What happens if I /we live a long time?

Annuity investment will provide a fixed income for my and my partner's life (if I include that option now and reduce my own income accordingly). If additional guaranteed income for life is a top priority in addition to state pension and other guaranteed benefits, then annuity makes sense. But remember with government bond yields at historic lows, annuities are expensive and there is no chance to change your mind afterwards.

3.2 What happens when I die?

As the question is when rather than if, the answer depends on how much is left in the pot and who is left to depend on the pot. As we can't answer either question with c ertainty in advance all we can do is decide which options we need to keep open and which ones we think we can afford to close off. For example are assets jointly owned, is there life assurance benefit in place, are own right dependents' pensions in place? The closer we get to the overall picture then the better placed we are to decide whether or not access to retirement funds on death is a necessity when planning our retirement income strategy.

3.3 Inheritance tax position

If I plan on leaving all my assets to my spouse then inheritance tax issues may not have a huge bearing on retirement income planning. However if my spouse will only inherit a dependent's pension from my retirement fund then s/he may not be in a position to pass on any assets to children until her/his subsequent death. For example in an ARF scenario the surviving spouse need not inherit the whole fund and the first death may provide greater opportunity to pass part of the wealth to the next generation.

3.4 Attitude to risk - income security vs. capital protection / growth

Probably the most important issue here is that retirement planning clients understand the range of risks associated with product type and investment choice. For example an annuity may seem like a risk free income delivery product but a level annuity will never increase in payment and will often provide no lump sum benefit on early demise. Likewise a fixed term deposit based ARF may be seen as a conservative investment – yet funds may be depleting each year due to the annual % per annum drawdown effect with no opportunity to review for up to a five year term. An equity based ARF may expose the client to high upside returns but also to unrestricted losses in a situation where recovery time is limited.

3.5 Taxation implications for income / growth

The general taxation treatment of retirement income from pension schemes is that pensions and income from annuity or drawdown products are added to all other income and are subject to income tax and USC in the year of payment. However there are still some anomalies, such as the fact that ARF drawdowns prior to age 66 are treated as earned income and subject to PRSI whereas annuity income is not. Also self-employed taxpayers may avail of the PAYE allowance against ARF income drawdown so it will often make sense to maximise drawdown to cover same.

One of the benefits of the ARF regime is that drawdown may be increased to cover increased tax credits / allowances as they become available. Likewise income tax on profits and capital gains tax may be deferred using the gross roll up regime. On the other hand imputed drawdown requirements mean that a minimum amount must be drawn down each year subject to PAYE and USC. However a planned approach to drawdown can add efficiency to overall tax planning.

3.6 Circumstances may change – can I change my mind?

Sometimes you can. Sometimes you can't. It all depends on the choices made at the previous post- retirement planning meeting. If you have only selected annuities then it is most important to be very clear on the features selected.

For example if you bought an annuity four years ago with a five-year guarantee on pension then once you live another year that annuity will cease on your death. However if you had included a 50% spouse pension,then while there will still be no lump sum payable, your spouse will receive 50% of your annuity payment each year upon surviving your death.

On the other hand you might have transferred funds into an ARF five years ago with the primary intention of preserving the capital for the future benefit of your spouse and possibly your adult children. Now your spouse has predeceased you and annuity rates have improved somewhat as you are five years older

The removal of the need to invest in an AMRF will further enhance the attraction of the ARF as a post retirement option as it means there is no need to tie up €63,500 until age 75 or until an individual can meet the minimum income requirement.

As the market evolves, annual post-retirement planning meetings between clients and their Financial Brokers will become a constant feature of retirement life.

WHEN DOES POST-RETIREMENT INCOME PLANNING START?

There are probably two parts to this question. When is the actual decision made as to which options best suit my needs? This decision is usually made at the time I first draw down benefits. However a properly planned approach will usually begin much earlier. For example there is little to be gained by waiting until leaving employment at age 65 to ask – what benefit options are available? The answer might well disappoint. The earlier the planning process begins the better, in order that there will be no surprises later on.

The following career / lifetime events all form part of the post-retirement planning process and provide an opportunity to consider current and future income requirements.

4.1 Normal retirement age

Traditionally age 60 or 65 is when most private pension schemes are designed to commence paying benefits. This is usually the time when contract terms and conditions are designed to pay out maturity values and when associated term assurance and disability risk cover may cease. As such, irrespective of entitlements to state old age pensions and regardless of employment income ceasing or continuing, retirement options should always be evaluated at this time.

4.2 Early retirement from age 50 or earlier: ill health

Personal pension plans allow retirement at any time after age 60. Occupational schemes and PRSAs allow employees to take

The earlier the planning process begins the better, in order that there will be no surprises later on.

early retirement benefits upon cessation of PAYE service after age 50. All three types of pension plans allow for early retirement regardless of age attained where justified on grounds of ill health.

Many of our clients will have built up multiple pension entitlements in several pots relating to earlier employments. Once age 50 is attained some or all of these funds may be accessed where benefits have not transferred to schemes linked to current employment. As such, benefit access options may frequently be considered at any time after age 50; and regardless of options chosen this is the beginning of post- retirement income planning.

4.3 Leaving a pensionable job

Every change of employment is an event in the post-retirement income planning process. Each change triggers pension options to be considered and possibly exercised now or at a future date. For example if I am leaving a pensionable job the following questions need careful consideration:

(1) Leaving a Defined Benefit (DB) scheme:

- Should I leave my entitlement in the scheme as a deferred benefit until retirement or take a transfer benefit?
- Is the DB scheme adequately funded and meeting the Pension Authority's minimum funding standard?
- Is the scheme likely to be still there by the time I reach my normal retirement date or more likely to be wound up before then?
- Is the employer fully committed to funding the scheme for the foreseeable future?
- If I am considering taking a transfer value - is there a reduction in value due to the underfunding position of the scheme?
- What % of the transfer value is available as a tax free lump sum?
- Are AVCs included in the quoted transfer value?
- Should I transfer to a scheme of a future employer or take my own control via a buy out bond or PRSA?
- If bond yields increase in the future – will this impact adversely upon my transfer value?
- Do I want to be in a position to access ARF options
- When will I want to access benefits and what options will be available?
- What is the position on death?

(2) Leaving a Defined Contribution (DC) scheme:

- Should I leave my entitlement in the scheme as a deferred benefit until retirement or take a transfer value?
- Is the scheme likely to be still in place by my normal retirement age or more likely to be wound up before then?
- Am I likely to stay in touch with the employer's HR personnel and trustees after leaving service?
- Should I transfer to a scheme of a future employer or take my own control via a buy out bond or PRSA?
- Should I amalgamate with previous benefits?
- When will I want to access benefits and what options will be available?
- What is the position on death?

Even leaving a non-pensionable employment is another milestone; and questions should be considered such as how can I best use future pension funding opportunities and previous fund entitlements to make up for lack of pension funding built up during the last employment.

4.4 Wind up of a Defined Benefit (DB) scheme

With many continuing DB schemes still in deficit such schemes may have little choice but to reduce benefits or wind up over coming years. We have already seen many high - profile employers and trustees decideto go down the wind up route, and this trend is expected to continue. Between

2014 and the end of 2020 the number of continuing funded defined benefit schemes has fallen from 703 to 671.

So if I am an active or deferred member of a DB scheme in wind up, my choices are fewer than upon leaving service - because I no longer retain the option to leave my benefits in the DB scheme until retirement. The DB scheme won't be there so my only option is the transfer value available.

The value of my transfer option will reflect the funding position of the scheme at the time of wind up. Historically wind up rules required priority to be given to buy out of 100% of rights for pensioners actually in receipt of pensions. This meant that active and deferred members often suffered significant reductions in transfer values upon wind up where scheme assets were insufficient to buy out 100% of all liabilities. The priority rules on scheme wind up were changed in the Pensions (Amendment) Act 2013 to lessen the gap between buy out rights for pensioners over active and deferred members. Now 100% priority is given only to pensions in payment not exceeding €12,000 pa. Where pensions in payment are between €12,000 and €60,000 pa only 90% of payment is prioritised. Where pension in payment exceeds €60,000 pa priority status is extended to only 80% of the payment with the balance available for distribution between all member classes. However this may be of little consolation to current and former employees in the current scheme wind up environment where transfers available may be well short of these percentages.

In a scheme wind up the questions are fewer:

- Is there a replacement Defined Contribution (DC) on offer from the same employer? If so is there any benefit (other than convenience) in considering a transfer to such a scheme?
- If applicable should I consider a transfer to a scheme of a future employer or take my own control via a buy out bond or PRSA?
- Should I amalgamate with any previous benefits?
- When will I want to access benefits and what options will actually be available?

4.5 Pre – retirement fund approaching SFT

From January 2014 the current standard fund threshold (SFT) is €2.0m per individual. The SFT is the maximum pension fund value where retirement benefits may be accessed under normal rules without possible taxation penalty. If my fund exceeds this amount then the balance over and above €2.0m is liable to a once off penalty tax at 40%. Certain individuals who had higher funds in place prior to the introduction of the current SFT were in a position to avail of a higher personal fund threshold (PFT) limit equal to the fund level in place at the 1st January 2014 subject to a maximum of the previous SFT of €2.3m. Application for a PFT on this basis had to be made by the 30th June 2015 via the Revenue Online Service (ROS).

