Your Future Compass

RETIREMENT GUIDE

Annuity vs drawdown: how to think about the choice

Annuity or drawdown is the big retirement-income decision. One trades your pot for guaranteed income; the other keeps it invested and flexible. Here are the trade-offs, the tax, the risks, and why blending the two is so common.

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Annuity vs drawdown: how to think about the choice

> **Guidance and illustrations only, not regulated financial advice.** This guide explains how annuities and drawdown work in general terms and the trade-offs between them. It isn't a recommendation about what *you* should do. The right choice depends on your circumstances, so consider speaking to a qualified, regulated financial adviser before deciding.

When you reach retirement with a defined-contribution pension (a pot of money you've built up, rather than a promised income), you face one big question: **how do you turn that pot into income?** For most people it comes down to two routes: an **annuity** or **income drawdown**, or, increasingly, a blend of both. Neither is "best." They trade the same things against each other: **certainty versus flexibility, and income-for-life versus control of your money.** This guide walks through the choice in plain English.

The choice in one sentence

- An **annuity** swaps some or all of your pot for a **guaranteed income**. You give up the lump sum and the flexibility, and in return you can't run out.
- **Drawdown** keeps your pot **invested** and lets you take money out as you choose, so you keep the flexibility and any growth, but you carry the risk that it falls or runs out.

Everything below is really about how much you value one side of that trade versus the other.

What an annuity actually is

An annuity is an insurance product: you hand over a lump sum and an insurer pays you a set income, either **for the rest of your life** or for a **fixed term**. The appeal is simple: it's an income you cannot outlive, regardless of what markets do.

The detail that trips people up is that **annuities come in very different shapes**, and the shape changes the income dramatically:

- **Level vs escalating.** A *level* annuity pays the same cash amount every year, which feels generous at first but loses buying power to inflation over a long retirement. An *escalating* annuity rises each year (e.g. with inflation) but starts much lower.
- **Single vs joint life.** A *joint-life* annuity keeps paying a partner after you die; a *single-life* one stops. Joint-life pays less to start but protects the survivor.
- **Guarantee periods and value protection.** Add-ons that pay out for a minimum period, or return part of the unused pot, so it's not simply lost if you die early.
- **Enhanced annuities.** If you have certain health conditions or lifestyle factors, you may be offered a **higher** income, because the insurer expects to pay it for fewer years.

The trade-offs of an annuity:

- **Pros:** guaranteed income for life; no investment decisions; no risk of running out; simple once set up.
- **Cons:** you typically give up access to the lump sum; less flexibility if your needs change; a *level* annuity is exposed to inflation; without the right features, money may not pass on.

What income drawdown actually is

With drawdown, your pot **stays invested** and you withdraw income (and lump sums) as you need them. You normally take up to **25% tax-free**, within limits, and the rest is taxed as income when drawn.

The big idea is **flexibility**: you control how much you take and when, the remaining pot can keep growing, and whatever is left can pass to your beneficiaries. The catch is that **the risks become yours to manage.**

The trade-offs of drawdown:

- **Pros:** full flexibility over income; the pot can keep growing; access to lump sums for one-off needs; what's left can be inherited.
- **Cons:** the pot can fall as well as rise; you can draw too much and **run out**; you (or an adviser) have to manage the investments; the outcome is uncertain.

Head to head: the trade-offs that matter

	ANNUITY	DRAWDOWN
Income certainty	Guaranteed for life	Depends on markets and how much you take
Flexibility	Low: set once	High: change any time
Run-out risk	None	Yours to manage
Growth potential	None (it's fixed)	Yes. Stays invested
Inheritance	Usually nothing (unless protected)	Whatever pot is left
Inflation	Only if you buy escalation	You can adjust withdrawals
Effort	None once set up	Ongoing decisions

The tax angle (the same for both)

A common myth is that one route is "taxed" and the other isn't. In reality, **income from both an annuity and drawdown is taxed as income** in the same way. The 25% tax-free entitlement applies to the pension either way (taken as a tax-free lump sum, or spread across drawdown). The difference isn't the tax rate. It's the **control**: with drawdown you can shape *when* you take taxable income to manage which tax band it falls in; with an annuity the income is fixed, so it's far less flexible for tax planning. The 25% has its own cap and its own traps, whichever route you take: the tax-free lump sum explained.

