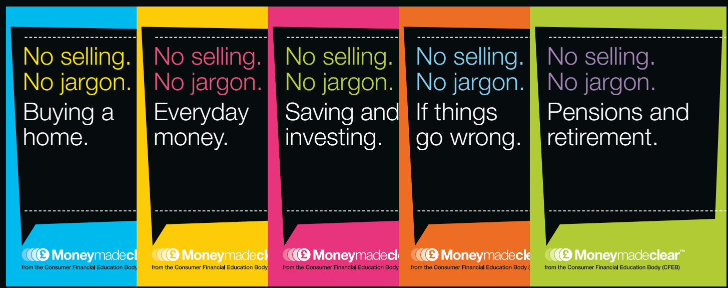
July 2010

## Our Moneymadeclear™ guides – here to help you

**This guide is part of our Pensions and retirement series.**




**Available from our helpline or website**

**www.moneymadeclear.org.uk**

**No selling. No jargon. Just the facts.**

If you would like this guide in Braille, large print or audio format, please call our Moneymadeclear™ helpline on 0300 500 5000 or Typetalk on 1800 1 0300 500 5000.

(Calls should cost no more than 01 or 02 UK-wide calls, and are included in inclusive mobile and landline minutes.)

To help us maintain and improve our service, we may record or monitor calls.



# No selling. No jargon. Just the facts about your pension – it's time to choose.

Moneymadeclear™

from the Consumer Financial Education Body (CFEB)

**Moneymadeclear**™ guides are brought to you by the Consumer Financial Education Body (CFEB). We aim to help you understand financial matters and manage your money better.

# Just the facts about your pension – it's time to choose.

We try to ensure that information in this guide, much of which comes from external sources, is correct at time of print. It is possible that some of it is oversimplified, or may become inaccurate over time, for example because of changes in UK law. You should always check the current position before you take action.

This is general information intended for consumers of UK financial services resident in the UK. It does not take account of individual circumstances. When making decisions about your own circumstances you should consider whether to consult a financial or other professional adviser.

cfeb consumer financial education body

# This guide is for you if

**You are**

**approaching retirement; and**

**You have**

**a pension fund with which to buy a lifetime annuity.**

It's about buying an annuity and:

- explains what you need to think about when choosing one;
- sets out how you can shop around to get the best deal for you; and
- answers some of the questions you may have.

**Contents**

# Buying a lifetime annuity

**A lifetime annuity converts your pension fund into pension income, which you'll be paid for the rest of your life.**

When you're approaching retirement your pension provider will write to you with details about your pension fund. They'll tell you about using your pension fund to buy a lifetime annuity.

It's important information, so read it carefully and ask your pension provider or financial adviser about anything that isn't clear.

See the *Jargon buster* on page 17 for an explanation of some words you may come across.

**We have updated this guide following changes announced in the June Budget, however the extent of these changes is still to be decided.**

## It's time to choose

There are several important decisions you have to make now, including:

- whether to delay buying an annuity or taking any pension income for now;
- where to buy it from to get the best deal – you don't have to buy it from your current pension provider;
- what sort of annuity to buy – one just for you or one to include a pension for your spouse or partner when you die;
- whether to take a tax-free lump sum from your pension fund first; and/or
- whether to go for one of the other pension income options – see page 9.

## Commutation

If the total of all your pension funds does not exceed a minimum amount (£18,000 in 2010/11), you can take it all as a cash lump sum instead of an income. You must be at least 60 to do this.

## Retirement

Retirement means the time from when you start to take the benefits from your pension.

You can take your pension benefits from age 55. You don't have to stop working to do this.

**This guide is *not* for you if:**

You're getting a pension from an occupational salary-related (final salary) pension scheme. This is because your pension income is worked out differently. Speak to your pension scheme administrators to find out more.

