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We produce a range of user-friendly factsheets and booklets which are available from our website and helpline.

If, after reading this booklet, you have any general queries, our helpline will try to clarify things for you.

We can tell you if a firm is authorised and help you if you have a complaint and don't know who to contact. But as the regulator, we can't recommend firms or advisers, or tell you whether a particular investment is right for you.

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

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Use the site to:

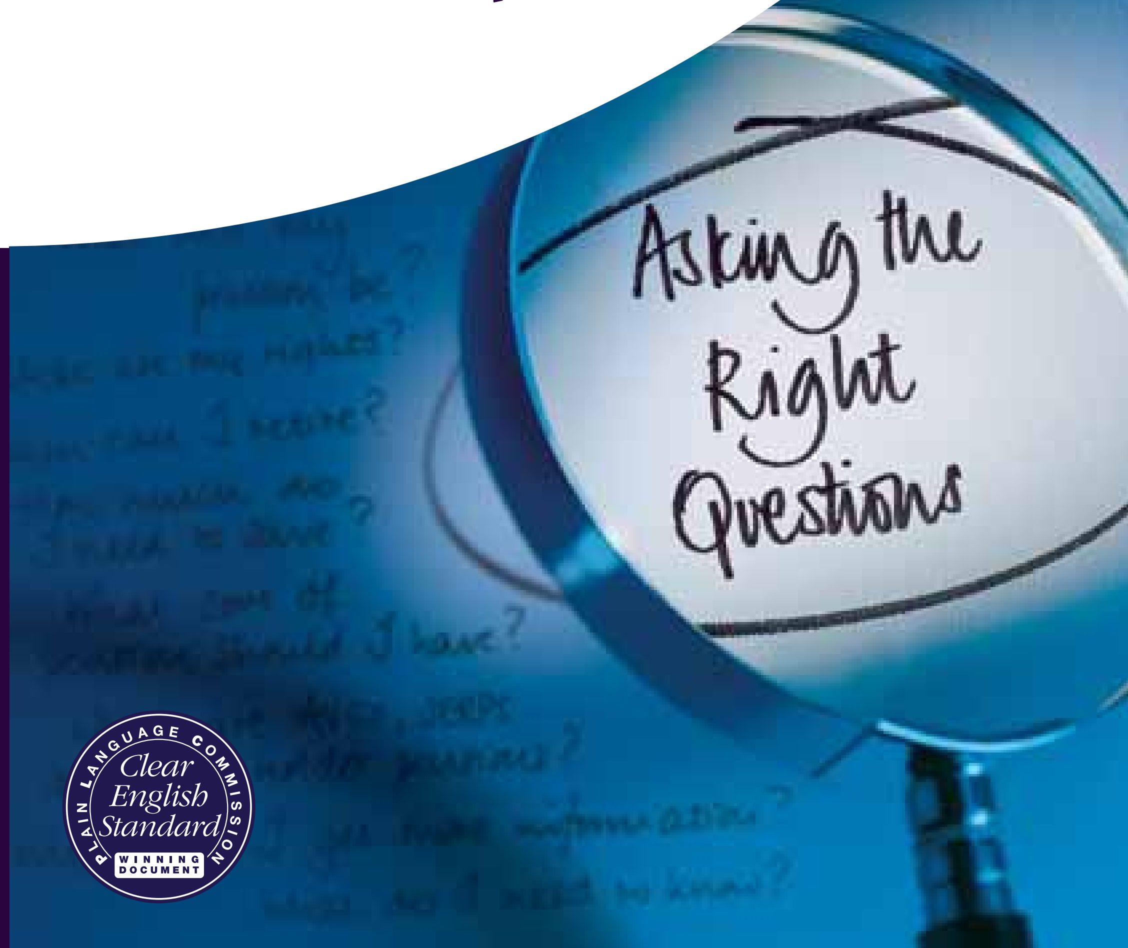
- shop around with our Comparative Tables – including mortgages, pensions and ISAs;
- check a firm is authorised by the FSA, or is the agent of an authorised firm. If they are not authorised you will not have access to complaints procedures and compensation schemes if things go wrong;
- order any of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

May 2006

FSA guide to pensions 3

Annuities and other retirement options

FSA
Financial Services Authority



Plain Language Commission – Clear English Standard – Winning Document

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The Financial Services Authority (FSA) is the UK's financial watchdog set up by government to regulate financial services and protect your rights. By law, most financial services firms in the UK must be authorised by the FSA. We regulate the way many (but not all) of them do business with you.