Defined benefit pensions accrued up to 1st January 2014 are valued at 20:1 for SFT conversion purposes, so that a pension in payment of €100k per annum was valued at €2m. In line with government policy that pension tax reliefs and exemptions should only be available to support maximum pensions of €60k p.a., the conversion factor applicable to retirement benefits earned after 1st January 2014 has been increased. Where benefits were earned prior to 1st January 2014 the conversion factor remains at 20:1. However where benefits are earned after that date the SFT conversion factor will be based on age at time of benefit drawdown in accordance with the following scale:

Age	Factor	Age	Factor
50 and below	37	61	29
51	36	62	28
52	36	63	27
53	35	64	27
54	34	65	26
55	33	66	25
56	33	67	24
57	32	68	24
58	31	69	23
59	30	70+	22
60	30		

The impact of the SFT is quite penal and may be demonstrated as follows:

Pension fund in place at age 60 equal to €2,500,000. Deduct SFT of €2,000,000. Taxable balance is €500,000. Penalty tax deducted of €500,000 x 40% = €200,000. Assume €60,000 tax credit available in respect of pension lump sum tax paid on €300,000 lump sum drawdown at flat rate tax of 20% (see Section 7.4 below). Residual excess fund available for taxable drawdown is now €500,000 less €140,000 = €360,000. If this residual fund is drawn down it is taxed again at 40% income tax plus 8% or 11% USC. At the highest rate the residual drawdown of €360,000 less 51% PAYE / USC would net out at only €176,400. As such the combined tax rate works out at over 65 % on the pension fund excess over and above the SFT. If drawdown attracts PRSI then the impact is even more penal. Where the lump sum tax credit is restricted the double tax impact is higher yet again.

For high earners the message is now quite clear – pension funding remains a most tax efficient vehicle for transferring pre-tax earnings into post-retirement funds, but only within current limits and thresholds.

Therefore post-retirement income planning comes into place as soon as current funds accumulated together with future contribution tracking come within range of SFT limits.

4.6 Approaching age 60 or age 50?

Following on from the above discussions it is clear that post-retirement income planning should certainly start before age 60 and in many cases can usefully commence approaching age 50 on the basis that access to some or all retirement funds may be available from then onwards.

Where SFT planning is involved it may make most sense to target some existing funds for early release into post-retirement accumulation products where subsequent growth in an ARF fund will not impact on the SFT.

Post-retirement income planning is about income planning for the pension holder and their dependents now and in the future.

Likewise, post-retirement planning from a relatively early date may help identify issues such as AVC overfunding. There is little point in directors and senior employees continuing to fund AVCs where accumulated AVC funds at age 60 could push employer funded benefits over the SFT. Replacing AVC savings now with after tax net investment plans may provide a more efficient outcome.

4.7 Change of family circumstances

Post-retirement income planning is about income planning for the pension holder and their dependents now and in the future.

Personal and family circumstances may change both before and after the point of retirement. Bereavements, marriage break ups, new partners, dependents and inheritances may impact greatly upon the retirement income planning process.

For example a divorce or legal separation resulting in a Pensions Adjustment Order (PAO) will have a very significant impact upon retirement planning for both parties. Choices need to be made as regards separating the benefits or not, and benefit access plans may be different for each party.

Likewise the receipt of an inheritance could have a significant impact upon a post-retirement plan. This could perhaps allow for some additional late pension funding or allow drawdown of retirement funds to be deferred to a later date due to availability of additional private funds and extra investment income available from the inheritance.

4.8 Need to access funds

The best made plans can always go wrong. Sometimes despite our best efforts a plan needs to produce a different result than was originally envisaged. For example a retirement fund earmarked for access at age 65 may be of little comfort if I need access to funds at age 55 to save my business or family home.

As mentioned above occupational pension funds and PRSAs are generally accessible from age 50 upon termination of relevant PAYE employment. Personal pension funds may be transferred into PRSA contracts. Buy out bonds holding deferred benefits from previous pensionable employments may usually be accessed from age 50.

The Finance Act 2013 introduced specific provisions allowing AVC investors to draw down up to 30% of AVC funds subject to tax prior to retirement regardless of age and was available for a 3 year period up to 27 March 2016.

Access to all or some retirement funds may well be available prior to age 60; and this may often be a critical component of a comprehensive post-retirement income strategy.

4.9 What retirement options are actually available?

In recent years this question is arising with greater frequency and unfortunately the answer provided is not always welcome. If we can see a problem with retirement options well enough in advance then there is time to address the issue and consider ways of fixing the problem.

It is most important for Financial Brokers to ensure that clients are provided with clear answers from trustees and pension providers as to exactly what retirement options are available and when - under each separate pension plan.

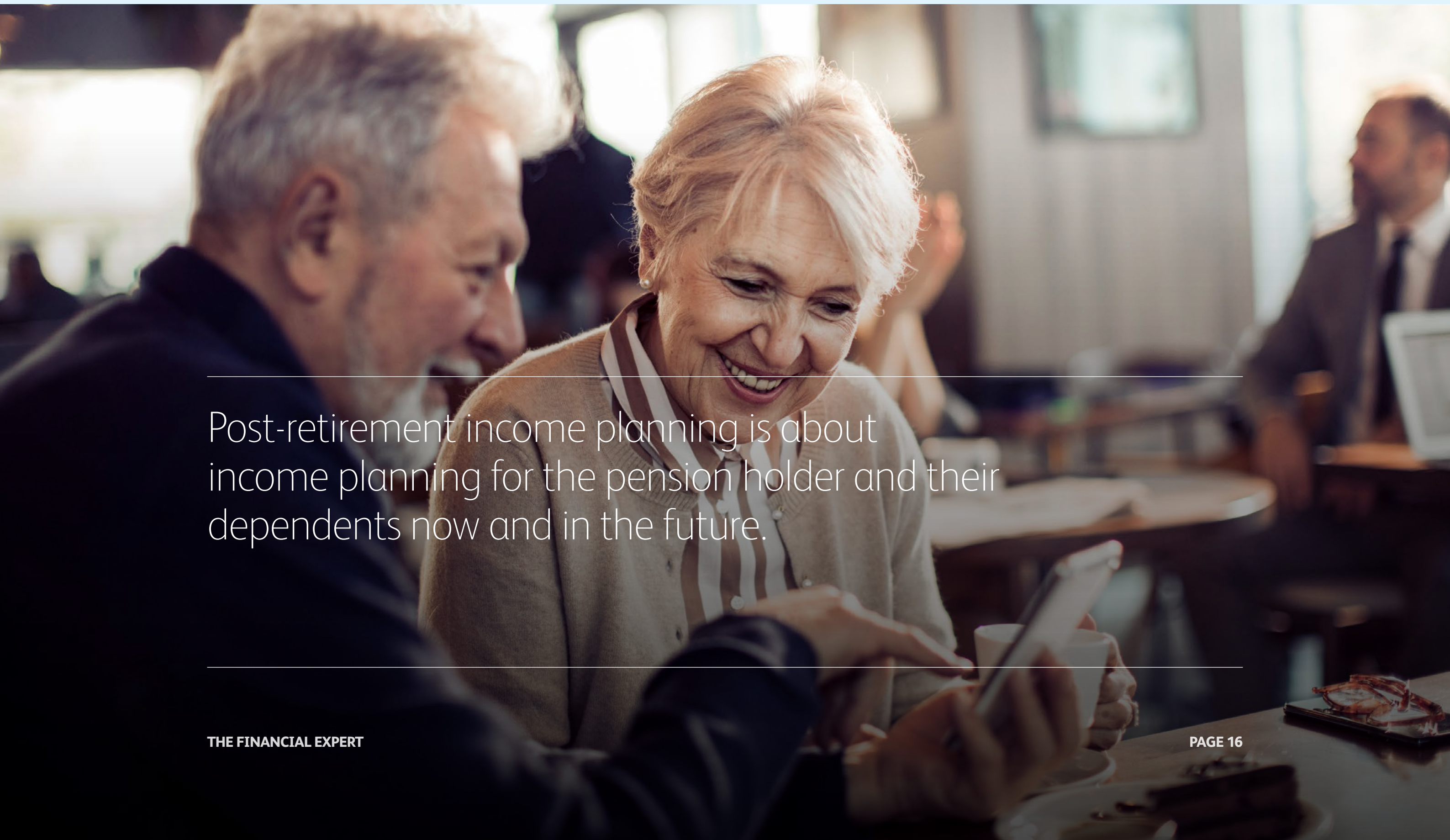
A simple checklist covering the following points may be useful:

- What is the earliest date on which retirement benefits are available?
- What is the latest date for benefit drawdown?
- Are ARF options available?
- What is the maximum retirement lump sum under salary and service rules (occupational schemes and buy out bonds only)?
- Are all necessary documents on file in order to pay out a retirement claim?
- What benefit is payable upon death before drawdown of pension benefits?
- To whom will this death benefit be paid?
- If trustee sign off is required for benefit payment – please confirm trustee details on file.

The answers to these questions should determine whether or not there are any surprises in store later on. If options are not as required then there is an opportunity to consider transfer options, or the need to request the trustees / providers to provide additional options. Either way the response will become an important template in the post-retirement income planning process.

4.10 Age 75

Following the passing of the 2016 Finance Act particular care is needed when advising clients who have either personal pensions or PRSAs . It is crucial that benefits are drawn down before age 75 to avoid the penal “lockdown” of the personal pension or PRSA.



Post-retirement income planning is about income planning for the pension holder and their dependents now and in the future.

WHEN DOES POST-RETIREMENT INCOME PLANNING FINISH?

There is no definite answer here but the current flexible environment certainly means that planning need no longer end on the day of annuity purchase, as was once the case. However the following scenarios may be worth some consideration.

5.1 Defined Benefit scheme is wound up or fails

This may seem like a most unlikely scenario but pensioners in receipt of DB pensions are less protected now than in the past. Previously if a DB scheme was in deficit at the time of wind up then the pensioners had first claim on scheme assets, with residual pay outs for active and deferred members taking the major hit. A fixed annuity was purchased from a life office to continue to pay the remaining pensions. However, since the introduction of the Pensions (Amendment) Act 2013, pensioners may be forced to share some of the deficit with the other member categories. Now DB pensions in payment of between €12,000 and €60,000 pa remain at risk of a 10% reduction and pensions in payment of over €60,000 pa remain in risk of a 20% reduction to support active and deferred members in the event of the scheme becoming insolvent. This is not news that a prospective DB retiree wants to hear but nonetheless a possibility of which DB retirees should be aware.