## Key points

- A lifetime annuity pays you a pension income for life.
- You don't have to buy one from your pension provider and you don't have to buy one when you reach retirement age.
- You may be able to increase your pension income if you shop around – see page 8.
- If you're getting a pension from an occupational defined contribution (money purchase) pension, your choices are set out on page 9.

# Choosing a lifetime annuity

**There are several things to think about to ensure you get the right pension income for you. Here we cover the following:**

- What is a lifetime annuity?
- Who can buy one?
- Why is it important when you take your annuity?
- How your pension income is worked out.
- Choosing the right annuity.
- Shopping around for the best deal.

We also cover some other retirement options that you can take.

## What is a lifetime annuity?

A lifetime annuity converts your pension fund into pension income and will be paid to you for the rest of your life.

Your pension income is subject to tax, just like your normal salary.

## Who can buy one?

You can buy a lifetime annuity if you have one of the following types of pension:

- Personal pension
- Stakeholder pension
- Most Additional Voluntary Contribution (AVC) schemes
- Free-Standing Additional Voluntary Contribution (FSAVC) scheme
- Retirement annuity contract (RAC)
- Section 32 policy (buy-out bond)
- Occupational money purchase scheme

If you have contracted out of the additional State Pension, you must use that part of your pension fund to buy a **protected rights annuity**.

You have the same options as with your other pension funds except that you must buy a joint-life annuity paying a 50% spouse's pension if you are married or have a civil partner.

## Why is it important when you take your annuity?

If you have a with-profits pension fund you are asked to state an age at which you would like to retire. Usually people choose age 60 or 65. This age will appear on your pension policy documents as your expected retirement date.

With-profits funds will usually only allow retirement benefits to be taken at set dates in the life of the policy, such as your selected retirement date.

Some insurance companies may reduce your fund at retirement by making a **market value reduction or other charge** if you don't buy an annuity on this date. Make sure you check what date you have said you want to retire at and whether you will be penalised if you don't take your annuity then.

## How your pension income is worked out

The amount of pension income you will get depends on several factors, such as:

- the **amount of money left in your fund** if you choose to take a tax-free lump sum;
- the **annuity rate** offered by the insurance company;
- the **type of annuity** you decide to buy – see page 6;
- your **sex** (women will get a lower income because they are expected to live longer);
- your **age** (you will get a lower income the younger you are); and
- your **health or lifestyle** (you may get a higher income if you are a smoker, have high cholesterol or are in poor health. Where you live or your occupation can also make a difference).

## Choosing the right annuity

There are different types to suit your needs and circumstances, but the basic types are:

- **single life** – an annuity just for you if either you don't have a spouse or partner, or they have their own pension arrangements; and
- **joint life** – an annuity that will pay out to you and then your spouse or partner after your death (normally at a reduced rate).

You can also choose whether you want your single- or joint-life annuity to be **level** or **escalating**.

### A level annuity

This pays out the same pension income throughout your life. In other words it does not increase in line with inflation.

You will get more money to start with than you would from an escalating annuity, but it will buy you less in the future because of inflation.

### An escalating annuity

This will normally start at a lower rate than a level annuity and will gradually build up.

With an escalating annuity there are two main choices:

- **fixed-rate** - your income increases each year by an agreed fixed rate (for example 3% or 5%); and
- **RPI-linked** - your income is adjusted each year to reflect changes in the Retail Prices Index (RPI), which is the most common measure of inflation used by the government (ie the cost of living). The actual increase in your annuity will vary from year to year to match inflation, so the buying power of your pension will stay the same.

**Although you will initially get less money with an escalating annuity than with a level annuity, it will increase each year. If inflation stays low, it can take up to 20 years or more for an escalating annuity linked to the RPI to pay out as much as a level annuity. But if you don't have an escalating annuity, even low levels of inflation can, over time, significantly reduce your standard of living.**

You can also add some options to your lifetime annuity.

### A guarantee period

You can **guarantee** your lifetime annuity for a specific number of years (usually five or ten) so it continues to pay the income for that time even if you die before then. The income is then usually paid to your partner or to another dependant.