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.

If you would like this guide 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).

Contents

The FSA – here to help you make more sense of your money.

This booklet is an introductory guide that outlines the main ways of converting your pension fund into an income for your retirement. It is general information designed to help you 'ask the right questions' and so make informed decisions.

Information in this booklet is based on the legal and tax position at April 2006.

Introduction

A guide to your retirement options if you are retiring soon.

This booklet is for you if you have saved or are saving for your retirement in a money purchase pension such as:

- a **personal pension;**
- a **stakeholder pension** scheme;
- a **group personal pension** plan arranged through your employer;
- a **retirement annuity contract** (similar to a personal pension but sold before July 1988 when personal pensions first became available);
- a **free-standing additional voluntary contribution** (FSAVC) scheme.

This booklet may also be relevant if you will be getting an income from:

- an employer's occupational pension scheme that builds up your own retirement fund – called a **money purchase** or **defined contribution** scheme;
- the type of **additional voluntary contribution** (AVC) scheme that builds up your own investment fund;
- some **Section 32 policies** – if you have used one to transfer out of your employer's pension scheme.

This booklet deals with converting your money purchase pension fund or funds into an income in retirement. For most people, this means buying a lifetime annuity.

It does not deal with employers' occupational salary-related (defined benefit) pension schemes. In these schemes, your income in retirement is provided by the employer's pension scheme and you do not need to buy an annuity yourself.

Important things to think about:

You will have many things to consider when you buy a lifetime annuity. It may help if you take financial advice. Here are some things to think about:

- You can choose to take up to a quarter of your pension fund as a tax-free lump sum. You can then use the remainder of the fund to provide you with an income by buying a lifetime annuity. This will pay you an income for life.
- If you choose a basic lifetime annuity, your choice will be between a level annuity that will pay you the same amount for the rest of your life, or an escalating annuity that will pay a lower initial amount but will increase each year with inflation.
- You'll need to consider whether you should provide for your partner after your death.
- You should shop around to get the best deal for your money. You can compare annuity rates on the FSA Comparative Tables at www.fsa.gov.uk/tables
- You might be able to get a better annuity rate for your money if you smoke or have health problems and qualify for an impaired life annuity.
- You don't have to buy a lifetime annuity at retirement. See page 26 for other options available to you.

Retirement

In this guide, we use 'retirement' to mean when you start to take benefits from your pension.

You can take your pension from age 50 onwards from a personal or stakeholder pension and you don't have to stop work. You can also do this with an employer's occupational pension scheme and carry on working for that employer, but only if the scheme rules allow.

The 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 bear this in mind when thinking about your retirement plans and check with your pension provider.

What is a lifetime annuity?

A lifetime annuity is a special type of investment because it will pay you an income for the rest of your life, however long you live.

If you have more than one pension plan or scheme, you don't have to use them all at the same time to buy an annuity, though you might be able to get a better income by combining them.

How lifetime annuities work

In most cases buying an annuity means that you are exchanging your pension fund for an income.

Lifetime annuities are sold by life insurance companies. The annuity rates they offer people are calculated by taking account of the fact that some people will live longer than others. Obviously people who live longer than average will take more from their annuity than, for example, someone who dies three or four years after retirement.

People who die early subsidise the annuity rates for those who live longer but everyone benefits from the payment of an income throughout their retirement – no matter how long or short that proves to be. Insurance companies adjust rates because average life expectancy is rising and people are living longer. Interest rates also affect annuity rates because they determine the returns on the investments from which insurers pay annuities.

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

In fact, if you have an illness or medical condition that means you don't expect to live as long as a healthy person the insurance company might offer you a higher annuity rate than it would a healthier person. Some companies offer higher annuity rates for smokers and people with specified health problems or who have worked in certain industries. These are called 'enhanced' or 'impaired life' annuities.

How lifetime annuities pay out

The amount of income an annuity will pay depends on, amongst other things:

- the amount you have in your pension fund;
- the amount of tax-free lump sum you take;
- if you have used your fund to contract out of the additional State Pension (see page 12);
- your health;
- your age;
- your sex;
- the benefits you choose, such as whether the annuity is for you or for you and your partner.