The risks each route leaves you exposed to

Whichever you pick, three risks decide how it plays out, and they hit the two routes differently:

- **Longevity.** Living longer is the whole reason an annuity exists. It removes "what if I live to 95?" In drawdown, longevity is a risk you carry, because the longer you live, the harder the pot has to work.
- **Inflation.** A *level* annuity quietly loses buying power over 20–30 years. Drawdown lets you increase withdrawals to keep pace, but only if the pot can sustain it.
- **Sequence of returns (drawdown only).** A bad run of markets *just after* you start drawing income does far more damage than the same fall later, because you're selling investments while they're down. An annuity is immune to this; drawdown is most vulnerable in its early years. This is the risk that most often decides the choice, so it's worth seeing the arithmetic: why the order of returns matters.

You probably don't have to choose

This is the part most "annuity *or* drawdown" framing misses: **it's not all-or-nothing.** Common blended approaches include:

- **Essentials covered, the rest flexible.** An annuity plus the State Pension provides enough guaranteed income to meet *non-negotiable* bills, with the remainder left in drawdown for flexibility and growth. Many people describe this as the most comfortable balance: security underneath, freedom on top.
- **Annuitising in stages.** Annuity income bought gradually over several years rather than all at once, which spreads the timing risk and lets you buy more as you get older (when rates for your age tend to improve).
- **Annuitise later.** Start in drawdown for the early, active years, then use part of the remaining pot to buy guaranteed income later, partly as longevity insurance for the years you're least able to manage investments.

Who each route tends to suit

These are tendencies, not rules. Your own circumstances decide it.

- People who **value certainty and a quiet life**, have little other guaranteed income, or worry most about outliving their money often lean towards **more annuity**.
- People who **value flexibility and control**, have other secure income, want to leave money behind, or are comfortable with investment ups and downs often lean towards **more drawdown**.
- A great many people sit in between, which is exactly why **blending** is so common.

Common mistakes people make

- **Buying the first annuity offered** without shopping around or disclosing health/lifestyle (which could qualify you for a higher, *enhanced* income).
- **Choosing a level annuity** without realising what inflation does to it over decades.
- **Forgetting a partner**: taking single-life income that stops when you die.
- **Drawing too much, too early** in drawdown, especially into a falling market (sequence risk).
- **Treating it as a one-time, irreversible decision**: an annuity is permanent, but a blended, staged approach keeps options open.

How to pressure-test the decision

Because so much rides on markets, inflation and how long you live, a single "you'll have £X" estimate won't settle it. The useful question is: *across many possible futures, how does each route, or a blend, hold up?* That's what **scenario modelling** does: it tests guaranteed income versus a drawdown pot (or any mix) against thousands of market paths, so you can see the trade-off in *your* numbers rather than in the abstract. You can explore this with a planning tool. Our app lets you model annuity, drawdown and a blend side by side, and a dedicated "how you draw" view shows how shifting the mix between your pensions and ISAs (Individual Savings Accounts: tax-free savings and investment accounts) changes your income tax *and* the inheritance tax your family might face, and a regulated adviser can model it with you too. If you're over 50 with a defined-contribution pension, the government's free Pension Wise service offers a free appointment to talk through your options.

Quick checklist

1. **Work out your essential income**: the bills you must cover no matter what.
2. **Add up your guaranteed income**: State Pension and any final-salary pensions (a guaranteed income based on your salary and years of service, not a pot) already cover some.
3. **Decide how much certainty you want** for the gap: guaranteed (annuity) vs flexible (drawdown).
4. **If leaning annuity:** consider escalation, joint-life, and whether you qualify for an enhanced rate.

5. **If leaning drawdown:** plan for sequence risk in the early years and a sustainable withdrawal rate (a pace of drawing the pot can keep up with).
6. **Consider a blend** (essentials guaranteed, the rest flexible) and pressure-test it.

There's rarely a single right answer. Only the mix that fits the life you want and the certainty you need. Start from your essential income, decide how much of it you want guaranteed, and test the rest.

This guide is general information, not regulated financial or tax advice. Annuity and pension rules change, and the right choice depends on your personal circumstances, so consider taking regulated advice before acting.

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