### Annuity protection lump-sum death benefit

This is a way of ensuring that your annuity doesn't stop when you die. A lump sum equivalent to the pension fund you used to buy the annuity, minus the income you've already been paid, will be paid to your estate or beneficiaries. There will be an income tax charge, and there may also be an inheritance tax charge.

### Enhanced and impaired-life annuities

Some companies offer **impaired-life** annuities that pay a higher than normal income if you have health problems that threaten to reduce your lifespan.

You might be able to get an **enhanced annuity** if you are overweight or smoke regularly. Some companies offer higher rates to people who have followed certain occupations or people who live in certain parts of the country.

**Always check whether you may be eligible for either of these options.**

**The government intends to remove the requirement to buy an annuity or alternatively secured pension by April 2011. The full extent of the proposed changes is still to be decided.**

## Key points

- Taking a tax-free lump sum is attractive, but it does reduce your pension income.
- Find out whether you'll be penalised if you don't buy an annuity at your stated retirement age.
- Check whether you could get a better income because of your health, lifestyle, occupation or where you live.
- Consider whether you need to provide a pension for your partner on your death.
- Consider whether you want your pension income to keep pace with inflation.
- Think very carefully about the type of annuity you want, as you can't change your mind once you've bought it.

## Shopping around for the best deal

Your pension provider should give you an estimate of the value of your fund at least six weeks before you plan to retire.

They should also tell you how much income the lifetime annuity they offer would give you.

You don't have to buy your annuity from your pension provider. You can shop around. This is known as an **open market option**.

However, always check what your provider is offering you first, as they may offer a **guaranteed annuity rate** written into the policy which may be higher than the rates offered in the open market.

You can shop around using our unique online **Comparison tables** at www.moneymadeclear.org.uk/tables to compare features and costs of lifetime annuities based on the actual amount in your pension fund.

Lifetime annuity quotes are usually fixed for between 7 and 28 days. The company will tell you if you have the right to change your mind and cancel the contract, and if so, how to cancel.

Not all companies will deal with you direct so it may be advisable to consult a **whole-of-market adviser**, who should be able to look at all the annuity rates on offer. To find a financial adviser see *Useful contacts* on page 21.

The insurance company usually pays commission to the adviser, so getting advice should not affect the amount you pay for the annuity. But ask whether you have to pay the adviser any added charges.

### Key points

- Always check what your provider is offering first and use this as a basis to shop around.
- You may be able to increase your income by as much as a third by shopping around.
- Use our online **Comparison tables** at www.moneymadeclear.org.uk/tables.

## Occupational defined contribution schemes

The rules for these schemes are different to those for personal and stakeholder pensions. The trustees of the scheme may buy an annuity for you, but you do have the right to shop around if you want.

For more information see the Pension Regulator's factsheet **Making your retirement choices – think before you choose** – see *Useful contacts* on page 20.

## Other retirement choices

If you don't want any of the types of annuity mentioned earlier, or if you decide to delay buying a lifetime annuity, then you may want to consider a few other options.

Some are only suitable if you have a large pension fund or other sources of income, and you are comfortable taking some risk with your fund. For advice based on your own circumstances, talk to a professional adviser.

After taking a tax-free lump sum, you may have the following options:

- **Investment-linked lifetime annuity**

  This relies on stockmarket performance and therefore your income could go down as well as up.

- **Phased retirement**

  You can split your pension fund up and buy annuities at different times.

- **Unsecured pension using income withdrawal or short-term annuities**

  This lets you draw an income from your pension fund while leaving it invested, but will stop when you reach 77. By that time you must secure an income, which usually means buying an annuity.

- **Hybrid products**

  These new products pay a regular income and offer guarantees of either investment growth or the amount of pension fund you will have left to buy an annuity later on. They vary in what they're called, the guarantees they offer, and the charges they make to cover the cost of the guarantees. You generally have to give up some investment growth potential to pay for the guarantees.