Usually the starting income from the same size of pension fund is higher for a man than for a woman of the same age. This is because, on average, the life expectancy of a man is less than that of a woman of the same age.

The older you are when you buy an annuity, the higher will be the income you get from it at the start. This is because, on average, an older person has fewer years left to live than a younger person. So an older person's pension fund does not have to last so long.

You can usually choose to have your income paid every month, every three months, every six months or once a year.

Taking a lump sum from your pension

Tax-free lump sum

You can take up to a quarter of your pension fund in cash, as a tax-free lump sum. You have to use the remaining fund to provide you with an income.

Trivial commutation

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 take an income. This is called trivial commutation. 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.

Increasing your income with a purchased life annuity

It may be worth taking the maximum tax-free cash sum and using it to buy a purchased life annuity (though this is not always the case so take advice). A purchased life annuity is similar to the lifetime annuities described in this booklet. But a purchased life annuity is taxed more favourably, so can pay more after tax than a pension annuity for the same amount of money.

Basic lifetime annuities

Before you buy a lifetime annuity you will have to decide what type you want.

There are different types 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 – see page 11.

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

- a level annuity – see page 9; or
- an escalating annuity – see page 9.

You can also 'guarantee' whichever annuity you choose for a specific number of years – see page 12.

Start thinking about your annuity choices at least four months before you retire.

Level and escalating lifetime annuities

A level lifetime annuity pays the same income year after year for the rest of your life.

Level annuities have a higher starting income than escalating annuities but what you can buy with the income from a level annuity falls as prices rise.

To protect your income from rising prices, you can choose an escalating lifetime annuity that pays a lower initial annuity but then increases each year.

There are two main choices:

- **fixed-rate escalating annuities –** your income is guaranteed to increase at a fixed rate each year, say, by 3%;
- **RPI-linked annuities –** your income is adjusted each year to reflect changes in the Retail Prices Index (RPI). So, if inflation is 2% one year, your income goes up by 2%. If inflation is 3% next year, your income goes up by 3%. However, your income is not guaranteed to increase each year – if the RPI did not rise, neither would your income. If the RPI fell, your income increase would be lower than previous years.

Example of level annuity

Harry retires at age 65 and reckons he has a good chance of living another 20 years. After taking a tax-free lump sum his remaining pension fund is £50,000. He chooses a single-life level annuity. This pays him around £3,400 a year (£282 a month or £70 a week).

If inflation averages 3% a year, the buying power of Harry's pension would fall dramatically as retirement progresses. After ten years, his £3,400 annual pension would buy only the same as £2,507 today.

Harry might be gaining in terms of the total amount he has received over 10 years, but his income will only buy around three-quarters of what it bought in year 1. After 20 years, its buying power would have fallen to around £1,850 a year.

If inflation is more than 3% a year, the buying power of Harry's pension will fall even further and faster.

The examples used below and elsewhere in this booklet are based on annuity rates in April 2006, as shown on the FSA Comparative Tables, and are for illustration only.

Annuity rates are changing all the time. In general, the annuity rate at the time you buy your annuity sets your income throughout retirement. Later changes in annuity rates do not affect your annuity income.

The table below illustrates the difference between the rates for a level annuity, and the starting rates for an annuity increasing each year by 3% and an annuity linked to the RPI.

With an escalating annuity, the starting income is a lot lower than you would get from a level annuity. It would take around 11 years for the 3% escalating annuity to catch up with the level annuity. It would take 20 years before the total you received from the 3% escalating annuity exceeded the total paid by the level annuity.

Man aged 65 with a pension fund of £50,000 buying a single life annuity

	Level £ per month	Escalating 3% £ per month	Escalating RPI £ per month
Best rate	290	212	196
Worst rate	259	180	179

Taken from the FSA's Comparative Tables on 6 April, 2006

Lifetime annuities if you have a partner

Joint-life annuities

Basic annuities can be single life or joint life. Unless there is a guarantee, see page 12, a single-life annuity will only pay out during your own lifetime. Your partner will get nothing when you die. A joint-life annuity continues to pay an income to your partner after your death.

