

Making your retirement choices

Think before you choose



The Pensions
Regulator

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This guide is for you if:

- you are approaching retirement; and
- you have any defined contribution (DC) benefits in an occupational pension scheme set up by your employer (even if it's mostly final salary).

The Pensions Regulator regulates UK work-based pension schemes. We have produced this guide to help you decide how to take your benefits from your pension scheme. We know that pensions language can be confusing and so have included a jargon buster (see page 22) to explain some of the important words.

For help with individual or group personal pensions, look at the guides issued by the **Money Advice Service**.

Your defined contribution or additional voluntary contribution (AVC) scheme documents will explain the choices you have when you retire. We have produced this guide to help you make sense of these choices so that you make a decision that is right for you.

Please read this guide and the information provided by your scheme carefully. If you have any questions, ask your usual pension scheme contact or financial adviser to explain anything you do not understand.

At a glance

- You do not have to accept the pension income offered by your pension scheme. You have the right to take your retirement income from a different provider – this is called the open-market option (OMO).
- Your scheme may not offer the best deal for your money when you retire, so check whether you can get more for your money by using the open-market option.
- In difficult economic times, your pension fund may be worth less than you expected, so getting the best deal is even more important.
- Choosing how to take your retirement income can be a complicated decision. We recommend that you consider getting advice from a financial adviser authorised by the Financial Services Authority (FSA). To find a financial adviser, please see page 21.

Things you should know

- Your pension scheme should send you, no later than 6 months before you are due to retire, details of the choices you have.
- This information will discuss buying an annuity (an arrangement which provides you with a pension income for the rest of your life).
- Your pension scheme must tell you that you have the right to shop around and about the different types of annuity that are available.
- You do not have to accept the annuity quoted by your pension scheme and you can shop around to find the best deal – this is called the open-market option.
- Your income in retirement will depend on 4 main things:
 - how much money you and your employer have paid into your scheme;
 - how this money has been invested;
 - how much of this money has been used to pay any charges; and
 - the decision you make now on how you take your retirement income.
- If your pension fund rises and drops in value (for example, all or some of it is linked to stocks and shares), you may want to consider switching your fund into a lower risk investment to reduce uncertainty in the run up to retirement. Check with your scheme whether this option is available and whether there is a charge for switching your money.

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You may get better value for your money if you shop around using your open-market option.

Before you make any decision, you need to consider:

- your overall financial situation;
- what you might need financially in the future; and
- how much tax-free cash you want to take (this is sometimes called a pension commencement lump sum).

There are limits on the amount of cash you can have as a lump sum – usually this is no more than a quarter of your fund. The cash you take will affect how much money is left over to buy your pension.

- If you are not sure what action to take, we recommend that you get financial advice – see page 21 for details of how to find an adviser.

What is an annuity?

An annuity converts your pension savings into a series of payments – the pension scheme pays your pension savings to an insurance company who, in return, agrees to pay you a regular income for the rest of your life. This is often called a lifetime annuity.

What affects the cost of an annuity?

- Type of annuity (see page 10)
- Age – annuity rates tend to get higher the older you are
- Sex – annuities for women currently cost more. This is due to a change which will apply from December 2012.
- Health and lifestyle
- Prices vary from provider to provider just like any other goods or services you buy, which is why it is so important to consider shopping around. You can get an immediate idea of the range of prices by putting your details into the **Money Advice Service** annuity comparison tables – www.moneyadviceservice.org.uk/tables

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What affects the cost of an annuity? continued...

The example below shows how the features on page 10 can affect the amount you are paid. It also shows the wide difference between how much insurance companies will pay. This makes clear how important it is to shop around using the open-market option.

An annuity example



These figures, based on monthly income, are for a male in BN1 4DW, age 65, using a pension fund of £30,000 to purchase an annuity.

1. Male, smoker, single-life, level annuity, no escalation with no guarantee
2. Male, smoker, joint-life annuity (50%), escalating (in line with the RPI) with a 5-year guarantee
3. Male, non smoker, single-life, level annuity, no escalation with no guarantee
4. Male, non smoker, joint-life annuity (50%), escalating (RPI) with a 5-year guarantee

(We explain about single and joint-life annuities as well as level and escalating options and the guarantee on pages 10 and 11.)

