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**Charting your Financial Future**



**Blended Retirement Solutions**

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## The Pension Freedom Landscape

The pension freedom rules can impact people with pensions of all types – although they are most relevant to people with Defined Contribution pensions, such as Personal Pensions.

The pension rules are very complex, and a detailed analysis is beyond the scope of this guide. Although the April 2015 rule changes are mostly aimed at Defined Contribution Pensions there are factors which may affect investors with Defined Benefit Pensions (such as a final salary scheme). We strongly urge anyone with a pension of any type to get a fresh view of their position and to take advice on how the rules impact on their position.

## The Pension Freedom Landscape

In March 2014 George Osborne announced a series of new rules relating to pensions. Known as ‘Pension Freedom’, the new legislation introduced far greater flexibility for people with pensions at the point of retirement.

This included being able to access your entire pension and much greater choice as to how to take your income during your retirement. There were also fundamental changes to the rules relating to Death Benefits.

### **These comprehensive changes came fully into effect in April 2015.**

However, the flexibility has, in some ways, come at a price. Although you now have more, and, arguably, better options, the position is somewhat more complex. This complexity spells danger.

The previous legislation usually led retirees to a relatively simple choice: either take a drawdown option or buy an annuity. Most people bought an annuity.

Under the new rules, the annuity option became less popular and the rules around drawdown more favourable, making it more popular.

The Pendulum has swung! Yet everything may not be so clear cut as first appears and there may be a mid-point between these polarised options.

This is where a Blended Retirement Solution comes in; one which avoids this choice in its traditional sense and one which aims to blend the best of both types of approach.

A Blended Retirement Solution is one which allows you to optimise your position and to make the most of the flexible rules. We will explain more through this guide; however as hinted, these are areas of financial planning with many dangers lurking.

When you are considering your position a guide of this type can only ever provide general information and guidance; to get appropriate solutions for your situation, you should seek comprehensive regulated advice before taking any action.



To explain further we need to start by examining products that are available to you and work backwards from there.

## Annuities

### Taking your Pension Fund (or Funds?)

We believe you need to examine your position from a financial planning point of view. What we mean is that you should not consider your options as a simple choice between different retirement products.

If you are going to consider a blended solution it will come from looking at your retirement income options from a new perspective.

Prior to the new rules being introduced in April 2015, the most popular way of taking an income in retirement was to convert your pension pot(s) into an annuity.

You would convert your lump sum pension (less a tax-free sum – normally 25%) into a lifetime income; the annuity is the lifetime income. Around 70% of retirees once did this; take-up fell after 2015 but has revived as annuity rates have risen.

So, the annuity is less popular as a result of the rule change.

Yet if you ask the simple question, “pound for pound, what is the best and most secure pension income product available to me?” even today the answer is still likely to be an annuity. This is because annuities have some special features which simply cannot be replicated by other alternatives.

This is not a technical guide; we write this to help you understand your options. In these pages we will avoid including any technical analysis of this position. Except to point out that annuities effectively **insure** your income through a method of **pooling risk**.

Insurance Companies offer annuities to people and a rate of annuity (income) which is normally guaranteed for life. In doing so they consider **mortality rates** and there is an element of **cross subsidy** in this rate. This is where people who live shorter lives than expected effectively cross subsidise people who live longer.

The result of this is to create an insurance for those of you who live longer lives.

You are unlikely to find such an attractive secure or guaranteed income from any other source. This cross subsidy is very important as is the related insurance of lifetime, and secure, income offered by the annuity.

Updates since this guide was written: the Lifetime Allowance was abolished (6 April 2024), replaced by the Lump Sum Allowance (£268,275) and Lump Sum & Death Benefit Allowance (£1,073,100). From 6 April 2027, most unused pension funds enter your estate for IHT.

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The trouble is that in the 'real world' the options available to you are not normally dictated by the simple question of what is the best (or most secure) **income product?**

Many retirees want flexibility and may want to consider their wider financial position, for example leaving money to their children. In this respect annuities start to fall down as a viable (or the best) option.

Yes, they provide a secure income with absolute certainty and yes, they insure against living longer than average, but they are inflexible, and they involve a potential sacrifice of the capital value of your pension pot (especially disadvantageous to your beneficiaries).