You can usually choose between a joint-life annuity that pays your partner the same as you were receiving, or two thirds or a half of what you were receiving. You can also choose a joint life annuity that is level or escalating.

If you are not married, check with your provider that your partner will be eligible to receive the income from a joint-life annuity.

With some occupational money purchase pension schemes, you must opt for an annuity that provides a pension for your widow, widower or civil partner equal to half the income you were getting. Your provider can tell you if this applies to your plan or scheme.

Joint-life annuities are more expensive than single-life annuities because the insurance company will expect to continue paying the annuity for longer. The table below shows the difference between single-life and joint-life annuities.

Man aged 65, wife aged 62 with a pension fund of £50,000 buying a level annuity

	Level annuity		
	Single £ per month	Joint 50% £ per month	Joint 100% £ per month
Best rate	290	260	236
Worst rate	259	227	192

Taken from the FSA's Comparative Tables on 6 April, 2006

If you have contracted out of the additional State pension

If you have contracted out of the additional State pension, known as the State Second Pension (previously called SERPS), and put your rebates into a personal pension fund, 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 take your protected rights pension at the same time as your occupational or personal pension, provided you are over 50 years old, rising to 55 by 2010 (check that your pension scheme rules allow you to take your pension at age 50);
- can convert up to one quarter of your protected rights fund into a tax-free lump sum;
- 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.

Lifetime annuities with a guarantee period

If you die soon after you buy an annuity, it will not have paid out much. To guard against this, you can choose an annuity with a guarantee period.

Guarantee periods are usually for five or ten years' worth of income, even if you die within this period. On your death, the income may continue to be paid for the rest of the guarantee period, or it may be paid to your estate (and tax might be due on it).

If anyone is financially dependent on you, do not look on a guarantee period as a substitute for a joint-life annuity. If you choose a joint-life annuity, a guarantee period may not be useful as you have already arranged for your annuity to continue to be paid on your death.

Annuity protection lump sum death benefit

Another way of ensuring that if you die before the age of 75 your money doesn't die with you is an annuity protection lump sum death benefit. A lump sum equivalent to the pension fund you used to buy an 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.

Example of an annuity with a guarantee period

Harriet, 60, retires. After taking a tax-free lump sum she uses the remaining £30,000 pension fund to buy an annuity. She hopes to live to a ripe old age but, if not and having no closer relatives, she would like to leave something to her nephew.

She chooses a single-life level annuity with a ten-year guarantee.

Harriet gets an income of £1,620 a year. Whatever happens the annuity guarantees to pay out for 10 years at £1,620 a year = £16,200.

After only two years, Harriet dies. The annuity has paid out a total income of £3,240. The rest of the guaranteed annuity payments continue to be paid to her estate and will be distributed according to her will.

Impaired life and enhanced annuities

Some companies offer annuities that pay you a higher-than-normal income if you have a health problem that threatens to reduce your lifespan. These are called 'impaired life annuities'. Relevant health problems might include, for example, cancer, chronic asthma, diabetes, heart attack, high blood pressure, kidney failure, multiple sclerosis or stroke.

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 and to individuals living in certain parts of the country – shop around and compare the income you can get from different providers.

More than one pension fund?

If you are using more than one pension fund to buy an annuity, think about combining them when you are shopping around – you may get a better annuity rate from a larger fund. Advantages of combining your funds:

- Many of the best-rate annuities have a minimum fund size.
- It's often easier to budget with just one payment a month.

Possible drawback:

- You might not want to convert all your pension funds at once.

How annuity rates vary – according to age, sex and type of annuity

These figures show 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 several reasons.

This chart gives an indication of the pre-tax monthly income from an annuity that could be bought in 2006 for a pension fund of £25,000. The figures in the joint life columns assume the person buying the annuity is a 65-year-old male who is five years older than his female partner.

Types of annuities	Single life				Joint lives (no reduction on death of scheme member)	Joint lives (reducing by 50% on death of scheme member)
	Male 60 £/mth	Male 65 £/mth	Female 60 £/mth	Female 65 £/mth	Male 65 Female 60 £/mth	Male 65 Female 60 £/mth
Level annuities						
Level (no guarantee period)	122	139	114	126	106	119
Level (guaranteed 5 years)	121	138	113	125	106	118
Escalating						
Increasing 3% each year (no guarantee period)	82	98	73	87	68	80
RPI linked (no guarantee period)	78	94	68	82	64	65

You may see an annuity rate expressed as a percentage, or as so many pounds of income for each £10,000 you have invested in your pension fund. For example, an annuity rate of 6% is the same as £600 a year income for every £10,000 in your pension fund.