5.2 Fixed annuity is purchased

This scenario can take place under a DC scheme or arrangement at the time when benefits are first drawn down, or at a later date where ARF options or vested PRSA options have already been selected. As mentioned above annuity purchase may also be undertaken by the trustees of a DB scheme at any time to match pension liabilities, or upon scheme wind up.

5.3 All ARF monies are withdrawn

This scenario may seem unlikely but is always a consideration in suitable circumstances. For example a retirement client may have considerable tax reliefs or losses that might be capable of offset against earned income. In such a case it could make good sense to clear out an ARF fund during the years when such tax relief is available. Likewise an ARF investor may become resident outside of Ireland in a state where lower personal taxation rates apply. In such circumstances it might make sense to look at withdrawing ARF funds during tax years when resident abroad in order to claim back the Irish income tax deducted on grounds of non- residence and pay the lower rate of tax in the new country of residence.

Fears of increased future rates of personal taxation can often pose the question – would I not be better off drawing down my ARF now at current rates of marginal income tax and USC rather than risk exposure to higher rates in the future? The main issue in considering questions of this nature is: what am I going to do with the net drawdown amount and who will be the ultimate beneficiary? If a spouse and /or adult children are the persons earmarked to ultimately benefit from the process then the likelihood is that they will benefit to a greater extent by taking an inheritance directly from the ARF rather than inheriting only the after tax drawdown.

Again, reference to a comprehensive post-retirement income planning strategy will assist in making best sense responses to questions of this nature.

5.4 ARF bombs out prematurely

This is the scenario which is not supposed to happen…but it does.

The table below illustrates the likely timeframe where an ARF can support an income drawdown at rates between 5 % and 10 % per year where the fund achieves a consistent investment return of 5 % per year after charges. As we can see the fund bombs out after 15 years where the drawdown at 10 % per year is double the rate of fund growth but can last a 60-year-old up to age 97 where drawdown is lower at 6 % per year.

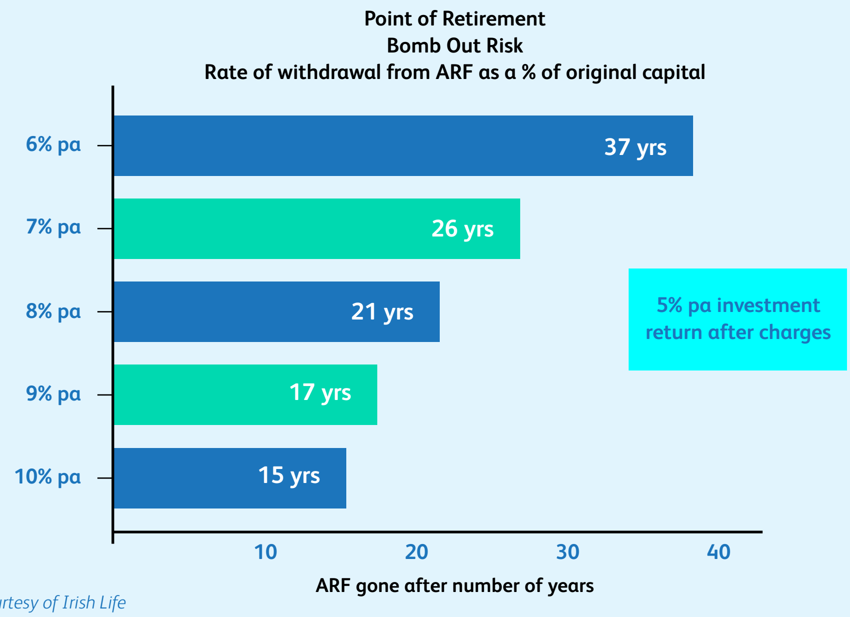


Table produced courtesy of Irish Life

Of course events will not always run to plan as per the table.

Many different factors and combinations of factors may apply: I lived too long – investment returns crashed
– I withdrew too much – the original capital investment was too little – I thought the income / capital was guaranteed – it was actually a bridging pension until eligible for contributory old age pension.

The most important issue is that the client should always have sufficient understanding of the ongoing position of the ARF in order to evaluate where s/he is on the post-retirement income plan. This means understanding the likely ARF payment duration based on drawdown and investment return projections at inception, and yearly monitoring of the actual position thereafter.

This regular review allows consideration of other investment options (including annuity purchase) along the way and / or review of drawdown rates. Such a review process also allows for recalculation of likely income payment duration capacity. So when bomb out arrives, it's part of the plan: not a nasty surprise!

5.5 Death of pensioner – no spouse's/civil partner's pension or ARF benefit

This is usually the end of the line. If there is no spouse and no ARF in place then in most cases this is the end of retirement income.

While most DB schemes will provide for a spouse's pension to be paid to a surviving spouse or dependent upon the death of a DB pensioner, there is frequently no benefit payable upon death with no dependents, usually after the pension has been paid for a 5 year period.

Where an annuity has been purchased under a DC scheme there is less likely to be a dependent's pension in place. However if death takes place within a guaranteed payment term (usually 5 years or occasionally 10 years after purchase of the annuity) then there may be a guaranteed payment due to the estate in respect of the unexpired period of the guaranteed payment term.

It pays to check the small print even where it might look unlikely that any benefit is payable.

5.6 Death of spouse in receipt of spousal pension – no ARF

If a spouse is in receipt of a DB or DC annuity dependent's pension based on the pension of the previously deceased spouse, then pension income will cease upon death. In the event that there were also dependent children's pensions payable linked to the spousal pension then some pensions and annuities provide for these pensions to be increased for their remaining duration to take account of the loss of spousal pension. In the rare enough event that such children's pensions might remain in payment at this juncture it may be important to claim the increased pension due, as annuity systems may not automatically pick up on the event.

The earlier the planning process begins the better, in order that there will be no surprises later on.

WHAT HAPPENS BETWEEN START AND FINISH OF POST-RETIREMENT INCOME PLANNING CYCLE?

This is where the first round of serious decisions are made. During this period clients will usually exercise retirement options depending on the selection of options made available from the outset of the planning period.

In some cases the choice of option will more or less determine retirement income levels for life. In other cases the choice may be the first in a long line of income / investment / family security decisions that will continue to be made throughout the duration of the retirement income planning period.

6.1 DB or DC pension or annuity comes into payment

This may take place at normal, early or late retirement age and will have involved lump sum access decisions having been taken prior to receipt of the first retirement income payment.
For DB scheme pensioners there are usually no decisions to be made after this point. Some schemes may offer an option to provide for a separate dependent's pension on death by giving up a part of your pension but usually fixed terms and conditions apply from this point forward. At this stage you are in the hands of the trustees or government department charged with safe delivery of your pension promise.

Where a life office annuity is purchased from a DC scheme or arrangement there are more choices to be made as to the annuity features selected and the impact these will have on both retirement and death benefits in the future. These choices are looked at in more detail in Section 9 of this guide. From this point forward the life office takes overdelivery of your pension promise. Under either scenario decision time is up. Time now to enjoy the hopefully adequate benefits

6.2 ARF put in place

Again ARF facilities may be put in place at normal, early or late retirement age and will have involved lump sum access decisions having been taken prior to the transfer of funds into relevant ARF contracts.

Unlike DB or annuity pensioners ARF investors remain responsible for the operation and performance of their post-retirement income plan. This means working with their Financial Broker throughout this period.

Financial considerations to be addressed at this time are covered in more detail in Section 10 of this guide but will normally cover at least the following issues:

- Depending on age will imputed drawdown tax apply from inception or from a later date?

- Taking account of tax- free funds already taken how much drawdown income will I need each month?

- Is this phase one of a lifetime ARF or is ARF intended to cover income over a shorter definite period until other pensions or investments become available?

- Will investment strategy be linked to that of other investments?

- What is the duration of the current investment strategy as agreed with the Financial Broker and in line with the risk profile?

- When is the next review date for the post-retirement income plan?

6.3 Change of family / financial circumstances

Regardless of choice of retirement income vehicle our own personal and financial circumstances are always subject to sudden or gradual change. Post-retirement income plans need to reflect these changes.
For pensioners in receipt of a DB pension or annuity, changes in personal circumstances should be evaluated to ensure that pension providers are advised where dependents' pensions may be linked to the benefits already in payment. This may or may not impact upon fixed benefits already secured, but it is best to know who is and who is not affected.

New issues such as pending bankruptcy proceedings can also impact here, as pension trustees may have the power to pay pensions to a person other than the scheme member in the event of the scheme member being declared bankrupt.

Where ARF structures are in place changes in personal and financial circumstances may be catered for by way of a purpose based review of the post-retirement income plan. Here matters for consideration may cover the following:

- Options to increase or reduce rates of annual drawdown

- Once off taxable drawdown options

- Change of ARF beneficiaries in will

- Creditor access issues

- Purchase of annuity

- Change of investment strategy.

Financial Brokers can play a very important role in assisting clients to adapt post-retirement income plans to changing personal and financial circumstances.

LUMP SUM CASH DRAWDOWN OPTIONS - FIRST CONSIDERATION

Retirement planning is primarily concerned with optimising usage of available funds during our working life in order to best maintain our lifestyle in retirement. Optimal planning then applies to the concept of preserving pre-tax earnings prior to retirement, investing them in funds where investment growth is tax exempt, then drawing these funds down tax free at retirement.

As such the first consideration of any post-retirement income plan should be to evaluate the scope available for tax free cash extraction. The process is not always as straightforward as it might seem and again is often much dependent on the status of the pension products housing the benefits at the time of drawdown and the knock on effect on other retirement income options.

