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FSA Factsheet

Your pension – it's time to choose

This factsheet is for you if:

- you are approaching retirement;
- you have a pension fund to invest in a lifetime annuity; and
- you want to know what to do next.

It sets out:

- some things you need to consider when you buy an annuity;
- how to shop around to get the best deal for you; and
- where to get more help and information.



If you are approaching retirement your pension provider will write to you with details about your pension fund. The details will include information about using your pension fund to buy a lifetime annuity to provide you with a pension income for the rest of your life. Please read this information carefully and ask your pension provider or financial adviser about anything you do not understand.

It's time to choose – whether to take a tax-free lump sum from your pension fund first; what sort of annuity to buy; whether to include a pension for your spouse/partner; where to buy it from to get the best deal for you; or whether to delay buying an annuity for now. You don't have to buy an annuity from your current pension provider – you may be able to get a better deal by shopping around.

We cover the different types of annuity briefly here but there are many variations and choosing the best one can be complicated. For more detailed information see the free **FSA guide to pensions 3: Annuities and other retirement options** – see Useful contacts on page 11.

The FSA's consumer publications aim to give you general information to help you make financial decisions. The information does not constitute financial or other professional advice; for advice about your own circumstances you should consult a professional adviser.

Retirement

We use 'retirement' to mean the time from when you start to take the benefits from your pension.

You can take your pension from age 50 from a personal or stakeholder pension and you don't have to stop work to start drawing the pension.

This minimum age from which you can take your pension is going up from 50 to 55 by 2010. The precise timing may vary between different pension schemes, so check with your plan provider.

What is a lifetime annuity?

A lifetime annuity converts your pension fund into pension income – the income you will be paid for the rest of your life. You buy an annuity with your pension fund from an insurance company, and your pension income from your annuity is taxable.

You can buy an annuity if you have one of the following types of pension –

- personal pension;
- stakeholder pension;
- most Additional Voluntary Contributions (AVCs);
- Free-Standing Additional Voluntary Contributions (FSAVCs);
- retirement annuity contract;
- Section 32 policy.

What happens if you have an occupational pension?

If you will be getting a pension from an occupational salary-related pension scheme (sometimes called 'final salary', 'superannuation' or 'defined benefits' schemes), you do not need to buy an annuity because your pension is worked out on a different basis; speak to your pension administrators to find out more.

If you will be getting a pension from an occupational defined contribution scheme (a 'money purchase' scheme), your choices are set out on page 10.

Did you know?

Government estimates for the UK show that life expectancy for people aged 65 in 2005 will be:

- around 84 for men; and
- around 87 for women.

You could be living on your retirement income for many years.

Source: Government Actuary's Department – cohort figures 2005

What types of lifetime annuity are there?

There are different types of lifetime annuity to suit your needs and circumstances. The basic types are –

- **single life** – an annuity just for you if you don't have a spouse or partner, or if they don't rely on you for income (for example they have their own pension arrangement);
- **joint life** – an annuity that will pay out to your spouse or partner after your death (normally at a reduced rate), if you have a spouse or partner who relies on you for income.

You can also choose whether you want your single- or joint-life lifetime annuity to be –

- **a level annuity** – this pays out the same pension income throughout your life. You will get more money to start with than you would from an escalating lifetime annuity, but it will not increase in line with inflation;
- **an escalating annuity** – there are two main choices:
 - **fixed-rate** – your income increases each year by a fixed rate (for example 3%); or
 - **RPI-linked** – your income goes up or down in line with inflation.

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

You can also add some options to your lifetime annuity, such as:

A guarantee period

You can 'guarantee' your lifetime annuity for a specific number of years. This means it will continue to pay the income for the rest of the guarantee period (5 or 10 years) even if you die before the time period is up. The income is usually paid to your partner, or to your estate if it is a single life annuity.

Annuity protection lump sum death benefit

This is a way of ensuring that if you die before the age of 75, your annuity doesn't die with you. 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 a tax charge, and may also be an inheritance tax charge.

Enhanced and impaired life option

You may also be able to benefit from an **enhanced annuity** or an **impaired life annuity**, which pays a higher income, depending on your state of health or lifestyle.

Once your annuity is being paid you can only switch annuity providers if you can find a provider willing to take it on. You cannot change the type of annuity if you do switch providers.

How is a lifetime annuity worked out?