These figures are based on the Money Advice Service tables on 14 February 2011. However, these figures will change over time and it's important to get up-to-date figures based on your own circumstances.

How does the open-market option work?

You have a choice of who provides your retirement income when you retire. Your pension scheme will normally offer you an annuity but you can also shop around so you can choose the annuity that best suits your needs. Shopping around using your open-market option helps you to:

- find out how the cost might vary between providers;
- identify different features which may help you find the annuity which best suits your circumstances and how these features can affect the cost of the annuity or how much pension you get; and
- decide if you want to choose another option instead of buying an annuity (see page 13) if your scheme allows this.

It is particularly important to shop around:

- to find out if the annuity offered by your scheme is competitive;
- if you are in poor health as this may mean you can get a higher annuity; and
- if your lifestyle may qualify you for a higher annuity, for example, if you smoke or do a particular type of job.

Even if you have been very happy with your pension scheme up to now, consider the open-market option to check that it is offering the best deal for you when you come to retire. Remember, if you do nothing, you may not get the best annuity.

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Who can help you with the open-market option?

- A financial adviser
- The Money Advice Service
- The Pensions Advisory Service (TPAS)

See pages 20 and 21 for their contact details.

Choosing an annuity can be complicated – so get all the help you can. There is much free help available. For example, you can get help from TPAS and The Money Advice Service.

What types of annuity are there?

There are 2 basic types of annuity – a single-life annuity and a joint-life annuity. There are other features that you could choose to include in the basic types, to suit your needs and circumstances. Check which features are included in the annuity offered by your scheme. We have described these below.

The 2 basic types of annuity

Single life

This pays an income to you for the rest of your life.

Joint life

This pays an income to you for the rest of your life. And then, when you die, it continues to be paid (usually at a reduced rate) to your husband, wife or partner until they die.

Options you may be able to include:

Level

The pension income you receive stays the same throughout your life. This means it starts at a higher rate than an annuity which increases. Over time, although the amount you receive stays the same, the amount the pension can buy will drop if prices rise (inflation) and increase if prices fall (deflation).

Yearly increases (escalation)

The pension income you receive increases each year, in line with inflation (the Retail Prices Index (RPI) or the Consumer Prices Index (CPI)), or at a fixed rate, for example, 3% or 5% each year. You will get a smaller starting pension than with a level annuity, but the increases help to protect the spending power of your pension. If inflation stays low, it can take as long as 20 years or more for an escalating annuity linked to inflation to pay out as much as a level annuity. If you choose to link your annuity to inflation, check with the insurance company what would happen at a time of falling prices.

Guarantee period

Your pension income can be guaranteed for a set period, usually 5 or 10 years, so that it continues to be paid (usually to your widow, widower, civil partner, or to your estate) for the rest of the guarantee period if you die before the period ends. If you include a guarantee period, it may involve a small reduction in the amount of your annuity.

Lump sum on death

A different type of guarantee you may be able to choose is an annuity protection lump-sum death benefit to make sure that if you die, the annuity will pay out a taxable lump sum, equal to the cost of your annuity less any income you have already been paid.

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Investment-linked annuities (including with-profit annuities)

These annuities offer the potential for you to receive a higher income but rely on stock-market performance. As a result, your income could go down as well as up.

Impaired life annuities

These annuities can pay a significantly higher income if you have a health problem that threatens to shorten your life. In cases of serious ill health, where a registered medical practitioner confirms that your life expectancy is less than a year, the law may allow you to take the whole of your pension fund as a lump sum.

Enhanced life annuities

These annuities can pay a significantly higher income if your lifestyle may shorten your life. For example, if you are overweight, a smoker, have done certain manual jobs or live in a particular part of the country.

What alternatives are there to an annuity?

When you retire, you may decide you do not want to buy an annuity.

Some of the alternatives we describe below may only be suitable if you have a large amount in pension savings or other sources of income and are comfortable taking some risk with your pension.

And, not every pension scheme offers all or any of these alternatives. So, you should speak to a financial adviser authorised by the FSA who will be able to tell you if the option you choose is available, or indeed suitable, for your circumstances.

Make sure you are comfortable with the risks of choosing one of the alternatives to an annuity shown here and on page 14.

Alternatives to an annuity

Cash lump sum – for smaller funds (this is sometimes called trivial commutation)

If you are at least 60, you may be able to take all your pension savings as a lump sum. You can usually only do this if the total value of all your savings in all pension schemes is less than £18,000.