7.1 Tax free lump sum of 25% of fund value

This benefit option is currently available to the following categories of retirees:

- Persons drawing down benefits from personal pension contracts – regardless of occupation
- Persons drawing down benefits from PRSA contracts – regardless of occupation
- 5% directors drawing down benefits under DB or DC occupational schemes or buy out bonds
- Employees (non- directors) drawing down DC and AVC benefits from occupational defined contribution schemes
- Employees (non- directors) drawing down benefits from buy out bonds .

The earlier the planning process begins the better, in order that there will be no surprises later on.

Where this 25% cash option applies the balance of funds may be used to purchase annuities, invest in ARF options or taken as taxable drawdown.

7.2 Tax free lump sum – final salary and service formula – occupational schemes and buy out bonds

This benefit option is available only to persons drawing down benefits from occupational DC or DB pension schemes or from buy out bonds. This option allows for calculation of the lump sum benefit on an independent basis rather than expressing the lump sum as a percentage of the overall pension funds available. For many persons drawing benefits under this formula the option of a lump sum of 25% of relevant fund may also be available; and therefore both formulae need to be considered before a final decision is made. For others where ARF options are not available then the final salary and service formula is the only consideration.

The maximum lump sum drawdown under this heading is 1.5 x final remuneration, but this benefit is only available where normal retirement age has been attained and the employee / director has completed at least 20 years' service with the actual employer providing the pension scheme. The following restrictions should also be borne in mind when working out the calculation:

- Where service at normal retirement age is less than 20 years the maximum lump sum benefit is 3/80ths of final salary for each completed year of service between one and eight years. Where service is between 9 and 19 years a formula known as the 'uplifted scale' applies, increasing from 30/80ths for nine years to 108/80ths after 19 years of service. The uplifted scale is set out at paragraph 7.2 of the Revenue Pensions Manual.

- Where a retirement lump sum is taken before normal retirement age the maximum payable may be reduced further in line with Revenue early retirement requirements.

- Where lump sum benefits have already been taken from a previous pension drawdown then the maximum payable now may need to be reduced accordingly.

- Where all benefits relate to the same employment then all benefits should be drawn down at the same time. The order of drawdown should be specified.

- Where benefits are being taken from different pension arrangements relating to different employments then each calculation may need to be made separately and may be based on different salary and service details attaching to separate employments. Drawdown need not take place at the same time.

- Where lump sum drawdown takes place from different scheme types such as executive and personal pensions then order of drawdown is important. Executive / occupational pensions must take previous lump sums already taken from other arrangements into account as retained lump sum benefits when calculating maximum pay out. \ Drawdowns from personal pensions and PRSAs may always pay out up to 25% of funds in lump sum form, regardless of previous pay outs.

- However all pension scheme retirement lump sum pay outs since 6th December 2005 are aggregated for the purposes of determining the tax rate, if any, applicable to payments.

7.3 Tax free cash cap – currently €200k

Prior to December 2005 there was no tax payable on any pension lump sum paid out either under the 25% rule at 7.1 above, or under the salary and service formula at 7.2. However, since 5th December 2005 the aggregate of all pension scheme lump sums received by an individual after this date is exempt from tax only up to a lifetime ceiling of €200k.

This €200k limit is now a retirement planning point in itself. For example, under the 25% of fund option a fund of €800,000 will be required to be in place to cater for the maximum lump sum withdrawal of €200k. On the other hand, a company director with a pension fund of €200k at age 60 could draw down the total fund as a tax- free lump sum payment under the service and salary formula, provided s/he had completed at least 20 years with the same employer and had a final salary of at least €133k per annum.

Clearly the anticipated level of tax- free cash extraction at retirement is capable of being estimated some years in advance and can then influence the level of funding in the years approaching planned drawdown day.

7.4 Taxable lump sum drawdown

Where all or part of a lump sum payment exceeds €200k then the next €300k of the lump sum is taxable at a flat rate of tax of 20%. Where aggregate pension lump sums received exceed €500k (25% of the current SFT of €2.0m), then any balance paid is taxed at the marginal tax rate and is liable for USC and for PRSI (up to age 66).

For example, if an individual is in a position to accumulate a retirement fund up to the current SFT of €2.0m and opts for the 25% retirement lump sum option then the maximum lump available is €2.0m x 25% = €500k.

The first €200k of this payment is fully exempt from income tax and the balance of €300k is taxed at a flat rate of 20%. This produces a tax deduction of €300k x 20% = €60k. This means that even though retirement lump sums are no longer fully tax exempt the maximum pay out of €500k is only subject to a total tax deduction of €60k, leaving a net payment of €440k receivable after tax. This equates to a maximum tax rate of just 12%.

Furthermore, the lump sum tax deducted is available as a credit against any chargeable excess tax (CET) payable where aggregate funds drawn down exceed the SFT or PFT. See example at section 4.5 above.

7.5 Cash option – impact upon residual fund options

As evidenced above the selection of lump sum drawdown options is in itself a hugely important aspect of the post-retirement planning process. However in the occupational pensions area, where individuals may choose between the 25% option and the salary and service formula, we also need to consider the impact of the lump sum decision as regards the options available on the balance of the maturing retirement funds.

The important rule to remember here is that ARF options may only be selected where the retirement lump sum option selected does not exceed 25% of the maturing pension funds. The following example may help to clarify the issue.

A company director is retiring at age 65 with an executive pension fund of €600k. The director has completed 30 years of service and final salary / BIK averaged out as €150k. If he opts for the 25% lump sum option, then he has a tax- free extraction figure of €600k x 25% = €150k. If he uses the salary and service formula, then the lump sum figure will be €150k x 1.5 = €225k. Tax on same will be €225k-€200k = €25k x 20% = €5k, leaving a net extraction figure of €220k. This is €70k higher than the figure produced by the 25% option. However, the problem is that the €225k figure produced by the salary and service formula is in excess of 25% of the retirement fund of €600k available. This means that ARF options are now not available and as such the director will be required to use the balance of the fund (€600k less €225k = €375k) to purchase an annuity.

So there is a major call to be made here:

A. Cash of €150k plus €450k to consider ARF / annuity / taxable drawdown options

B. Cash of €220k plus €375k to purchase annuity options only.

Again, the earlier these decision areas can be identified, the better will be the understanding of the retirement planning process.

7.6 Interaction with redundancy / employment termination payments

Where an individual receives a lump sum payment on termination of employment (other than statutory redundancy), the taxation exemption status of this payment ranges between a basic exemption of €10,000 up to a maximum of €200,000 and depends on a number of factors.

One such factor is the present or future value of the lump sum payment from an occupational pension scheme linked to the terminated employment. If applying for a taxation exemption threshold over and above the basic level the higher threshold is reduced by the value of the lump sum received or receivable from the occupational pension scheme. Therefore, in order to maximise the taxation exemption threshold it is possible to irrevocably waive the right to take a retirement lump sum under the occupational scheme
linked to the relevant employment. If the option is waived this means that the value of the lump sum option is zero and there is a corresponding zero reduction in the higher termination payment tax exemption limit.

Where a termination or redundancy payment forms part of a retirement planning exercise, or has previously resulted in an irrevocable waiver of the option to take a retirement lump sum, then this will be a key element of point of retirement planning. The important issue here is that an irrevocable waiver of a retirement lump sum option refers only to occupational pension schemes (including buy out bonds) linked to the relevant employment. The waiver does not apply to occupational schemes related to a different employment and does not apply to benefits drawn down under PRSAs.

So as retirement drawdown approaches it makes sense to identify any possible barriers to maximum lump sum drawdown, such as waivers of this nature, and see if opportunities exist whereby benefits from the scheme where the waiver applies could be transferred to an occupational pension scheme of a subsequent employer or to a PRSA. Of course, any such action needs to be weighed up against any associated loss of DB or death benefit protection arising from such a transfer.

7.7 Size of residual fund – trivial benefits option

Revenue rules allow for two options whereby small pension funds may be considered trivial in nature and may be fully drawn down subject to specified tax treatment.

Option A

This option may be exercised under occupational pension schemes where benefit funds from all relevant sources at the time of drawdown are sufficient only to purchase a single life level annuity of €330 per annum. In such a case the full amount may be drawn down in lump sum form subject to a special low tax rate of 10%. The problem here is that the provision refers to the whole fund before normal lump sum drawdown and based on a 3% annuity rate the whole fund needs to be less than €10,000. For a 65-year- old, where the annuity rate would be around 4.5%, the corresponding fund cap would be only €7,333. The option has limited application.

For example, a 65-year-old is retiring with a very small preserved pension fund of €6,000. Based on past service and salary details he can take up to €2,500 of the fund as a tax- free retirement lump sum. The balance of €3,500 would then need to be used to purchase an annuity of around €13 per month. By exercising option A the retiree could instead opt to draw down the full €6,000 fund as a lump sum payment less €600 (10% tax rate). The net result would be an after-tax lump sum of €5,400 and no annuity.

Option B

This is a more flexible option with significantly greater application scope and may be applied across the full pension product range. This option deals with funds remaining for annuity / ARF investment after a lump sum retirement drawdown has taken place. Where residual funds from all relevant sources do not exceed €30,000 investors are provided with the option of taking the fund as a once off taxable drawdown subject to the marginal rate of income tax and to PRSI and USC.

For example, a 60-year-old company director has €40,000 in an executive plan and has €30,000 in a PRSA related to a separate business. Based on salary and service formula he is entitled to take a tax-free retirement lump sum of €52,000 from the executive pension. If PRSA funds are transferred into the executive pension then there are sufficient funds to draw down the full €52,000 tax free lump sum entitlement, leaving a residual fund of €18,000. Option B may now be exercised and the residual €18,000 may be drawn down subject to tax, USC and PRSI (where applicable). Assuming an aggregate tax rate of 52% this gives a net drawdown of €60,640 out of total funds of €70,000.