On your 77th birthday, if you haven't bought an annuity, another option is to use an alternatively secured pension. This works in a similar way to unsecured pensions but has different limits and rules.

Alternatively secured pensions are not suitable for everybody and it is important that you take professional advice if you are thinking of taking this option. Inheritance tax and other significant tax charges may apply to any leftover funds on your death.

For more information, get a copy of our **Retirement options** guide – see *Useful contacts*.

# Key things to think about

## Getting financial advice

Firms selling pensions and annuities must be regulated by the Financial Services Authority (FSA), the UK's financial services regulator. This means they have to meet certain standards which the FSA monitors, and it can take action if they don't. Advertisements, product brochures and other promotions produced by regulated firms must be clear, fair and not misleading.

You can check if a firm is regulated and report any misleading promotions to the FSA by phone or online – see *Useful contacts*.

You may also be able to use the Financial Ombudsman Service if things go wrong, or the Financial Services Compensation Scheme if your adviser or provider stops trading – see page 16.

## Information you will get

You will usually get a **Key Features Document** describing the main aspects of an annuity, such as its aims and risks. Make sure you read and understand this information and ask questions if there's anything you're unsure about.

With annuities, you will usually get an illustration showing the amount of income you would get (depending on the size of your pension fund), your personal details and the current annuity rates. The figures are shown after deducting any lump sum you have chosen to take as tax-free cash.

For more information get a copy of our **Retirement options** guide – see *Useful contacts*.

### When shopping around for an annuity

**Check**

the value of your pension fund and how much pension income your provider's annuity would give you. Use this to compare rates when you shop around. Your provider should give you an estimate at least six weeks before you plan to retire.

**Check**

whether you'll lose any benefits if you buy from elsewhere instead of taking up your provider's offer, such as an option to buy a lifetime annuity at a guaranteed rate. These are very valuable, as current annuity rates on the open market may be much lower.

**Check**

whether your provider will make a charge if you buy an annuity from somewhere else. If so, make sure the estimate that they have given you includes these charges.

**Check**

that you read the **Key Features Document** carefully, and ask questions if there's anything you're unsure about.

# Your questions answered

Question

## How can I boost my pension income?

Answer

You can usually postpone converting your personal or stakeholder pension fund into pension income, in consultation with your pension provider, and continue contributing to your pension fund.

You can continue working and contributing to an occupational pension scheme only if the scheme rules allow – so check with your scheme administrators.

You can postpone taking your State pension and get either extra State pension or a one-off taxable lump sum. You stop paying National Insurance contributions, however, once you reach State Pension Age – currently 65 for men and between 60 and 65 for women depending on when you were born. This is scheduled to go up to 68 for men and women retiring from 2046.

However, the government has announced that it will consult on raising the State Pension Age to 66 from 2016. For information on the State Pension, go to Directgov's website – see www.direct.gov.uk.

Question

## Do I have to buy an annuity when I stop work?

Answer

No, you can postpone buying an annuity and you can continue paying into your pension fund (but possibly not if it's an occupational pension scheme).

If you do postpone, you may get a higher annuity because the money will have been invested for longer and you will be older. However, lifetime annuity rates can go down as well as up, so there are no guarantees that you will get a better rate if you postpone buying an annuity.

Question

## I only have a small pension fund. Does this make a difference?

Answer

It may do. If the fund is worth £10,000 or less, you may find it hard to shop around or you may have to pay higher charges. Shopping around may be easier if you think you may be eligible for an impaired-life or enhanced annuity.

If the total of all your pension funds does not exceed £18,000 (in 2010/11) you can take it all as a cash lump sum rather than taking an income. This is known as **commutation**. You must be aged 60 or over, and you must do it within a 12-month period. One quarter of the lump sum will be tax free and the rest is taxed as income.