These are the most important factors that affect the income you will get from your lifetime annuity:

- The amount of money in your pension fund when you retire.
- The amount of tax-free lump sum you decide to take – this will reduce what you have left in your fund to buy an annuity with.
- The annuity rate offered by the life insurance company – annuity rates vary from company to company.
- The type of annuity you decide to buy – joint or single life, level or escalating, with or without a guarantee.
- Your age.
- Your sex – annuities for women cost more, as they are expected to live longer than men.
- Your health or lifestyle – some companies will pay higher annuities to people who are overweight, have high cholesterol, are smokers, or are in poor health. Your occupation or where you live might also affect your annuity.

You may be able to get a higher annuity if your health is poor, if you are a smoker, are overweight or have followed certain occupations – so shop around!

To help you consider what sort of lifetime annuity might be best for you, see page 8, and the Next Steps checklist on page 9.

If you have contracted-out of the additional State Pension

If you have contracted-out of the additional State Pension (this was called SERPS, now the State Second Pension), you must use that part of your pension fund to buy a ‘protected rights annuity’. Your pension provider will tell you if protected rights applies to you and what it means in your circumstances.

With a protected rights pension you:

- can draw your protected rights pension at the same time as your occupational or personal pension, provided you are over 50 years old, going up to 55 by 2010. (Check that your pension scheme rules allow you to draw your pension at age 50);
- can convert up to one quarter of your protected rights fund into a tax-free lump sum. Any money you take as a lump sum will reduce the amount you have available to buy your annuity;
- will have to buy a joint life annuity paying a 50% spouse’s pension if you are married or have a civil partner; and
- can choose between taking a level or escalating annuity.

How can you shop 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. This will help you shop around and compare the income offered by other insurance companies.

Your pension provider might deduct charges from your fund if you decide to buy your annuity from another provider – check this. You need an estimate of the value of your fund which takes account of any charges so you can use your ‘open market option’ to shop around.

You can then ask other insurance companies to give you a personalised quote, after giving them all the details they need. But remember to compare like for like and look at lifetime annuity quotes based on your circumstances.

Lifetime annuity quotes are usually fixed for a limited number of days, 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’. These advisers should be able to look at all the annuity rates on offer. Some advisers specialise in annuities and it may be worthwhile going to one that does.

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

You can check on ‘open market option’ annuities by going to the FSA’s Comparative Tables on the Internet at: www.fsa.gov.uk/tables

Some people have found they have been able to increase their income by as much as a third by shopping around for their annuity.

Where can you buy a lifetime annuity from?

Your pension provider will usually offer you a lifetime annuity, but you can shop around to see what rates or arrangements other insurance companies offer – this is called the ‘open market option’. But you may find it difficult to shop around if you have a small pension fund, say below £5,000.

Check whether you will lose any benefits (for example, an option to buy a lifetime annuity at a guaranteed rate) if you don’t take up your pension provider’s offer.

What other options are there?

If you don't want a type of annuity mentioned earlier or if you decide to delay buying a lifetime annuity, there are a few other options you might consider.

Some are only likely to be suitable if you have a large pension fund and other assets or sources of income, and are comfortable taking some risk with your fund. For more detailed information on these options see the **FSA guide to pensions 3: Annuities and other retirement options**.

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

■ Investment-linked lifetime annuity

This type of annuity relies on stock-market performance and involves some risk that your income could go down as well as up.

■ 'Phased retirement'

This is where you split your pension fund (or funds, if you have more than one) into two, three, four or more slices with which you can buy annuities at different ages.

■ Unsecured pension using income withdrawal or short-term annuities

This is a way to draw an income from your pension fund while leaving it invested.

An unsecured pension will stop at age 75. By that time, you must secure an income from your pension funds, which generally means buying a lifetime annuity. A variant to this is an alternatively secured pension, which works in a similar way to an unsecured pension but has slightly different rules.

However, the Government has indicated that alternatively secured pensions are only intended for a small group of people who have a principled religious objection to buying an annuity. You should take this into account when

making a decision on how to secure your pension. Also, inheritance tax may apply to any leftover funds on your death.

You would probably need to have a large pension fund to take advantage of these more complex options. You should get professional financial advice – see Useful contacts on page 11.

Some other things you might consider

■ Not buying a lifetime annuity or drawing an income when you stop work

You don't have to buy an annuity or draw an income from your fund when you stop working. You could postpone buying a lifetime annuity to a later date if it suits you.

You can continue paying into your pension fund (but not if it's an occupational pension scheme).