Small pension funds may often have a role to play in planning tax efficient fund drawdown - either by way of early trivial access or via transfer to other pension arrangements

Small pension funds may often have a role to play in planning tax efficient fund drawdown - either by way of early trivial access or via transfer to other pension arrangements

RETIREMENT INCOME OPTIONS - ANNUITY - ARF- DRAWDOWN - COMBINATION

Once the lump sum options have been considered and actioned we can now consider the options remaining for the balance of retirement funds to provide income security and cater for future capital needs.

8.1 What options remain available?

This all depends on how much funds have been accumulated, what options have been ruled out already, the pension vehicle from which funds are drawn down and the lump sum options selected.

For example, under a Defined Benefit scheme with no AVCs there may be little or no decisions left to make after a lump sum benefit has been selected. However, if there is an AVC fund remaining after drawdown of a retirement lump sum then there are additional income options to be considered. On the other hand, a company director with a maturing executive pension scheme who has opted for a lump sum benefit under the 25% option will see a range of income / drawdown options available via ARF and annuity products.

8.2 Need for immediate income?

This is usually the first question that needs to be addressed. The clearer the picture is as regards income entitlements outside of the currently maturing pension arrangements the better. For example, the following issues will always be relevant.

- Is the contributory old age pension already in payment or due to commence within a relatively short period?

- Is there an occupational DB income already in place or due to commence shortly?

- Is there a continuing income stream from employment or self-employment and for how long is this likely to continue?

- Is the spouse or civil partner in receipt of pension or employment income and is this income jointly taxed and available to meet the living requirements of both parties?

If the answer to one or more of these questions is yes, then there is some certainty that a basic or more significant level of ongoing income will be in place and there is more scope to examine complementary income strategies.

If the contrary is the case, then there is a pressing need to establish how best to create income over the immediate years ahead. For example, take the case of a 58-year-old female forced to retire early through redundancy with a PRSA fund of €200,000. The client will be aged 66 or possibly 67, before becoming entitled to her state old age contributory pension. The proceeds of a 25% cash drawdown of €50,000 together with a redundancy lump sum may firstly have to cover the pay down of an outstanding mortgage or other financial commitments. If the client is unable to find suitable replacement employment, then Jobseeker's Benefit will only last for a nine-month period prior to a claim for the means tested Jobseeker's Allowance. In this case there may be a eight / nine-year period until age 66/67 where income drawdown from remaining ARF assets of €150,000 becomes a priority issue. The position may always be reassessed in the event of resumption of paid employment.

8.3 Range of annuity options

Whether the decision to go down the annuity purchase route is elected or forced upon the client, the next decision is the type of annuity to be purchased. The position is considered in more detail in Section 9 of this guide, but it is important to ensure that the client is aware of the range of annuity features available under the following broad headings:

- annuity policies must guarantee income for life and currently may only be issued by a life office licensed to provide annuities to Irish citizens

- do guaranteed minimum annuity rates apply or only current open market options?
- choice of single life or joint life annuity

- can client and /or partner access enhanced annuity rates due to lifestyle or medical conditions

- with or without a minimum guaranteed payment period

- choice of level payment only or with fixed or CPI related annual increases in payment

- payment frequency: monthly or quarterly in arrears / in advance etc.

Once the annuity is purchased the transaction is irreversible after the 30-day cooling off period – so it's very important to get it right first time!

The earlier the planning process begins the better, in order that there will be no surprises later on.

8.4 Range of ARF options

When the decision is made to go down the ARF investment route, it is at least less final, as investment strategy and drawdown decisions may always be reviewed and changed along the way. Annuity purchase options remain open and may also be exercised at a later date. The range of options is considered in more detail in Section 10 of this guide, but it is important at inception to be clear on the following general criteria.

- ARF accounts may only be provided by Qualifying Fund Managers (QFMs), being entities such as life offices, banks, stockbrokers, MIFID firms, credit unions, building societies or collective investment undertakings (e.g. unit trusts) who have notified Revenue of their activity in this field and continue to satisfy Revenue reporting requirements.

- The client may hold multiple ARF accounts / contracts with multiple QFM providers but may be required to appoint one 'nominated QFM' to coordinate imputed drawdown issues.

- No restrictions (other than self-investment) apply to investment options that a QFM may offer on both ARF accounts / contracts.

- Income from ARF drawdown is subject to PAYE, USC and PRSI (before age 66).

- ARF funds may pass on death to spouse and /or estate and specific taxation provisions apply.

- ARF funds may run out and are not guaranteed to provide income for life or to provide a benefit fund on death.

A client discussion around these issues at an early stage may help to point in the direction of suitable ARF providers and investment strategies.

8.5 Drawdown requirements

Current legislation does not technically require an ARF investor to take a specific income drawdown each year but encourages ARF investors aged 61 or more to so do by imposing an income tax penalty where minimum drawdown amounts are not taken. These requirements are known as 'imputed drawdown' provisions and are covered in Section 10.3 of this guide. Most ARF investors will require some level of regular income drawdown and the following issues should be considered when discussing this requirement.

- What level of regular income is already in place? See 8.2 above.

- Will ARF income be needed on a regular monthly basis or by way of lump sum irregular withdrawals?

- Will a regular monthly drawdown of 4% or 5% of fund value meet income needs?

- Will additional regular drawdown income be required and at what level?

- For how long can the fund support the desired level of annual drawdown both on a fixed and an inflating basis?

- At what intervals should income drawdown requirements be reviewed?

The answers to these questions should help point the way to the ARF structure best suited to meeting income drawdown requirements until the next review date.

8.6 Tax credits available for offset

Once a suitable level of drawdown is selected the next step is to discuss the likely impact of taxation on both this income stream and on aggregate income. The objective here is to ensure that the client is not lining up any unexpected tax demands down the road. The client should be made aware that ARF drawdown amounts will be subject to PAYE and USC, and also to PRSI where drawdown is taken under the age of 66. Also, where the state contributory old age pensions are payable these pensions (which themselves are not taxed at source) will be aggregated with drawdown amounts and income from all other sources in order to determine the overall marginal tax rate payable.

The following issues should be considered.

- Current income tax exemption limits depending on age and single / joint assessment status. For example, a couple with one party aged over 65 may now jointly from all sources earn up to €36,000 pa without paying income tax. USC and PRSI liability may still arise.

- Is PAYE tax credit already in use? If not, same may be claimed against ARF income drawdown.

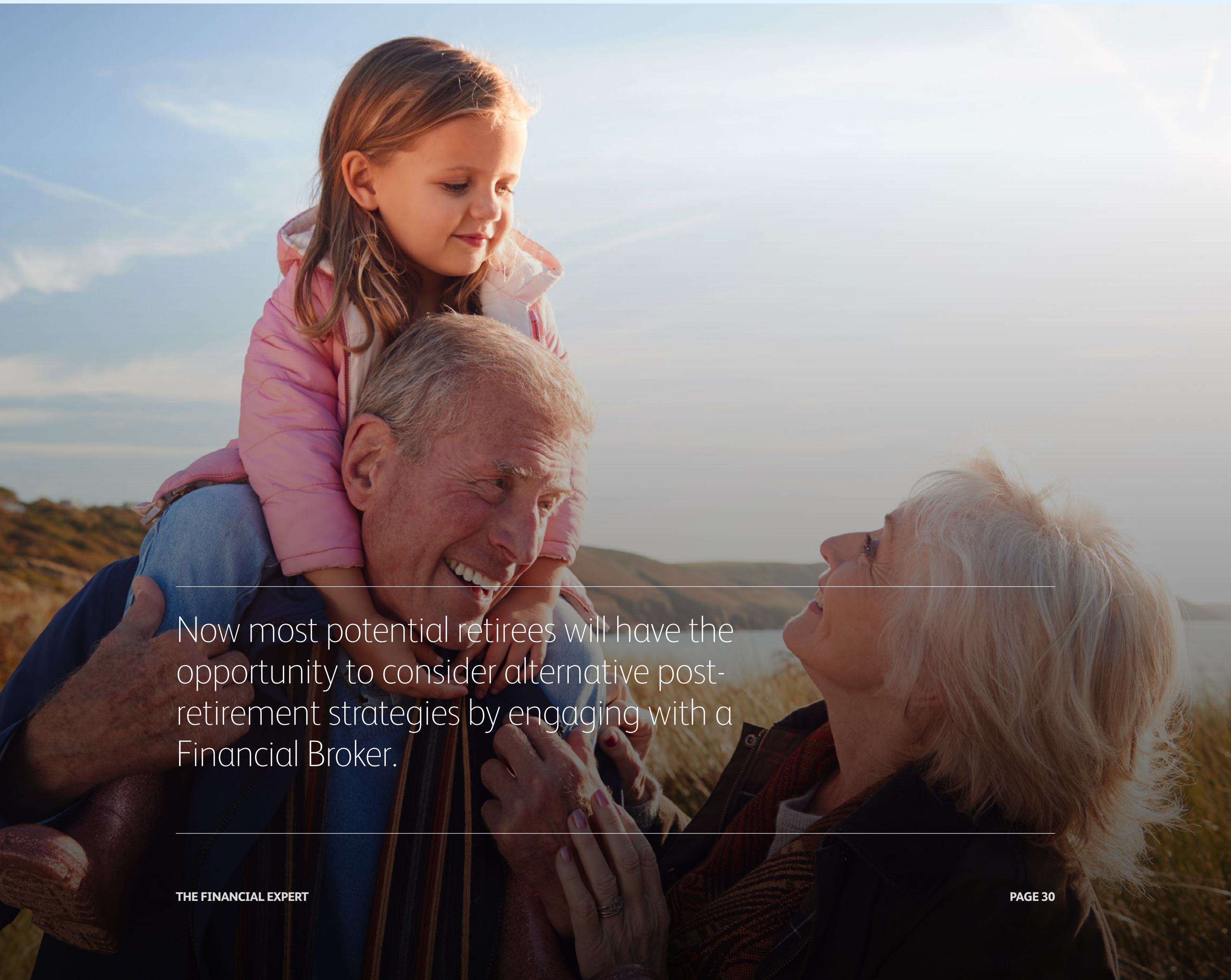
- Should tax credits be reduced to cover tax liability on state old age pensions?

