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The cost of early withdrawal from your pension

How retirees are impacting their financial future by accessing pension pots too soon

More than three-quarters (78%) of retirees have already dipped into their pension pots by the time they retire, according to recent data[1]. Of these, more than half (52%) withdraw funds five years before their Selected Retirement Age (SRA), with 21% opting to start taking out funds nine to ten years before they retire.

This trend highlights a significant shift in retirement planning behaviours, where immediate financial needs or desires often outweigh the long-term benefits of leaving pension funds untouched. Factors such as unexpected medical expenses, the desire to pay off debts or the need for additional income to support a particular lifestyle can drive retirees to access their pension savings earlier than planned.

CONSIDER THE TIMING OF PENSION WITHDRAWALS

The implications of early withdrawals are multi-faceted and can significantly impact retirees' financial security. By withdrawing funds early, retirees potentially miss out on the compound growth that could have been achieved if the money had remained invested. This can result in a smaller pension pot during the later years of retirement when the need for financial stability is often greater.

Furthermore, early withdrawals may indicate insufficient financial planning or awareness about the benefits of delaying pension access. As people live longer and retirement periods extend, it becomes increasingly important for individuals to carefully consider the timing of their pension withdrawals to ensure they stay within their savings.

FINANCIAL IMPACT OF EARLY WITHDRAWALS

The data revealed that the average amount an individual withdraws by age 65 is £47,000. Financial modelling shows how much that £47,000 could grow if invested for longer. If the money stayed invested from age 55 (when the member would have first been able to take benefits) for an additional five years, they would have £13,925 more on average by the time they reach 60.

That figure rises to £24,661 if it were to stay invested for ten years to age 65 – a rise of more than 50%; and to more than £38,000 if invested to age 70. A separate modelling exercise was conducted assuming that individuals claimed the maximum tax-free cash available at age 55, which currently stands at 25%, equivalent to £11,750.

MAXIMISING PENSION BENEFITS

If the same modelling were run with the remaining £32,250 left in individuals' pots after taking the tax-free cash, savers would, on average, be £10,441 better off after five years and £18,496 after ten years if they decided to stay invested. These figures

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highlight the significant financial benefits of delaying withdrawals and allowing pension funds to grow.

The data further shows that most people withdraw money from their workplace pension before retirement age. While early withdrawals are often unavoidable, draining a pension pot too soon can carry substantial risks, which providers and retirees should be aware of and take steps to guard against where possible.

NAVIGATING A CHANGING PENSIONS LANDSCAPE

The pension landscape is ever-changing. People are living longer, which means pensions must cover longer retirements. Additionally, more individuals are choosing to phase into retirement with part-time work, changing how and when they access their pension funds.

Early withdrawals can severely impact the long-term financial stability of retirees. Therefore, individuals must seek professional financial advice to make informed decisions about their pension pots.

PLANNING FOR A SECURE RETIREMENT

Retirees should also consider other sources of income and investments that can support them during their retirement years. Diversifying income streams can provide a safety net and reduce the need to dip into pension funds prematurely.

Proper financial planning ensures that retirees can maintain their desired lifestyle without compromising their financial security. By understanding the implications of early withdrawals and exploring alternatives, retirees can make decisions that will benefit them in the long run. ■

WANT TO MAKE INFORMED DECISIONS THAT WILL HELP YOU MAXIMISE YOUR PENSION BENEFITS?

If you are approaching retirement or have already started considering your pension options, it's crucial to understand the impact of early withdrawals on your long-term financial security. Contact us today to explore your options and create a personalised retirement plan that aligns with your goals. Secure your financial future now – don't wait until it's too late!

Source data:

[1] The statistics cited were the result of an analysis by Scottish Widows on 232,654 different retirement claim transactions between 2019 and 2023, which has been used from different sources to give a single view.

THIS ARTICLE DOES NOT CONSTITUTE TAX, LEGAL OR FINANCIAL ADVICE AND SHOULD NOT BE RELIED UPON AS SUCH. TAX TREATMENT DEPENDS ON THE INDIVIDUAL CIRCUMSTANCES OF EACH CLIENT AND MAY BE SUBJECT TO CHANGE IN THE FUTURE. FOR GUIDANCE, SEEK PROFESSIONAL ADVICE.

A PENSION IS A LONG-TERM INVESTMENT NOT NORMALLY ACCESSIBLE UNTIL AGE 55 (57 FROM APRIL 2028 UNLESS THE PLAN HAS A PROTECTED PENSION AGE).

THE VALUE OF YOUR INVESTMENTS (AND ANY INCOME FROM THEM) CAN GO DOWN AS WELL AS UP, WHICH WOULD HAVE AN IMPACT ON THE LEVEL OF PENSION BENEFITS AVAILABLE.

YOUR PENSION INCOME COULD ALSO BE AFFECTED BY THE INTEREST RATES AT THE TIME YOU TAKE YOUR BENEFITS.