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Briefing note

How much cash do you need when you are drawing an income?

We explore the issues around drawing an income and offer some tips on keeping cash afloat. If you are taking an income from a capped or flexi-access drawdown arrangement, we can only pay it to you if your SIPP (Self-Invested Personal Pension) or SSAS (Small Self-Administered Scheme) has enough cash available. It is a statement of the obvious, but how much is enough?

Please note that this piece is for information purposes only and should not be construed as formal advice.

"The more money you take out when your fund value is down, the less likely it is to recover."

It's one of those 'how long is a piece of string?' questions, but there are essentially two sides to weigh up in order to arrive at your answer. Amongst other things, it will depend on how financially conservative you are and how much work you want to put in to managing your fund.

More

There are a number of advantages to holding enough cash to meet many months or even years' worth of income withdrawals. This approach ensures that there is cash available and your income payments won't be missed. The more you rely on those income payments, the more important that these will likely to be to you.

Having a cash buffer will tend to reduce the risk of being forced to choose between selling investments when values are low, reducing income payments or suspending them altogether. Drawing an income when your fund value is down may cause lasting and sometimes irrecoverable damage to the value and sustainability of your fund. Ultimately, the more money you take out when your fund value is already down, the less likely it is to recover. Instead, keeping enough cash gives you a window to try to ride out falls or at least provide more flexibility about when to top cash levels back up again.

In addition, while it is important to keep an eye on your fund to ensure that it is going to last long enough to meet your income needs, you probably won't need to manage the liquidity so closely or so often, compared to keeping your fund fully invested.

However, caution has a price and it is important that you weigh up the other side of the argument.

Or less

Keeping very low levels of cash allows you to keep more of your money invested for longer. While markets can fluctuate over short periods of time, over longer periods of many years, they tend to grow (although this is not guaranteed). Funds left in cash may miss out on this potential growth. When interest rates are very low, cash will grow very slowly or possibly not at all; real but hard-to-spot damage may be done to your fund if the value of cash does not keep up with inflation. Inflation invisibly eats away at your fund as it means that you need to take out more money to buy the same things as before, which now cost more.

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Depending on what you are invested in and how much you withdraw from your fund, it may be possible to meet your income needs from things like dividends without needing to sell investments to generate cash. This is easier said than done, as investment income is not guaranteed and may decrease. Furthermore, the timing of investment income may not match the timing of the income you take out of your fund.

Those who have other sources of income or other savings they can draw on may be able to ride out falls in investment values. Rather than being forced to sell investments when their value has fallen to provide cash for their SIPP or SSAS to pay out, they may simply stop taking income from the fund and rely on other sources.

Advice

This simplified look at some of the considerations to weigh up, hopefully conveys that this is neither an exact science nor an easy one. Solving this conundrum is just one of the benefits of using the services of a financial adviser who is experienced in understanding people's circumstances; what they are aiming for and what risks they are (and, perhaps more importantly, aren't) willing to live with.

Of course, liquidity is not the only drawdown conundrum: knottier problems include how long your fund needs to last, how to invest it or even how much you can afford to take out – all of which a financial adviser can help you with. There are others, too.

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You may also choose to use the services of a discretionary fund manager (DFM), such as those who appear on our SIPP panel (we allow the use of many others and for SSAS we do not operate a panel). A DFM can tailor an investment portfolio not only to produce enough cash at the right times to meet your income needs, but also to meet your wider investment objectives, as identified by your adviser.

Your call

If you prefer to do things yourself, it is vital that you closely monitor cash levels within your SIPP or SSAS, particularly if you opt to keep minimal levels.

Our top tips regarding drawdown liquidity for those keeping little cash would be:

- Review cash levels regularly:
    - If you have a SIPP, this is best done via SIPPs Online.
    - If you have a SSAS, check your printed cash statements or you may be able to check via BWebstream.
- Don't cut it too fine:
    - Remember to allow for any SIPP/SSAS and advice fees (including when they fall due); and
    - Allow time for disinvestment and moving money between accounts.

If your approach is to keep more cash, it is important to monitor the rate of interest you are receiving. The more of your fund that you keep as a cash float and the longer you keep it in cash, the more important this is.

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> The more of your fund that you keep as a cash float and the longer you keep it in cash, the more important the rate of interest you are receiving.

At the heart of a SIPP or SSAS is effectively a current account. Interest rates on these vary over time (at the time of writing, they are zero), but they are always likely to be lower than term deposit accounts - possibly significantly lower.

Our top tips for those keeping more cash would be:

- Consider using term deposits
  - Match the length of the term deposit with the time until you will actually need the cash to meet your income; and
  - Remember to allow for any SIPP/SSAS and advice fees (including when they fall due), allowing time for moving money to the main SIPP or SSAS bank account.
- Look at the pre-approved banking lists for SIPP and SSAS

These accounts come from a range of different financial institutions which may help ensure your deposit is protected by the Financial Services Compensation Scheme (FSCS) of up to the current limit of £85,000,per institution. They also offer a wide range of terms, from instant access up to 60 months.

You can choose accounts that are not on our list, subject to certain conditions.

We would suggest that you:

- Consider their credit rating;
- Check if they are covered by the FSCS; and
- Weigh up whether additional Barnett Waddingham fees negate any extra interest earned (accounts not on our list cause additional billable work for us).

Please contact your your financial adviser or your usual Barnett Waddingham client manager if you would like to discuss any of the above topics in more detail. Alternatively contact us via the following:

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