If your fund value in an occupational fund is less than £2,000 then you can take it as a cash lump sum if your scheme rules allow, even if all your pension savings are more than the minimum amount mentioned above.

You usually pay tax on part of these lump sums.

Phased retirement

You can use your pension savings to buy annuities at different ages in the future.

Drawdown pension (sometimes also called income withdrawal or drawdown)

You take an income direct from your pension savings.

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Short-term annuities

You can buy a series of annuities each lasting for a fixed term (usually up to 5 years). You can then leave the rest of your savings invested or use them to buy a lifetime annuity.

Putting off buying an annuity

Your scheme rules may allow you to put off (postpone) buying an annuity, whether or not you stop working. By postponing buying an annuity (either for a limited time or indefinitely), you may get a higher annuity because your pension savings will have been invested for longer and you will be older.

However, annuity rates and investments can go down as well as up. Check whether you may lose any guarantees or have to pay any charges by putting off taking your pension income. It may also be possible for you to be paid your tax-free lump sum but delay taking any income.

Other ways

There are new options now available which 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.

What things should I keep in mind if I shop around?

- If you use your open-market option and decide to buy your annuity from another insurance company, your pension scheme might take charges from your fund. You need to get an estimate of the value of your fund (less any charges) before you can ask insurance companies for a quote for an annuity.
- Make sure you compare like with like. For example, don't compare a level annuity with one that increases.
- Make sure any annuity you choose fits with your circumstances. (For example, do you need an escalating annuity or do you qualify for an enhanced annuity?)
- Check whether you will lose any benefits (for example, the option to buy an annuity at a guaranteed rate) or pay any charges if you don't take up your pension scheme's offer.
- Quotes for annuity rates are often available only for a limited time, usually seven to 28 days. Also find out if there is a 'cooling-off' period during which time you can cancel any choice you make.
- You may find it difficult to shop around if you have a small pension fund (less than £5,000) as some firms may not be interested in providing an annuity or in giving you advice, or they might charge for this service.
- Not all companies will deal with you direct. It may be better to ask a financial adviser to look at the annuity rates on offer. Some advisers specialise in annuities, and it may be worthwhile going to one that does.

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- If you use the open-market option, the adviser may be paid commission. The insurance company will pay this, so this should not affect the amount you pay for the annuity. But ask the adviser if you will have to pay any other charges. If you take your annuity from your pension scheme, your adviser may ask you to pay a fee for the advice they have given you.

If you are comparing annuities under the open-market option, remember to compare like with like.

Frequently asked questions

What if I have a defined contribution fund in more than one pension scheme?

You may want to get financial advice. For example, you may be able to combine the money from all your schemes and use it to buy one annuity rather than buy a different annuity for each scheme. This may give you better buying power.

Do I have to pay tax on my pension income?

Yes, your pension income counts as earned income for tax purposes. Remember that most schemes will allow you to take a part of your fund, normally up to a quarter, as a tax-free lump sum, as well as receiving an income.

What if I am contracted out of the additional State Pension (the State Second Pension)?

Your employer's money purchase scheme will be able to tell you if it is contracted out of the **State Second Pension (S2P)**. (This used to be called the **State Earnings Related Pension Scheme (SERPS)**.) If so, you must currently use part of your pension fund to buy a 'protected rights annuity'.

For example, the annuity rates are the same for men and women and the annuity will have to be joint life if you are married or in a civil partnership. From 6 April 2012, you will not need to buy a protected rights annuity.

The Pensions Advisory Service (TPAS) has free online information on contracting out at www.pensionsadvisoryservice.org.uk

What if I have an individual pension policy or a free-standing additional voluntary contribution (AVC) plan?

If you have an individual pension arrangement, for example, a personal pension (including those which are part of a group personal pension scheme taken out by an employer), please see the Money Advice Service guide '**Just the facts about your pension – it's time to choose**'. Go to www.moneyadvice.service.org.uk/pdfs/pensions_choose.pdf

How will I know how much I have available to buy an annuity?

You can get an estimate of the value of your pension fund (less any charges for using the open-market option) from your pension scheme. Your pension scheme should send this to you before your retirement date, so you can start to shop around. You should then take off any amount you plan to take as a tax-free lump sum when you retire.

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What things should I keep in mind if I shop around? continued...

