the Money Advice Service™

Your pension – it's time to choose

The **Money Advice Service** is here to help you manage your money better. We provide clear, unbiased advice to help you make informed choices.

About this guide

This guide is for you if you are approaching retirement and have a pension fund with which to buy a lifetime annuity.

When you read it you will know:

- what you need to think about when shopping around for an annuity
- how the decisions you make now will affect you for the rest of your life, and
- the answers to 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. You will usually have to pay tax on your pension income, just like your normal salary.

When you're approaching the retirement age set out in your pension plan, your provider will write to you with details about how to use 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.

It's time to choose

There are a number of 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. Whatever you choose will be for life, you cannot change it
- whether to take a tax-free lump sum from your pension fund first, and
- whether to go for one of the other pension income options – see page 10.

Taking your pension benefits as cash

If the total value of all your pension funds is not more than £18,000, you can take it all as a cash lump sum instead of an income. Other limits apply for occupational pension schemes.

This is called trivial commutation. 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 and 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 for life.
- You don't have to buy the one offered by your pension provider, you can shop around.
- You don't have to buy one when you reach retirement age, you can delay.
- Once you've bought an annuity you cannot change it – it's for life.
- You may be able to get more pension income if you shop around – see page 9.
- If you're getting a pension from an occupational defined contribution (money purchase) pension, your choices are set out on page 10.

Choosing a lifetime annuity

There are different types of annuity to choose from, depending on your circumstances. Here we cover some of the things you should think about to get the one to suit you:

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

We also cover some other retirement options you can take.

Who can buy a lifetime annuity?

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

- 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.

The need to buy a protected rights annuity is expected to be removed from 6 April 2012.

Why is when you take your annuity important?

If you have a with-profits pension fund, you would have been 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.

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 things, 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 **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. We cover the basic types here – also see the chart on page 8. If you have access to the internet, you can use The Pensions Advisory Service's online Annuity Planner to help you decide – see *Useful contacts* on page 19.

- **Single life** – an annuity just for you if either you don't have a spouse or partner, or they have their own pension arrangements.
- **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 doesn't go up 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 goes up each year by an agreed fixed rate (for example 3% or 5%), and
- **index-linked** – your income is adjusted each year to reflect changes in the Retail Prices Index (RPI) or the Consumer Prices Index (CPI). The amount by which your annuity goes up will vary from year to year to match inflation, so the buying power of your pension will stay the same.

Although you will get less money in the early years from an escalating annuity than from a level annuity, it will go up 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 if you die before then. The income is then usually paid to your partner or to another dependant until the guarantee period ends. If you don't die within that time, it will continue to pay you until you die.

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.

Annuity protection lump-sum death benefit

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

These are sometimes called **capital protected annuities** but not all annuity providers offer them.

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.

Choosing between the common types of annuity

NO

Do you need a pension for a partner as well as yourself?

YES

Choose a **single-life annuity**. This pays out until you die.

Choose a **joint-life-last-survivor annuity**. This pays out until the last of you and your partner die.

Are you worried an annuity will be poor value if you die soon?

NO

YES

Consider, for example, an **annuity with a guarantee period**. It pays the promised income for a set number of years – say, five or 10 – even if you die before then. If you don't die within that time, it will continue to pay you until you die.

Example: (single) [1] [2] £50
(joint) [1] [2] [3] £45

Do you want an income that increases each year?

NO

YES

YES

Consider a **level annuity**. It pays a fixed amount of income each year.

Example: single [1] £52
joint [1] [3] £45

Consider an **escalating annuity**. It increases by a fixed amount each year.

Example: single [1] £37
joint [1] [3] £31

Consider an **RPI-linked annuity**. It increases each year in line with inflation (and may fall if prices fall – deflation).

Example: single [1] £32
joint [1] [3] £26

[1] Rates from the Money Advice Service **comparison tables**, June 2011. These figures show average annuity rates at one point in time. They are only an illustration to help give you an idea of what you might get. Annuity rates change frequently for a variety of reasons. Amount per month for each £10,000 of pension fund for a man aged 65, non-smoker, no guarantee unless stated otherwise. Escalating annuity increases by 3 per cent a year. For escalating and RPI-linked annuities, the starting income is shown.

[2] 10-year guarantee period.

[3] Female partner, two years younger, income falls by one-third on first death.

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 your stated retirement date.

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 moneyadviceservice.org.uk/tables to compare features and costs of lifetime annuities based on the actual amount in your pension fund and on your postcode.

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 you may need 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 19.

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 get as much as a third more income by shopping around.
- Make sure you check whether you could get more from an enhanced annuity.
- Use our online **comparison tables** at moneyadviceservice.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 19.

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 financial adviser.