Question

## What are my options if I have more than one personal pension?

Answer

You may be able to get a higher lifetime annuity if you combine them by transferring them all into one stakeholder or personal pension and then buying one annuity.

On the other hand, if you don't need the income right away, you could buy a lifetime annuity with one pension fund and leave the other(s) until later.

It really depends on the type of pensions you have, so you may want to get professional financial advice.

# Next steps

## Step 1

Go through the chart on the next page to help you decide what type of annuity would best suit you.

## Step 2

Get an estimate of the value of your pension fund, taking into account any charges. This estimate should be sent to you at least six weeks before your retirement date, but you can ask for it earlier so that you can start shopping around.

## Step 3

Check what your pension fund provider can offer on the type of annuity you want. Check whether they offer a guaranteed annuity rate.

## Step 4

Shop around and get quotes for the type of annuity you want from a range of providers. Use our **Comparison tables** to help you at www.moneymadeclear.org.uk/tables.

**Remember, if you need help, take advice from a professional financial adviser as they will be able to make recommendations based on your financial objectives and personal circumstances.**

### Use this chart to help you decide what type of annuity would best suit you

Do you have a spouse or partner who will rely on your pension income after your death?

- No: A single-life annuity which pays out a pension income only to you might be suitable.
- Yes: A joint-life annuity will pay out a lower income than a single-life annuity but will pay out to your spouse or partner when you die.

Do you want to ensure that the spending power of your pension is not eaten away by inflation?

- No: A level annuity pays out the same pension income throughout its life.
- Yes: An escalating annuity can be set to increase at either a fixed rate (eg 3% or 5%) or it can be linked to the RPI so that your income will rise (or fall) in line with inflation.

Do you have a history of poor health?

- No
- Yes: Check if you are eligible for an impaired-life annuity.

You may be able to get an enhanced annuity if you are overweight, a smoker, have done some manual jobs or live in a particular part of the country. So this is worth checking.

Do you want your annuity to pay out for a specific number of years if you die shortly after retiring?

- No
- Yes: Check out guaranteed annuities, which will pay out for a guaranteed period of up to 5 or 10 years if you die before then.

Do you want to take a tax-free lump sum from your pension fund?

- Yes: Check with your pension provider how much you can take.
- No: You can now start shopping around – see Steps 3 and 4 on page 14.

# If things go wrong

If you have a complaint about the advice you received when you bought your annuity or other retirement option, first take your complaint to your financial adviser or the company that advised you.

If you cannot resolve the problem with them, you may be able to use the Financial Ombudsman Service. See our **Making a complaint** guide for more information – see *Useful contacts* on page 19.

If a provider is unable to meet claims against it, the Financial Services Compensation Scheme may be able to help you. Get a copy of its guide **How we can help you** – see *Useful contacts*.

No selling.
No jargon.
Just the facts about your pension – it's time to choose.

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# Jargon buster

**Some key words and phrases explained.**

## Additional State pension

A pension paid on top of your basic State pension. It used to be called SERPS but is now called the State Second Pension. Self-employed people cannot build up an additional State pension.

## Alternatively secured pension

A way of getting an income from your pension fund without buying an annuity. This income is taxable.

## Annuity rate

The amount of monthly income you get for your pension fund, which is dependent on several factors such as your age, sex, state of health and the type of annuity you want.

## AVCs – Additional Voluntary Contributions

A pension top-up policy for an occupational pension. You pay contributions into a scheme run by your employer to boost your main pension.

## Commutation

Taking your pension benefits as cash if they do not exceed a certain level. This level changes each tax year. This is sometimes known as 'triviality'.

## FSAVCs – Free-Standing Additional Voluntary Contributions

A pension top-up policy for an occupational pension, but separate from your employer's pension scheme and normally run by an insurance firm.

# Jargon buster

### Inflation
This happens when prices go up throughout an economy. The effect of inflation on your money means that it will buy less each year.