If you do postpone buying a lifetime annuity you might get a higher annuity later because you are older and your fund will have been invested for longer. But lifetime annuity rates change and the value of your fund can go down as well as up – a higher annuity can't be guaranteed by postponing.

■ With-profits funds

If your pension fund is invested in a with-profits fund you need to be very careful about changing your retirement date. With-profits funds usually pay out at set dates in the life of the policy. If you change your original retirement date the company managing your fund may reduce your fund by making a 'market value reduction'. Check this if you have a with-profits fund.

■ More than one personal pension fund?

If you have more than one personal pension fund, you may be able to get a higher lifetime annuity if you combine them, by transferring all or some to a single stakeholder or personal pension, and then buying one annuity. It depends on the types of pension you have and you may wish to get professional financial advice.

On the other hand, if you do not need the income immediately, you could buy a lifetime annuity with one pension fund and leave the other(s) till later.

■ Your pension funds are small

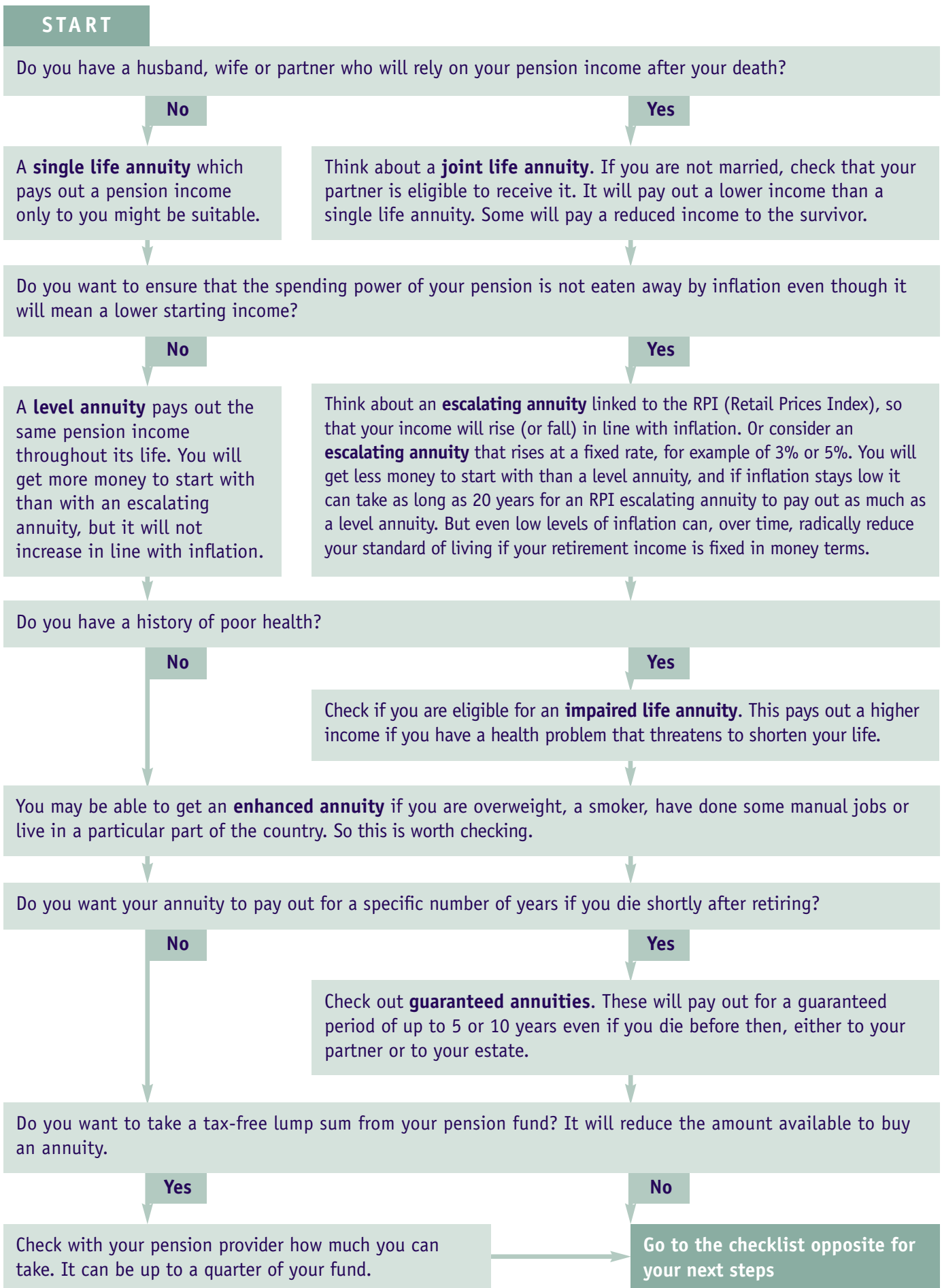
If the total of **all** your pension funds is less than £15,000, you can take all your pensions as a cash lump sum rather than taking an income. To take this option you must be between 60 and 75 and must convert all your pension funds to cash within a 12-month period. One quarter of the lump sum is tax-free and the rest is taxed as income.