Check annuity rates as you near retirement and shop around for the best deal.

Notes to the chart opposite

1. Level (no guarantee period): The income provided is the same each year for the rest of your life.

2. Level (guaranteed 5 years): The income is the same each year for the rest of your life and is guaranteed to be paid for at least 5 years, regardless of when death occurs.

3. Escalating 3% each year (no guarantee period): The income increases each year by 3% but stops immediately on death.

4. RPI linked (no guarantee period): The income increases each year by the Retail Prices Index (RPI) but stops immediately on death.

5. Joint lives: On the death of the scheme member, the income continues (at the level you select when you take out an annuity) to your spouse or partner for the rest of their life.

6. Better rates may be available for people with health problems, or who have followed certain occupations.

7. Source: FSA Comparative Tables website. April 2006. www.fsa.gov.uk/tables

Retiring gradually

‘Phased retirement’ uses annuities to provide a flexible income.

Phased retirement is suitable only if you have a fairly large pension fund (after taking any lump sum), or have other assets or income to live on.

You can arrange most personal pensions as a single plan, or as a cluster of many separate plans, sometimes called ‘segments’. You can use these segments to buy a lifetime annuity at different times. This process is called ‘phased retirement’.

Each time you convert a segment to an annuity, you can first take part of the segment’s fund as tax-free cash. Converting segments regularly – for example, once a year – means you can effectively use the tax-free cash, as well as the annuity, to provide your income. Alternatively, you can take all your tax-free cash in one go and use the remainder of the fund to provide you with an income.

You must convert enough segments each time to buy an annuity. Insurance companies often set a minimum fund size for annuity purchases.

Phased retirement can be a useful financial planning tool, for example, if you want to ease back gradually on work and start to replace your earnings with pension income.

It also provides more flexible help for your survivors if you die. Segments that you have not yet converted to annuities can provide a pension for your surviving dependants or a lump sum, depending on the terms of the pension plan.

By taking an income in this way you are reducing your overall pension funds and relying on investment growth to replace part or all of what you have taken.

An alternative to buying an annuity would be to draw an income directly from the fund. This is called ‘phased income withdrawal’, and carries more risks than buying a lifetime annuity because the whole fund remains invested and so the income it will provide is not guaranteed. See page 27 for information about income withdrawal.

Another way of retiring gradually is to buy a series of short-term annuities lasting for 5 years at a time – see page 26.

Phased retirement is complicated and needs thought, planning and management. You’ll probably need some specialist financial advice – see page 28.

Retiring later and postponing your annuity

You don't have to buy an annuity with your pension fund at retirement. You may consider postponing buying an annuity until a later date. Alternatively you may decide not to buy an annuity at all and draw an income directly from your pension fund instead – see page 26.

If you delay buying an annuity you might expect a higher annuity rate because you're older. But because people are on average living longer, annuity rates are periodically adjusted to reflect this. So it could be risky to assume that annuity rates will be higher if you postpone buying your annuity. And of course rates may fall or rise for a number of reasons.

You can also postpone taking your State Pension, in exchange for a higher pension or a taxable lump sum when you decide to take it. (See *Useful contacts* on page 31 for details of how to get a leaflet from the Pension Service.)

Example

Ted is 65 years old and has a pension fund of £60,000. He plans to work part-time for the next three years and will have a steady, but reduced income. He checks on his options for deferring his pensions.

- **State Pension now (including Pension Credit) – £114**
- **State Pension (including Pension Credit) in three years' time:**

According to the Pensions Service leaflet, if he puts off claiming his State Pension for three years, he could, at current prices, get:

- **a lump sum of about £19,138 (before tax) plus his weekly pension; or**
- **extra State Pension of about £34.75 a week (£150.58 a month) for life, when he starts claiming it.**

- **Private pension now**

He has a pension fund of £60,000 and, after taking a tax-free lump sum of £15,000 (25%), he is interested in a single-life, level annuity with a five-year guarantee.