## Drawdown

The normal alternative to an annuity is to opt to convert your pension pot(s) into some form of drawdown. Again, this is not a technical guide so we will avoid any in depth description of all your drawdown options. Suffice to say taking your income from a drawdown plan is a method which allows you to keep your pension pot invested and to draw an income of your choice as you like, when you like.

This works because it has **flexibility** at the forefront and a **variable income**, which could grow AND your capital stays invested (good for your beneficiaries) – and the capital may also grow in value.

However, whereas annuities de-risk your position, drawdown comes with a lack of guarantees or certainty and is **risky**.

To maximise the benefit of using drawdown (from an income generation viewpoint) you will probably have to take a risk in your investment approach to generate enough income. As with any risk if this 'goes wrong' you could either run out of money (worst case) or get less income in the future or have an income which is lower **than if you had bought an annuity**.



## The Retirement Income 'Product' Paradox

You will probably already see from the basic descriptions above that there is a clear paradox with these two options.

## The Retirement Income 'Product' Paradox

The advantages of annuities (security, no risk, known income, insurance against long living) are in effect the disadvantages of the drawdown route. On the other hand, the disadvantages of annuities (inflexibility, loss of capital on death, locking into low rates) are reflected in the advantages of using a Drawdown product.

We have, however, over simplified because your options are not just annuity or drawdown. There are other products, sometimes known as third way products. These are often 'hybrids' having some of the features of an annuity and some of the features of drawdown. They may provide some guarantees (of capital and/or income) and some flexibility.

Likewise, there are two other options. One is to ignore products and under the new rules take your pension fund, cash it in and have done with it. You can, for example, on the day you 'retire' take the whole pot (less any tax) and do what you will with it.

Spend it, reinvest it, give it to your children, there is (now) no restriction. This is, however, often very tax inefficient. You could easily pay unnecessary tax.

The second is to ignore choosing one or more products as the only option and to mix and match different products into a blended solution.

## The Blended Position

The new flexible pension rules were introduced on 6th April 2015. The economic environment at this time was instructive. At the time of introduction the interest base rate was 0.5% and this was relevant (and still is at the time of writing) because it directly affects prevailing annuity rates. Plus, rates from other interest-bearing accounts (such as a building society or bank). Savers trying to generate income in this environment have their work cut out.

Annuity rates were at basement levels when this guide was first written. Since 2022, however, sharply higher gilt yields have lifted annuity rates substantially, and guaranteed income has become far more attractive than it was. (In the 1990s it was even possible to lock into rates of well over 10% a year.) Because annuity rates move with gilt yields and depend on your age and health, always check current rates before deciding.

## The Blended Position continued

The exact levels are not important. It is safe to state that annuity rates are very low today compared to historic levels. And annuity rates are set and locked in at the time you convert your pot. This is very important.

Imagine you are retiring and you set out your position to aim for the best income you can get, and you want maximum certainty. With this objective there is a powerful argument for an annuity. Let's assume you plump for an annuity.

Suppose inflation takes hold and interest rates rise rapidly – as happened in 2022. What happens to annuity rates? They rise too, through the well-established link between interest rates and annuities. If you convert your pension pot when rates are low but, a few years later, the prevailing annuity rate is 50% higher, then for every £1 of income you locked in you could now be getting £1.50 – yet you cannot change it, because your rate is fixed for life.

## “Alternatively let's consider the drawdown option”

Alternatively let's consider the drawdown option – you retire and you say you want income as an important part of your planning but you also want flexibility and to preserve the value of your pot for your beneficiaries. You plump for a drawdown option. You want to draw 6% of your pension (now in drawdown) per year. Where, today, are you going to get 6% per year (after costs)? Not from cash, not from Gilts, not from anything remotely safe. You have to invest to get this sort of income and because it is a relatively high income (compared to cash etc.) you have to take some risk.

## “Today's markets are uncertain...”

Today's markets are uncertain, with significant economic and political uncertainty clouding future returns. What happens if all goes horribly wrong and assets fall precipitously (a risky thing for us to write because when you read this it may already have occurred!).