### Lifetime annuity
An investment that converts your pension fund into pension income that is paid to you for life. The income is taxable.

### Market value reduction
A reduction to your pension that could apply if you want to cash in your with-profits policy before or after its maturity date or other date(s) specified in the policy.

### Open market option
Your right to shop around and buy your annuity from the company offering the best deal for you.

### Retirement annuity contract (RAC)
An RAC is similar to a personal pension, but was sold before 1988 when personal pensions first became available.

### S32 policy (buy-out bond)
Used by members of occupational pension schemes when they leave service or the scheme is wound up. A way of securing scheme benefits in the name of the employee.

### Tax-free lump sum
An amount of cash set by HMRC which you can take at retirement free of tax. Individual pension schemes may have different rules on the amount of tax-free cash you can take.

### Whole-of-market adviser
An adviser who offers advice on products from the whole market.



# Useful contacts

### Consumer Financial Education Body (CFEB)

**To order other Moneymadeclear™ guides or for general information or guidance**

Helpline: 0300 500 5000
Typetalk: 1800 1 0300 500 5000
(Calls should cost no more than 01 or 02 UK-wide calls, and are included in inclusive mobile and landline minutes.)

**Other Moneymadeclear™ guides**

- Getting financial advice
- Managing in retirement
- Retiring soon
- Retirement options
- Making a complaint

For more titles, call us or go online **www.moneymadeclear.org.uk**

**On our Moneymadeclear™ website you can find**

- a **Budget calculator** to help you work out your spending; and
- **Comparison tables** for annuities, savings and investments.

Go to **Tools and calculators** at **www.moneymadeclear.org.uk**.

**Call rates may vary – check with your telephone provider for their charges.**

### Financial Services Authority (FSA)
0845 606 1234
Minicom/textphone: 0845 730 0104
**www.fsa.gov.uk**

To check the FSA register, or to report misleading financial adverts or other promotions.

# Useful contacts

### Pension enquiries

**The Pensions Advisory Service**
0845 601 2923
www.pensionsadvisoryservice.org.uk

An independent organisation providing help with pension and annuity queries.

**The Pensions Regulator**
0870 606 3636
www.thepensionsregulator.gov.uk

Factsheet: Making your retirement choices – think before you choose.

### Pension information and advice

**The Pension Information Ordering Line**
For booklets about State Pensions

0845 7313 233
Textphone: 0845 604 0210
www.direct.gov.uk

**Future Pension Centre**
For a forecast of your State Pension

0845 3000 168
Textphone: 0845 3000 169
www.direct.gov.uk

**The Pension Tracing Service**
(at The Pension Service)

To trace pensions you've lost track of

0845 600 2537
www.direct.gov.uk

**The Pension Service**
To find out about deferring your State Pension

Leaflet: State Pension Deferral – your guide (SPD1).

0845 606 0265
www.direct.gov.uk

**The Pensions Ombudsman**
020 7834 9144
www.pensions-ombudsman.org.uk

For details of your occupational pension scheme talk to your pensions administrator, pensions manager or pension trustees at work.

### Finding a financial adviser/planner

**Unbiased.co.uk**
www.unbiased.co.uk

For financial advisers in your area.

**Personal Finance Society**
www.findanadviser.org

For financial advisers in your area.

**Institute of Financial Planning**
www.financialplanning.org.uk

Financial planners can help you to achieve your goals by planning your finances.

### Find an ethical product or provider

**Ethical Investment Research Services**
www.yourethicalmoney.org

Find an ethical product or provider.

### Complaints and compensation

**Financial Ombudsman Service**
South Quay Plaza
183 Marsh Wall
London E14 9SR

0845 080 1800 or 0300 123 9123
www.financial-ombudsman.org.uk

**Financial Services Compensation Scheme (FSCS)**
7th Floor, Lloyds Chambers
Portsoken Street
London E1 8BN

020 7892 7300 or 0800 678 1100
www.fscs.org.uk