- What level of tax credits may be applied against various sources of ARF drawdown income?

- What is the standard rate cut off point and will drawdown increase the marginal tax rate?

- Should the desired drawdown level be increased / reduced to make the best use of likely taxation rates and bands?

While any actions arising from this discussion are the responsibility of the client to follow through, the exercise will normally be of benefit to all parties engaged in the ongoing income planning process.



Now most potential retirees will have the opportunity to consider alternative post-retirement strategies by engaging with a Financial Broker.

ANNUITY OPTIONS - BIG DECISION

The most important aspect of annuity purchase is the fact that there is no opportunity to change the terms of the contract after purchase. The role of the Financial Broker is therefore critical at this point in time in order that the client may be satisfied that all relevant choices have been explained and that relative impact on income pay-out has been made clear. For example, a 60-year-old with €400k to purchase an annuity could expect to receive an initial income of around €11,720 per year if selecting a level annuity, compared to just €6,904 per year if opting for an annuity with fixed increases of 3 % each year. The increasing annuity will take over 18 years to match the initial pay out of the level annuity, and over 41 years to double that payment. No one knows future life expectancy or future inflation rates; so choosing annuity features is a big once off call and this should be clearly understood.

9.1 Annuity rates – guaranteed rates – open market rates – provider strength

In the past many traditional life office pension plans (predominantly non unit linked investment policies) included features such as guaranteed annuity rates at a specified retirement age, usually at age 60 or 65. As these annuity rates were struck in times when higher interest rates prevailed, any such rates attaching to existing policies will usually be much higher than the corresponding open market rates available from current annuity providers.

As such any long-established pension policies issued by life offices operating with profits or deposit administration funds should be checked to ensure that any guarantees relating to immediate or deferred annuity options are fully evaluated. Where no such guarantees apply most contracts will provide for exercise of an open market option. This option allows the fund to be transferred to the current provider offering the highest rate for the selected annuity option.

Once the best rate has been established (pre-guaranteed or open market) the final check is to ensure that the client is happy with the financial strength position of the annuity provider; or alternatively wishes to consider a lower annuity rate from a provider with a stronger rating.

9.2 Level or escalating annuities

As mentioned already the most expensive annuity feature is the incorporation of fixed annual or CPI related increases in benefit payment. Naturally the younger the age at commencement the greater the difference between the initial payment rate for a level annuity and the rate for an escalating annuity. Annuity rates below calculated on a purchase price of €100,000.

Age	Level Guaranteed 5 Years	3% Increasing Guaranteed 5 Years	% Difference in rates
60	3.03 %	1.79 %	69 %
65	3.62 %	2.32 %	56 %
70	4.43 %	3.08 %	44 %
75	5.63 %	4.22 %	33 %

9.3 Single or joint life annuities

Annuities will always be paid for the duration of the lifetime of the pension holder. However, subject to certain exceptions dealt with in Sections 9.4 and 9.5, the annuity payment will cease upon the death of the pension holder and no further benefit will be received by the spouse, civil partner, children or other financial dependents. Clearly where a spouse or other person is financially dependent on the annuity holder the question of providing a continued income for the life of the dependent must be considered.

A spouse or recognised civil partner will always be regarded as a dependent. Likewise, a child up to age 18, and usually up to age 23 if in full time education. Otherwise, a person who can be shown to be financially dependent on the annuitant may be regarded as a dependent. However, the selected dependents must be approved and named on the annuity contract at inception, as joint annuitants and the age of the dependent(s) will have a bearing on the rate of pension payable. Under certain occupational schemes there may be an option to apply part of the funds to purchase a deferred annuity for a dependent to commence on the death of the main annuitant – but this option is now relatively rare.

Where an annuity is set up to incorporate a spouse /civil partner pension the reduction in pay out rate depends on the ages of the parties and the percentage of replacement pension to be paid to the surviving spouse. This will normally range between 50 % and 100 %. The normal reduction in rate for a 67 % joint life pension from that of a single life annuity for a 65-year-old with a three year age gap between the parties is around 15 %.

Again, whether this option is a near necessity or nice to have will depend on what other protections and assets are in place in the event of the death of the annuitant.

9.4 Guaranteed periods / overlap / protected annuity / payment frequency

Annuity payments will cease on death unless a specific minimum guaranteed payment period has been selected at the outset and has been specified in the annuity contract. Legislation allows for a guaranteed period of up to 10 years. However not all annuity providers offer this level of guarantee, with a 5-year guaranteed period being the most frequently offered choice. Also, if a spouse pension on death is selected (as in 9.3 above) then there may be little rationale in also incorporating a guarantee on the first life pension. Where a minimum payment guaranteed period is selected clarification should be sought from the annuity provider as to any provisions applicable in the event of a death claim to commute the remaining guaranteed payments to a once off payment, and to whom the payment may be paid. The cost of a 10-year guarantee will of course exceed the cost of a 5-year guarantee; and a guarantee for a 75-year-old retiree will cost more than that for a 60-year-old.

However, a feature known as overlap may be selected where an annuity purchase fund comes from an occupational scheme. Overlap means that in the event of the death of the annuitant the original annuity payment will continue to be payable for a minimum period of up to five years from the commencement date, together with the specified spouse's annuity, which would commence on death. For example, John purchases a level annuity of €15,000 p.a. with a 5-year guarantee with an overlap spouse pension of 66.67% payable on his death to his spouse Mary. John dies three years later. Mary will now receive the benefit of John's annuity of €15,000 per year for a further two years following John's death, and at the same time will receive a spouse annuity in her own right of €10,000 per year from the date of John's death for the remainder of her own life. In this case because overlap was selected Mary benefits from both annuities for a two year overlap period. Had overlap not been selected then Mary's own right spouse pension would not commence payment until the end of the 5-year guaranteed period attaching to John's annuity.

Most annuity payments are paid monthly in arrears – similar to monthly salaries. However, the client will normally have the option of electing for less frequent payments: quarterly, half yearly or yearly in advance or in arrears. Again, an annuity that pays yearly in advance will be more expensive than one paying yearly in arrears.

All of these features contribute to both the income protection that the annuity provides and the price of the annuity package, which is reflected in the initial rate of payment.

9.5 Enhanced or Impaired annuity rates

So far adding annuity features has meant decreasing rates of annuity payment. However recently some leading annuity providers have introduced higher annuity income rates for retirees who are considered more likely to live shorter than average in retirement due to lifestyle and / or medical conditions.

For example, potential retirees with a history of smoking and / or obesity may qualify for higher pension payment rates to reflect these lifestyle factors.

Likewise existing medical conditions such as diabetes or high blood pressure and more serious conditions such as heart problems and cancer can impact quite favourably upon annuity payment rates. Both retiree and spouse / civil partner may apply for assessment for enhanced annuity rates and may benefit by way of payment rate increases by as much as 30%. Recent research from Reinsurance Group of America based on UK annuity market statistics suggest that up to 60% of potential retirees could benefit from some degree of enhanced annuity payment.

Given current all time low rates for basic annuities – it makes sense to check out possibilities for enhanced rates

9.6 Death Issues

When the annuity holder dies, what happens depends on the annuity features selected at the time the annuity was purchased. There are no new options or planning issues at this stage.

Income payments will cease completely on death where the

- annuity was a single life annuity with no guaranteed payment period
- annuity was a single life annuity and death takes place after the expiry of the guaranteed period
- annuity was a joint life annuity and the named spouse / dependent has predeceased the annuity holder

- annuity holder was in receipt of spouse / dependent's annuity following the death of the first life

- annuity was not a 'protected annuity' purchased under ARF / AMRF provisions.

If payments are to continue after the death of the annuity holder then payments will be of the following nature:

- spouse or dependent annuity payable to a pre-named dependent for the remainder of his / her life

- balance of guaranteed payment period – maximum 10 years. There may be provisions to negotiate payment as a once off taxable lump sum. Clarity should be obtained from the annuity provider and agreed with personal representatives as to how and to whom any such payments may be made

The most important issue here is that there are no surprises. The death benefit position (if any) has already been established at the time of annuity purchase and all concerned parties should be aware of the position..

9.7 Annuities pros and cons

The benefits and drawbacks of annuity purchase may basically be summarised as follows:

Pros	Cons
Income is guaranteed for life	Ownership of funds is gone forever
Certainty of income and ability to plan financially for future	Annuity rates are low and have followed interest rates downwards
No investment risk (except inflation)	Inflation can erode value of income (unless high price paid now for some inflation proofing)
Don't need to predict life expectancy	Premature death – all benefits gone unless price paid for protection on commencement
Decisions are made - no more hassle	No scope to reconsider – control gone

Prior to 1999 there were no alternatives to annuity purchase for DC pension investors. Now most potential retirees will have the opportunity to consider alternative post-retirement strategies by engaging with a Financial Broker.

Existing medical conditions such as diabetes or high blood pressure and more serious conditions such as heart problems and cancer can impact quite favourably upon annuity payment rates

ARF - ALTERNATIVE TO ANNUITY PURCHASE

Section 8 of this guide has already looked at some of the technical issues associated with ARF access and the considerations when deciding whether or not to choose this investment route. Once the decision has been made in favour of ARF investment the next matter is to look at the options available and consider the most appropriate investment / product strategy.