He checks the FSA's Comparative Tables for annuities and finds that if he buys an annuity now with the remaining £45,000, the best rate is £274 a month.

- **Private pension in three years' time**

If he postpones taking an annuity for three years, he reckons that his fund will grow over that period. As he intends to move his fund to relatively lower-risk investments for the next three years, he estimates that, after charges, his fund will grow by 5% a year.

Ted's estimated pension fund in three years' time is £69,500, assuming his pension fund grows by 5% a year after charges. He can take a tax-free lump sum of £17,375, leaving £52,125 to buy an annuity.

Ted uses the FSA's Comparative Tables to check the annuity rate for his estimated fund at age 68 (he can only use today's annuity rates as annuity rates in three years' time are not available).

The best rate he finds is:

Single-life level annuity with a 5 year guarantee period at age 68 with a fund of £52,125 = £349 a month.

To summarise

If other factors stay the same, Ted could be £75 a month better off by postponing his annuity for three years. But he will have given up income of £274 a month for three years, amounting to £9,864.

It will take him over 12 years at his higher annuity rate before he gets back the income he gives up by postponing buying an annuity for three years.

On the other hand, he could:

- defer taking his State Pension for three years, which would give him a lump sum; and
- buy an annuity now with the whole of his £60,000 private pension fund, which would give him an annuity of **£366 a month** (£92 a month more than his original annuity).

Investment-linked annuities

The chance of a higher income in future – but only by taking extra risk. Investment annuities also have higher charges.

Investment-linked annuities offer the chance of a higher income than you can get from basic annuities. With a basic annuity the insurance company decides where to invest your pension fund – mostly in low-risk investments such as fixed-interest assets, gilts (loans to the government) and bonds (loans to companies). You receive a pre-determined income from the insurance company for the rest of your life.

Investment-linked annuities offer you the opportunity to invest your pension fund in higher-risk investments, such as funds investing in stocks and shares.

Many experts believe that investment annuities are unsuitable for people with pension funds below £100,000 – unless they have other assets.

If you take this route with your pension fund, you will be linking your income in retirement to the ups and downs of the stockmarket instead of receiving a pre-determined income – see page 9.

Once your investment annuity is being paid you can only switch annuity providers if you can find a provider willing to take it on, though the costs involved might make it impractical.

You cannot change the type of annuity if you do switch providers. If the risk of an unpredictable and possibly falling retirement income worries you, stick to basic annuities.

You should get specialist financial advice if you are considering an investment annuity – see page 28.

Investment-linked annuities can be either:

- **with profits**; or
- **unit-linked**.

Investment-linked annuities are higher risk than basic annuities.

With-profits annuities

These link your income directly to the performance of the insurance company's with-profits fund.

Typically, your income is made up of two parts:

- **a minimum starting income**

This is set at a low level, but, unless investment conditions are very bad, you'll usually get at least this much income.

- **bonuses**

The insurance company usually announces bonus rates once a year. Bonuses can be both 'reversionary' (paid for the duration of your annuity) and 'special' (paid for a year or so) until the next bonus announcement. The amount of any bonuses depends on many factors, such as:

- how well investments are doing – for example stockmarket performance;
- business risk – the financial strength of the fund; and
- the insurance company's assessment of what it can afford to pay out in bonuses.

With-profits annuities might offer:

- a minimum, guaranteed bonus rate – for example 3% a year;
- the option of a guaranteed rate – but the higher the guarantee, the lower your starting income;

Remember, bonuses are not guaranteed, but will depend on the financial strength of the guarantor.

- an option of an 'assumed (or anticipated) bonus rate' (ABR). You choose the ABR at the outset from a range set by the insurance company – for example 0% (which assumes no bonuses at all) to 5%. Once chosen, most insurance companies do not allow you to change the ABR.

The insurance company announces new bonus rates every year. If the rate equals your chosen ABR, your income does not change. If the declared bonus is higher than the ABR, your income increases. But if the bonus is lower than the ABR, your income falls.

If you choose a low ABR, your starting income is low. But you increase the likelihood that future bonuses will exceed the ABR and that your income will rise. You also reduce the risk that your income will fall. If you choose a higher ABR, your starting income will be higher, but you run the risk that your income could fall.