Falls of 50%+ in mainstream assets/markets are not common but they do (and can) occur. Imagine your pension pot falling in value by a big percentage (you choose the amount you want to imagine). As an example, your pot falls 33% - now what? You keep taking your income of 6% at your peril because this will only deteriorate your pot further. You must cut your income or suspend it altogether and now you wish you had bought an annuity.



## Longevity, tax, an uncertain future, legislative complexities and financial planning

All the parts of this guide, so far, describe why the options available to you should not be considered a choice between products.

The one thing planning retirement isn't - is simple!

If anything, the new rules emphasise why taking a financial planning route when you come to retire is the only viable approach.

What exactly does this mean? Financial Planning is an approach which considers everything. Not just your pension needs but your overall retirement needs, your total assets and liabilities, your family position, your tax position, your income/expenditure patterns (both current and future), your health, your wider lifestyle requirements, your risk position and your views on the world. Everything matters.

It's only by considering 'the whole' that a plan can be formulated – a retirement plan. And it is this retirement plan in its entirety that will instruct how best to deal with your pension pot(s).

It seems inconceivable that anyone can make a decision about their pension in isolation or chose between one option (an annuity?) and another (a drawdown?) without wider appraisal.

### **There are so many other aspects:**

- The rules around pensions remain complex, there are pitfalls to beware. For example, early retirees who still want to contribute to pensions can easily fall foul of penalties on drawing a pension whilst still contributing to one. There is a potential penalty for retirees who spend their pensions quickly deciding that the buffer of the State Pension will act as a fall back (the 'deprivation of capital' rule allows the government to withhold state pension payments). These are just two examples of countless complicating factors or considerations.
- There is the whole question of longevity which seems to be commonly misunderstood (many reports indicate retirees often misjudge how likely it is they will live a longer time than average). Your income may have to last many decades.....
- You need to consider tax; how best to structure your pension income and invested monies in your own lifetime, balanced with the need to pay as little Inheritance Tax as possible. Tax rules are constantly changing and remain complex.
- There is the wider market to consider, changes of government, market surprises, changing economic conditions.
- Your own position may change, with a typical example being the need for care and having to cover the costs of care.



## Time

One reason why a blended solution may be better than any other is the notion that retirement is not a fixed period with fixed circumstances.

Expertise and securing expert help can make all the difference.

You need skilled analysis and advice to answer these questions, using professional help.

Retirement planning and taking income from a pension may have been given a boost by the new rules, but the opportunities this presents for more dynamic solutions comes with many complexities. This was pension freedom, not pension simplification!

As time moves on things change. All those variables we touched on above may (and almost certainly will) change. Interest rates, annuity rates, investment returns, the economy and your own personal circumstances are all subject to change. Many of these future changes will be unforeseen at the point you retire. They may also be substantially different.

This makes the idea of fixing your position risky, because if you pursue one strategy which becomes inefficient if wider changes occur, then you could find yourself highly disadvantaged and stuck. The time many people spend in retirement is generally increasing. The total number of years that your assets may need to last and/or the period you need to sustain income could easily run into several decades.

## Blended Retirement Solutions

Ultimately there is nothing black or white, nothing certain, no right way or wrong way. Taking a financial planning approach which creates an overall plan of action, coupled with working with an experienced adviser who is trained and qualified in these areas is the best way of handling this tricky pathway.

As there is so much uncertainty and so many unknown factors, having an appropriate approach built around a flexible plan is likely to be the best retirement plan for many retirees.

The concept of blending different products to support such a flexible plan is a powerful one, which should be considered. However, the considerations do not stop at saying 'yes' to a blended solution.

If you were to consider a blended solution, then what 'blend' do you apply? For example, if you have £100,000 to work with, what balance should you allocate between drawdown and an annuity? 80/20, 50/50, 20/80?

Or do you use some form of hybrid product which effectively creates the blend within its own product structure? What is the optimal position for your requirements?

As above, there is no single 'right way' that will work for everyone all of the time; we recommend you pursue a financial planning view of your position first and only then, once you have determined your strategic plan, work through your product choices as a consequence.



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## BLEND RETIREMENT SOLUTIONS

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The information contained in this guide is based on legislation as of May 2026.

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