10.1 Approved retirement funds – the big questions

Investment strategy will of course differ from client to client and will centre around attitude to risk as determined from the know your client fact find carried out by the Financial Broker. However in terms of ARF investment the following questions may help determine a more specific post-retirement investment strategy:

- What is more important: security of income, security of capital, or maybe both equally?
- How long must ARF support self and spouse?
- How much monthly income is really needed?
- Can ARF handle monthly drawdown and retain funds for future needs?
- Attitude to post-retirement risk – go for growth and risk falling capital and income?
- Attitude to post-retirement risk – protect capital – will 4% or 5% drawdown still erode ?
- What if or when fund runs out – is there a plan B?
- How flexible must a strategy / product be – new vehicles coming to market?

If these questions are answered then the ARF investment strategy is starting to take shape.

10.2 Need for income – minimum drawdown requirements – imputed drawdown

In recent years this issue has changed the way ARFs work and has had a major influence on the investment strategy underlying ARF investments. Since 2010 ARF investors aged 61 and over who do not draw down an income of at least 5% of aggregate ARF assets each year have been required to pay income tax at the marginal rate on a notional (called imputed) drawdown of 5% of aggregate ARF assets valued on 30th November in the relevant year. The tax will be paid by the relevant QFM (see Section 8.5 of this guide) or appointed QFM as the case may be during the first quarter of the following tax year. This tax amount will be deducted by the QFM from relevant ARF and vested PRSA assets. From 1st January 2001 the 5% drawdown rate is reduced to 4% for investors aged under 71 during the relevant tax year. The relevant 4% or 5% drawdown rate is increased to 6% where ARF / vested assets exceed €2m. Amounts drawn down from AMRFs were (AMRF requirement now abolished) regarded as forming part of the aggregate ARF drawdown for the purposes of meeting imputed drawdown requirements.

The impact of these drawdown implications is that ARFs are really no longer suitable for long term asset roll up without annual drawdown.

Take the example of a 71-year-old investor with an ARF of €1m paying tax at 40% and USC at 8%.

If drawdown of 5% is taken, then the investor is left with total assets of €976,000. These assets comprise €950,000 in the ARF and net cash of €26,000 (€50,000 less tax / USC at 48%) in the hands of the ARF holder.

If drawdown is not taken, then the imputed tax and USC of €24,000 must still be paid by the QFM. The QFM will then reduce ARF assets by a corresponding amount. The investor still has the same level of total assets of €976,000 but this time all assets remain within the ARF, and the investor has zero tax paid cash in hand. If the investor needed access to €26,000 net cash, then a further €50,000 would need to be withdrawn from the ARF, which would then reduce the ARF value to €926,000. This would leave the client with a €24,000 extra loss in ARF value than would be the case had drawdown been taken in the first instance.

As such for most ARF investors (whether or not income drawdown is required for day to day living purposes) the reality is that management of the income drawdown process is now an integral part of post-retirement income planning.

10.3 Investment issues

ARFs potentially offer a very wide range of investments. Essentially each QFM provides a range of investment options and ARF holders may invest with one or more QFMs and may transfer funds between different QFMs. Investment options will normally be classified under risk return rated categories and will include the following:

- short term and fixed deposits
- unit linked funds: cash, property, fixed interest, commodity, equity, managed / multi asset, absolute return
- direct shares, indexed funds and exchange traded funds
- direct property holdings and pooled funds-unit trusts, UCITs, structured products with or without guarantees
- annuities: traditional, protected, enhanced and variable lifelong income products.

The following types of ARF investment transactions are not permitted on the basis that the asset concerned is required to be treated by the QFM as a taxable distribution made from the ARF:

- use of an ARF asset as security for a loan
- loans made to the ARF holder or connected person
- sale of an ARF asset to the ARF holder or connected person

- acquisition of property from the ARF holder or connected person
- acquisition of residential or holiday property for use by the ARF holder or connected person
- acquisition of property to be used in connection with any business of the ARF holder or connected person
- acquisition of shares in a close company where the ARF holder or connected person is a participator.
- Investments in conjunction with pre - retirement assets of connected persons where value can move from ARF to connected person assets.

Different QFMs, as in life offices, banks, stockbrokers and asset managers, will specialise in particular ARF investment options and product lines. Certain products may have some access restrictions in order for the QFM to be in a position to manage the relevant % drawdown required to avoid the penal impact of imputed drawdown tax.

Financial Brokers will be best placed to compare different offerings to match the investor's risk profile and income needs.

10.4 Deposit Issues and Relevant Drawdown

Deposits provide a good example of how the relevant annual drawdown requirement can impact on ARF investment strategy. A number of years ago, when 'cash was king', artificially high retail fixed deposit rates looked very attractive for ARF investors on the basis that yield could be drawn down and ARF capital remained intact. These rates are now history but demonstrated the difficulties faced by ARF investors even when deposit rates looked attractive.

For example, a 65-year-old ARF investor with €100k wishes to lock into an attractive 3% p.a. 5 year fixed deposit rate. The annual management charge on the ARF is 1% p.a. The problem is that net yield is effectively only 2% p.a. but the annual drawdown requirement is now 4% p.a. In order to pay the drawdown, the QFM cannot invest the full €100k in the deposit and must now withhold approximately 10% of the ARF funds as liquidity to service the management and drawdown requirements. After the five year deposit matures the value of the ARF capital is now down to c.88% of its original value.

So what looked like a straightforward solution poses a number of questions.

- Income is required for a life expectancy of 12 to 30 years so does locking into a five year fixed rate make a good fit?

Once the decision has been made in favour of ARF investment the next matter is to look at the options available and consider the most appropriate investment / product strategy.

- A fixed deposit term means out of market for that full term.

- What happens if inflation takes off?

- What happens on death or if fund access is needed in the interim?

- If five years later capital is guaranteed to be down to around 88% of the initial amount and interest rates are still low: what next?

Asking the questions is the key. What is the alternative strategy? Does the risk profile provide scope for an alternative investment approach? Perhaps a 5 year review period is too long where funds have no exposure to real assets? However a 5 year fixed rate means exactly that. The review period may become the driver of the preferred investment approach.

10.5 Death Benefits under ARF

For many pension investors the major attraction of the ARF structure is that fund ownership is retained at all times. This means that in the event of death the ARF assets are beneficially owned by the ARF investor and not by the QFM. ARF assets may be passed on to dependents in the same way as other personal assets. However different taxation rules apply, depending on how the benefits are inherited.

In general, the principle is as follows.

Assets transferred from an ARF to an individual on death are treated as taxable distributions in the same way as withdrawals prior to death. There are two exceptions:

- A) Transfer of assets to an ARF owned by the spouse or civil partner of the deceased. Here the spouse/ civil partner is referred to as ‘stepping into the shoes’ of the ARF of the deceased.

- B) Transfer of assets to a child of the deceased under the age of 21.

Transfers at A and B above are exempt from treatment as a taxable distribution. CAT will apply as normal in respect of the transfer of assets at B above but the normal CAT parent to child aggregate exemption threshold will apply.

Otherwise, payments made from the ARF of the deceased will be subject to income tax, USC and PRSI (where applicable) as if payment constituted a distribution made to the deceased in the year of death. Again, there are two exceptions:

- C) Transfer of assets to a child aged 21 or over from the ARF of the deceased.

- D) Transfer of assets to a child aged 21 or over from the ARF of the surviving spouse or civil partner of an ARF funded by ARF transfer from the deceased.

Transfers at C and D above are subject to a special ring-fenced final liability tax rate of 30%. As persons at C and D above are taxed as in receipt of a distribution taxable under Case IV of Schedule D rather than receiving an inheritance, there is no liability to CAT.

Effectively this means that the ARF ends on the death of the ARF holder. However, the spouse or civil partner of the deceased (as at A above) is permitted to establish a new ARF in his/her own right in order to receive a non-taxable transfer from the ARF of the deceased.

ARFs can therefore play a significant role in tax efficient estate planning. On the one hand a transfer to an ARF of the surviving spouse effectively means that the full ARF fund transfers without tax leakage. However,if the surviving spouse subsequently needed to transfer funds to a child (for example to purchase a property) then s/he would need to withdraw funds from the replacement ARF less PAYE/USC / PRSI (possibly up to 55%) in order to make this transfer before looking at any CAT liability.

For example, take a situation where John dies at the age of 64 with an ARF of €900k. The personal representatives transfer total ARF assets of €900k to an ARF in the name of spouse Joan, aged 60. Two years later Joan agrees to gift €200k net from the ARF to her son Michael, aged 25, for property purchase. In order to release €200k net from the ARF Joan must draw down €444,444 (nearly half of her fund). Michael may also have a CAT liability on the net €200k gift from his mother depending on any other inheritances taken on the death of his father.

On the other hand, if Michael had inherited a €300k distribution from the €900k ARF from his father John, then he would have received a net amount of €210k after final liability tax. This would not have affected his threshold for CAT purposes. Mother Joan would not need to withdraw funds from her ARF to fund the property purchase and could retain ARF funds of €600k.

ARFs have introduced a new dimension of succession and estate planning into the post-retirement tax planning process. Now pension funds have a tangible value which can benefit both the current and following generation.

10.6 ARF flexibility issues – full and partial drawdown – annuities deferred / protected / variable

The ARF investor is at all times the beneficial owner of the ARF assets. This means that where assets are liquid the ARF investor retains the right to consider and execute the following:

- change investment strategy or product – already discussed at 10.3 above
- purchase an annuity
- draw down all or part of the assets as a taxable distribution.

The ARF model has always provided the option to transfer funds to purchase an annuity at a later date. Now the relevant % drawdown requirement is causing older ARF investors to pay closer attention to this option, particularly where deferring annuity or joint annuity purchase to an older age can generate a higher level of secure income for life while retaining a lesser pure ARF investment for emergency drawdown. This concept is sometimes referred to as deferred annuity planning, and Financial Brokers will welcome further product development in this area.

Clearly ARF product design is evolving all the time in terms of responding to

- drawdown requirements and related taxation issues
- volatile investment market conditions
- lowest ever interest rates
- increased longevity.