Will the stock market affect the value of my pension fund?

If you are invested in a fund which rises and falls in value (for example, it is invested in the stock market), the value can change. You may want to investigate whether you have the option to switch into a lower risk fund to reduce uncertainty in the run-up to retirement.

Who regulates annuities?

We, The Pensions Regulator, regulate workplace pension schemes. However, you will usually buy your annuity from an insurance company and these are regulated by the FSA.

If an insurance company cannot pay all amounts due, the Financial Services Compensation Scheme (FSCS) may be able to help you.

Ten important things to consider

- 1 Once you have bought an annuity, you cannot normally change your mind. So, it's worth making sure you get the right one.
- 2 In difficult economic times, your pension fund may be worth less than you expected.
- 3 Talk to a financial adviser to see if they can help.
- 4 If you want to delay taking your pension income, check for charges or penalties which might apply.
- 5 Do you want to change funds before you retire – for example if your fund rises and falls in value?
- 6 Do you want to take tax-free cash from your fund before you take an income?
- 7 What annuity options are available from your scheme?
- 8 Compare what your scheme offers with the open-market option.
- 9 Do you qualify for an impaired life or enhanced annuity?
- 10 Would one of the alternatives to an annuity be suitable for you?

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Where to get more information

You can get more information from the following organisations.

The Money Advice Service

The Money Advice Service has produced a range of free guides, available from its website. The website also has tables of different annuity rates to help you compare prices.

Helpline:
0300 500 5000

Typetalk line:
18001 0300 500 5000

Website:
www.moneyadvice.service.org.uk

Department for Work and Pensions (DWP)

For advice on preparing for your retirement including state pensions, see The Pension Service website. If you live in Northern Ireland, see the Department for Social Development website at **www.dsdni.gov.uk**

Phone:
0845 606 0265

Textphone:
0800 731 7339

Website:
www.direct.gov.uk

Financial Services Compensation Scheme (FSCS)

The FSCS helps protect consumers against financial loss when firms authorised by the FSA cannot or are unlikely to pay claims against them.

Phone:
0207 741 4100 or 0800 678 1100

Website:
www.fscs.org.uk

It provides a guide 'How we can help'. Go to **www.fscs.org.uk**

The Pensions Advisory Service (TPAS)

TPAS is an independent organisation which can help with questions about your pension and annuities. You should also consider using the annuity planner on the TPAS website homepage.

Phone:

0845 601 2923

Email:

**enquiries@pensions
advisoryservice.org.uk**

Website:

**www.pensionsadvisory
service.org.uk**

The Pension Tracing Service

The Pension Tracing Service can help you track down pension schemes you have been a member of in the past. Their tracing service is free – you can either phone them and ask them for a tracing request form or you can use their online form.

Phone:

0845 600 2537

Textphone:

0845 300 0169

Website:

www.direct.gov.uk

Your trustees or your scheme administrator

You'll find their contact details in your scheme literature.

A financial adviser

To find a financial adviser or financial planner, you can contact one of the following organisations:

Unbiased.co.uk

Website:

www.unbiased.co.uk

Personal Finance Society

Website:

www.findanadviser.org

Institute of Financial Planning

Phone:

0117 945 2470

Website:

www.financialplanning.org.uk

Jargon buster

Additional voluntary contributions (AVCs)

Extra contributions that you pay into your pension scheme to boost your pension.

Annuity

An annuity changes your pension fund into an income when you retire. This is often called a lifetime annuity.

Annuity rate

The amount of income you get for your pension fund, which depends on several factors such as your age, annuity rate, health and the type of annuity you want.

Defined contribution (DC)

A pension scheme where the benefits depend on how much you and your employer contribute, how well your investments do and annuity rates when you retire.

Final salary

A pension scheme where the benefits are linked to your earnings. This is sometimes called defined benefit (DB).

Hybrid

A pension scheme that contains both defined contribution and defined benefit elements.

Occupational pension scheme

A pension scheme with trustees set up by an employer.

Open-market option (OMO)

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

Pension commencement lump sum

The part of your pension fund that you can take as tax-free cash (usually up to a quarter).

About The Pensions Regulator

We regulate work-based pension schemes in the UK. Our aims are to protect members' benefits, promote good administration and reduce the risk of anyone needing to claim from the Pension Protection Fund (PPF).

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