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

- **Investment-linked lifetime annuity**
  This relies on stock market performance, so your income could go down as well as up.
- **Phased retirement**
  You can split up your pension fund and buy annuities at different times.
- **Income withdrawal**
  This lets you draw an income from your pension fund while leaving it invested. There are two kinds:
  - **capped drawdown**, where there are limits on the income you can take, and
  - **flexible drawdown**, where there are no limits provided you can show you have other income of a certain level called the **Minimum Income Requirement**.
- **Hybrid products**
  These 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.

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 about seeing a professional adviser, get a copy of our **Getting financial advice** 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 your provider will make a charge if you buy an annuity from somewhere else. If so, make sure the estimate they have given you includes these charges.

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 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 delay converting your personal or stakeholder pension fund into pension income, by talking to your pension provider. You can then continue paying into your pension fund.

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

You can delay taking your State Pension and get either extra State Pension or a one-off taxable lump sum. You stop paying National Insurance contributions (NICs), however, once you reach State Pension age – currently 65 for men and between 60 and 65 for women depending on when you were born.

The State Pension age for men and women is increasing and will reach 66 by 2020. Further increases after that are to be linked to changes in the average length of time people are living. These proposed changes are not yet law and still need the approval of Parliament. 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 delay 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 delay 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 is not more than £18,000, you can take it all as a cash lump sum rather than taking an income. This is known as **trivial 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 page 8 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. You can use our **comparison tables** to help you at moneyadviceservice.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.

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 UK-authorised provider is unable to meet claims against it, the Financial Services Compensation Scheme (FSCS) may be able to help you. The FSCS is independent and its service is free to customers. To find out more, contact them or visit their website - see *Useful contacts* on page 19.

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.

Annuity rate

The amount of monthly income you get for your pension fund, which depends on several factors such as your age, 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.

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.

Income drawdown

Allows you to draw an income from your pension fund while leaving the fund invested – either through income withdrawal or a short-term annuity.

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 fund 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 value option

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

Retirement annuity contract (RAC)

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.

Trivial commutation

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

Whole-of-market adviser

An adviser who offers advice on products from the whole market.

Useful contacts

Money Advice Service

For advice based on your own circumstances or to order other guides

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

Other Money Advice Service guides

- Getting financial advice
- Making a complaint
- Your bank account
- Your guide to retirement (explains your choices if you are two years or less from retirement)

For more titles, call us or go to **moneyadviceservice.org.uk/publications**

On our Money Advice Service website you can find:

- a **budget planner** to help you work out your spending
- a **savings calculator** to help you see how your money might grow
- **comparison tables** for annuities, savings and investments, and
- a **health check** to help you build up some good financial habits and reach your goals.

Go to **moneyadviceservice.org.uk/interactive**

Call rates to the following organisations may vary – check with your telephone provider.

Financial Services Authority (FSA)

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

Consumer helpline: 0845 606 1234
Minicom/textphone: 0845 730 0104
www.fsa.gov.uk/consumerinformation

Pension information and advice

The Pensions Advisory Service
An independent organisation providing help with pension and annuity questions.

0845 601 2923
Women and pensions helpline:
0845 600 0806
www.pensionsadvisoryservice.org.uk

The Pensions Regulator
Factsheet: Making your retirement choices: Think before you choose.

0870 606 3636
www.thepensionsregulator.gov.uk

The Pension Information Ordering Line
For booklets about State Pensions.

0845 731 3233
Textphone: 0845 604 0210
www.direct.gov.uk

Future Pension Centre
For a forecast of your State Pension.

0845 300 0168
Textphone: 0845 300 0169
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
For details of your occupational pension scheme talk to your pensions administrator, pensions manager or pension trustees at work.

020 7630 2200
www.pensions-ombudsman.org.uk

Finding a financial adviser/planner

Unbiased.co.uk

For financial advisers in your area.

www.unbiased.co.uk

Personal Finance Society

For financial advisers in your area.

www.findanadviser.org

Institute of Financial Planning

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

www.financialplanning.org.uk

Ethical Investment Research Services

Find an ethical product or provider.

www.yourethicalmoney.org

Complaints and compensation

Financial Ombudsman Service

South Quay Plaza
183 Marsh Wall
London E14 9SR

0800 023 4567 or 0300 123 9123
www.financial-ombudsman.org.uk

Financial Services Compensation Scheme (FSCS)

7th Floor Lloyds Chambers
Portsoken Street
London E1 8BN

0800 678 1100 or 020 7741 4100
www.fscs.org.uk

the Money Advice Service™

This guide is part of our pensions and retirement series.

For further information on pensions and retirement see our website

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All our guides are available from:

Our website
moneyadviceservice.org.uk

Money Advice Line
0300 500 5000

If you would like this guide in Braille, large print or audio format, please call us 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.

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