The ultimate test of ARF flexibility is the option to draw down all or part of the remaining funds at any time. For example, if funds are needed for medical care or pay down of debt, or for other investment or family financing requirements then ARF funds may be used. Drawdown of course will be taxable but may perhaps be spread out over a number of years to minimise the impact of marginal tax. Such discretionary drawdown will of course impact upon from where ongoing retirement income will be produced. But that's another plan to be made – at least the choice is there.

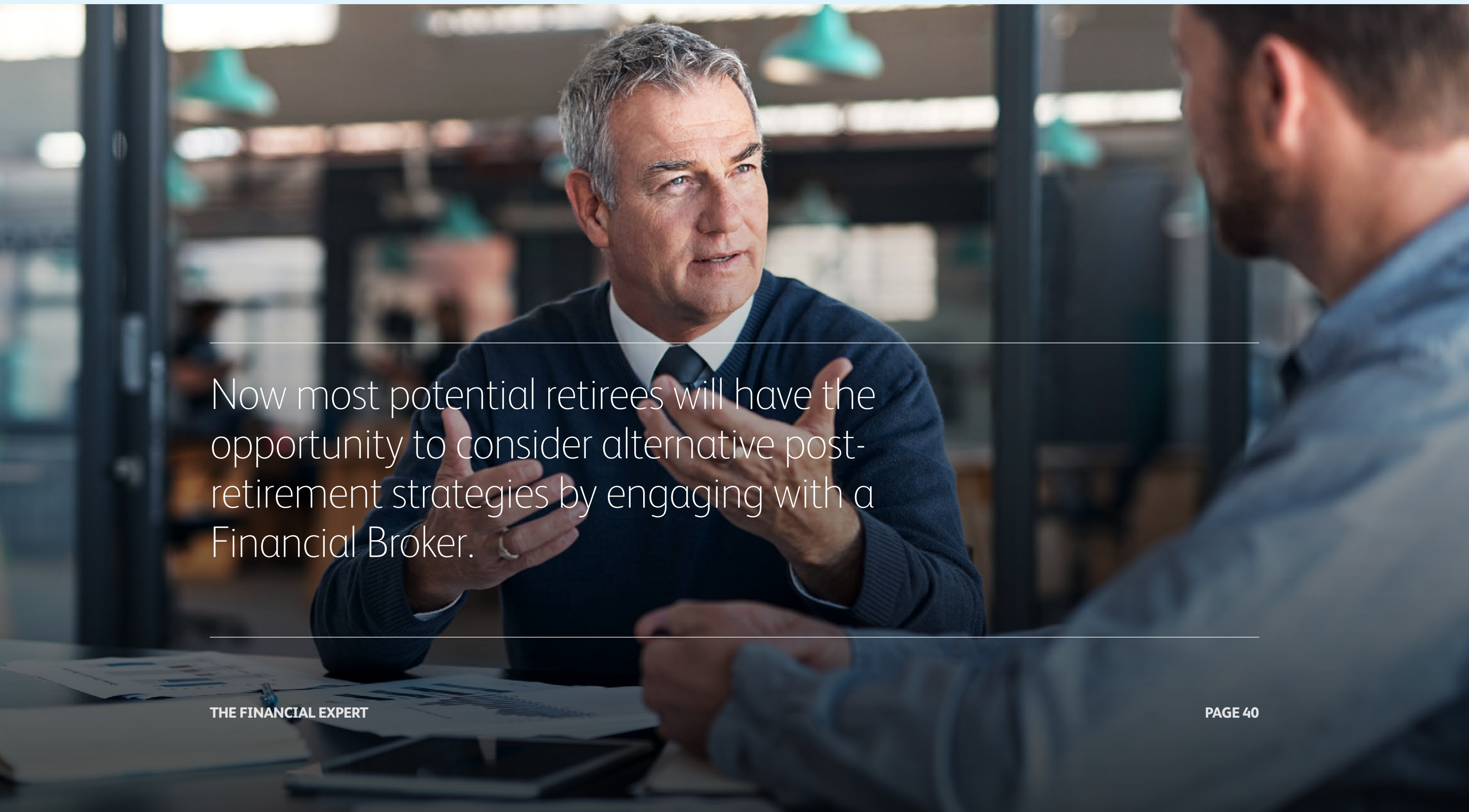
ARFs have introduced a new dimension of succession and estate planning into the post-retirement tax planning process.

10.7 ARFs – pros and cons

The benefits and drawbacks of ARF investment may basically be summarised as follows:

Pros	Cons
Ownership of pension capital and investment retained	Must take 4 % or 5 % p.a. drawdown or pay penal tax (6 % for €2m funds)
Fund passes to family/estate on death	No certainty – could get investment wrong
Fully flexible – drawdown income or lump sum	Could outlive the fund – what happens then? Safe assets and inflation can erode fund
New strategies new products – even buy annuity	

Since 1999 there have been significant developments both in terms of access to ARF post-retirement planning and to a greater range of investment and product strategies. Now most potential retirees will have the opportunity to consider alternative post-retirement strategies by engaging with a Financial Broker.



Now most potential retirees will have the opportunity to consider alternative post-retirement strategies by engaging with a Financial Broker.

VESTED PRSA-ALTERNATIVE TO ARF

Usage of a PRSA as a vehicle to cater for post-retirement investment and income drawdown is relevant only where retirement benefits are taken from an existing PRSA. PRSA rules allow a PRSA holder to hold a PRSA as a pre-retirement funding contract, and also to exercise retirement options from the same contract. To this extent the PRSA is different from other individual Defined Contribution retirement contracts, as pre- and post-retirement situations may be encompassed under one and the same contract.

11.1 PRSA drawdown provisions

PRSA contracts cater for exercise of retirement drawdown options as follows:

- draw down up to 25% of PRSA assets as lump sum and purchase annuity with balance of fund
- draw down up to 25% of PRSA assets as lump sum and transfer balance to ARF taxable cash
- draw down up to 25% of PRSA assets as lump sum and retain balance in PRSA (now called vested PRSA)

Where the investor opts to retain post-retirement funds in the vested PRSA the following provisions are relevant:

- investment choices and charges, terms and conditions remain as per existing contract terms
- lump sum drawdown of up to 25% of fund is subject to the same tax treatment as retirement lump drawdown from other pre-retirement products
- imputed drawdown tax provisions apply as per ARF position where required 4%,5% or 6% drawdown is not taken

PRSA rules allow a PRSA holder to hold a PRSA as a pre-retirement funding contract, and also to exercise retirement options from the same contract.

- transfer is allowed to a corresponding ARF structure or to an annuity at any time

- transfer to another PRSA or occupational scheme is not permitted

- transfer to an ARF may be required in order to access drawdown after age 75. This is because PRSA legislation suggests that the PRSA must be used for either annuity or full taxable drawdown at this stage

- benefits held in AVC PRSA contracts are linked to the main occupational scheme(s) under which they were funded and required to be drawn down as part of the drawdown of main scheme benefits.

11.2 Multiple PRSA post-retirement strategies

A particular advantage of vesting PRSA benefits (other than AVC PRSAs) is that each PRSA held represents a distinct pension contract and is not linked to any other PRSA. This means that use of multiple PRSA contracts close to retirement will enable staggered drawdown of benefits from the point of first drawdown until age 75.

For example, a 60-year-old 20%+ male director has a retirement fund of €800,000 under a single member occupational executive pension scheme. If benefits are drawn down directly from this scheme under the ARF option, then the director may access €200k (25% x fund) as a tax free cash payment. The balance of the fund, €600k, is then available for ARF / taxable drawdown. In the event of his subsequent death the balance of the fund may pass tax free to an ARF of his spouse or else will be treated as a taxable distribution paid to the deceased at date of death. Either way the spouse will effectively pay income tax at the marginal rate on any amounts drawn down from the €600k balance of funds.

The director could consider winding up the scheme prior to retirement and transferring the fund to a series of PRSA contracts. Let's say the fund was transferred to four separate PRSA contracts with a contribution of €200k to each contract. The director decides to vest one of the PRSA contracts for immediate drawdown, leaving the other three contracts intact as non-vested pre-retirement funds with the option to defer drawdown until any time not later than age 75. Now immediate tax-free cash is limited to €50k (25% x €200k), with the balance of the vested PRSA of €150k subject to ARF drawdown and death rules. However in the event of death the balance of €600k retained in the three non-vested PRSA contracts may be paid directly to the estate subject to normal CAT conditions. This means that the surviving spouse could inherit the balance of €600k gross as the payment would be regarded as a pre-retirement death benefit. Clearly in this case the surviving spousecould inherit higher gross funds by preserving as much as possible of the benefit in the form of non-vested PRSA pay out. Likewise, 5% drawdown obligations extend only to the vested PRSA element of the package, allowing greater scope for income tax management and capital accumulation.

However, if the first death does not take place until after age 75 then no real benefit applies, as age 75 is the last opportunity to vest a PRSA contract. During this time investors could have lost out on usage of tax-free cash and paid additional pension levies as applicable to pre–retirement pension funds. So there is no foolproof formula here.

In practice retention of funds post-retirement in vested PRSAs is now less common than was the practice some years ago, before the imputed tax regime was extended to PRSAs. Lack of transfer flexibility and access issues from the age of 75 make transfer to ARFs the likely outcome. However, this aside, post-retirement planning issues are as relevant to vested PRSA holders as they are relevant to ARF investors.

SUMMARY

As discussed in the introduction to this guide, we are living longer than our predecessors and as a consequence we need to make our retirement savings work harder to provide income and preserve capital for longer.
Government policies encourage private pension provision but pull in tax breaks and move out qualification terms for state pensions at the same time. Traditional final salary schemes continue to fold and leave their members to make the best of what is left in the pot.

This means that more and more individuals are working with their Financial Brokers in taking responsibility for and planning their post-retirement income needs. The purpose of this guide is to provide Financial Brokers with an easy to reference document to assist in this process.

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