■ Working beyond retirement age

You might want to boost your retirement income by working beyond retirement age. You can postpone taking your State Pension for as long as you want and get either extra State Pension or a one-off taxable lump sum. You can usually postpone taking a personal or stakeholder pension, in consultation with your pension provider, and continue contributing to the pension. You can continue working and contributing to an occupational pension scheme only if the scheme rules allow.

You stop paying NI contributions, however, once you reach State Pension age.

Use this chart to help you decide what sort of lifetime annuity would best suit you.



Occupational defined contribution ('money purchase') pension schemes

The rules for occupational defined contribution schemes are different to those for personal and stakeholder pensions. If you belong to this type of scheme, ask the Pensions Regulator for their factsheet '**Your retirement choices – money purchase benefits in occupational pension schemes** – see Useful contacts on page 11.

- The trustee of your occupational defined contribution scheme may buy your lifetime annuity for you, but you have the right to shop around and buy it for yourself if you wish.
- You may be able to transfer your fund to a stakeholder or personal pension if you think this would increase your choice of annuity (check your scheme rules).
- You can continue working for the employer who pays your pension once you draw your pension as long as the scheme rules allow.
- If you have AVCs or FSAVCs you can take approximately a quarter of your fund as tax-free cash.

Further help and advice

FSA publications

■ **FSA guide to pensions 3: Annuities and other retirement options**

■ **FSA guide to financial advice**

Useful contacts

0845 numbers will be charged at the local rate based on current charges from BT landlines. Charges for calls from mobile phones and other networks may vary.

To obtain free FSA publications

FSA Consumer Helpline

Tel: 0845 606 1234

Minicom/textphone: 0845 730 0104

Website: www.fsa.gov.uk/consumer

Pension enquiries

The Pensions Advisory Service

Tel: 0845 601 2923

Website: www.pensionadvisoryservice.org.uk

An independent organisation providing help with consumers' pension and annuity queries.

The Pensions Regulator

Tel: 0870 606 3636

Website: www.thepensionsregulator.gov.uk

Factsheet: Your retirement choices – money purchase benefits in occupational pension schemes

To trace old pensions

Pension Tracing Service

Tel: 0845 600 2537

Textphone: 0845 300 0169

Website: www.thepensionservice.gov.uk

Financial advice

IFA Promotion

Tel: 0800 085 3250

Website: www.unbiased.co.uk

(for a list of three independent financial advisers local to your area)

Personal Finance Society

Website: www.thepfs.org/findanadviser

(can help you find up to six financial advisers in your local area)

Financial planning

Institute of Financial Planning

Tel: 0117 945 2470

Website: www.financialplanning.org.uk

(can help you search for a qualified financial planner)

The Financial Services Authority (FSA) is the independent watchdog set up by government to regulate financial services and protect your rights.

If you have any questions about your pension fund you need to contact your pension provider. The contact details are on letters from your pension provider.

Our Consumer Helpline can answer general queries about financial products and services, tell you if a firm is authorised, and help you if you have a complaint and don't know who to contact.

We also produce a range of user-friendly factsheets and booklets available from our website and helpline. But remember that, as the regulator, we can't recommend firms or advisers or tell you whether a particular investment is right for you.

If you would like this factsheet in Braille, large print or audio format, please call our Consumer Helpline on 0845 606 1234 or Minicom/Textphone 08457 300 104 (call rates may vary).

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

Our website, www.fsa.gov.uk/consumer, aims to help you understand financial services and get a fair deal.

Use the site to:

- **shop around with our comparative tables – including mortgages, pensions and ISAs;**
- **check a firm is authorised by the FSA, or is the agent of an authorised firm. If they are not authorised you will not have access to complaints procedures and compensation schemes if things go wrong;**
- **order any of our wide range of consumer publications;**
- **report any misleading financial advertising;**
- **see explanations of financial products in plain English;**
- **read recent alerts that we have issued.**