Unit-linked annuities

Your income in retirement will be linked directly to the funds you have invested in. You can usually choose the types of fund, for example:

- **medium-risk managed fund** where a fund manager selects a broad range of different shares and other investments – spreading your money widely reduces risk;
- **higher-risk fund** where a fund manager selects shares and other investments in a particular country or sector, such as smaller companies. Because your money is less widely spread the risk is higher;
- **tracker fund** (usually medium risk) which closely follows the performance of a particular stockmarket index.

Usually, these have lower charges than managed funds.

The more risky the underlying fund you choose, the more your retirement income may vary – both up and down.

Some unit-linked annuities work in a similar way to with-profits annuities. Your starting income is based on an assumed growth rate (this works like the assumed bonus rate – see page 21). If the fund grows at that assumed rate, your income stays the same. If growth is less than the assumed rate, your income falls. A few unit-linked annuities let you invest in a 'protected fund' which limits the fall in your income.

Most unit-linked annuities do not guarantee a minimum income. Even if your income is based on an assumed growth rate of 0%, your income could still fall if the value of the underlying investments falls.

You should not consider a unit-linked annuity unless you can cope with an income that may swing widely and may fall. You would need a large pension fund or other sources of income (or both) to fall back on.

Where to buy annuities

Insurance companies sell annuities – the rates vary from company to company so shop around for the best deal.

As with most things, shopping around can get you a better deal. Although you can usually buy an annuity from the same company with which you built up your pension fund, do not assume it will automatically offer you the best rate. You may do better by shopping around and checking if another company could offer you more.

In most cases, you can use your pension fund to buy an annuity from another company. This is called using your '**open market option**'.

Your insurance company must tell you about this and explain the advantages and disadvantages. Make sure you ask for all the information you need to shop around for the best deal.

If you are a member of an occupational money purchase pension scheme, you can shop around on the open market and find the insurance company with the best annuity rate for you if you wish, or your scheme trustees can do this for you.

Before shopping around, make sure you understand what your existing provider is offering you.

Check:

- Does the company holding your pension fund offer you a 'guaranteed annuity rate'? This is not the same as a guaranteed period. In the past, some insurance companies sold pensions with a 'guaranteed annuity rate'. Now that annuity rates are a lot lower, these guarantees can be very valuable.
- Will your existing pension company impose a charge against your fund if you buy your annuity from another company?

- Get a quote from your pension provider for the type of annuity you want.

There can be a big difference between the best and the worst annuity rates.

You could be better off in retirement by shopping around for the best annuity.

Shopping around for an annuity

Some companies are keen to attract annuity customers, so they offer competitive rates; others are less keen. The rate you get can affect your income by hundreds of pounds a year. When comparing different quotes, make sure you base your request on identical types of annuity.

Annuity rates can be compared by visiting the FSA's Comparative Tables at www.fsa.gov.uk/tables

Alternatively, get specialist financial advice – see page 28.

Seven steps to shopping around for your annuity

It's usually a good idea to allow around six weeks before you want to buy your annuity to get quotes.

1. Get an estimate of the value of your pension fund, taking account of any charges, from your pension provider.
2. Decide how much tax-free lump sum you want to take (usually up to a quarter of your fund) and deduct it from the pension fund value your pension provider gives you.
3. Decide on whether you want:
   - a single or joint-life annuity; if joint life, whether the pension to your partner is paid in full or reduced (say by one-third);
   - a level or escalating annuity; if escalating – then by the RPI or a fixed rate.
4. Think about whether you want payment of your annuity to continue for a specific number of years (5 or 10), should you die shortly after retiring.
5. Does your fund need to be a certain size to qualify for the better rates offered by another company? You may find it difficult to shop around if you have a small pension fund (say less than £10,000). Some firms may not be interested in advising on small sums.
6. Are you a smoker? Some annuity providers offer higher rates for smokers.
7. Do you have a medical condition that could reduce your life expectancy? Some providers of impaired life annuities are interested in pension funds smaller than £5,000.

You should now have the facts you need to get quotes from a range of providers. Remember that annuity quotes are usually only fixed for between 7 and 28 days from the date they are issued.

Other retirement options

Alternatives to buying a lifetime annuity.

All these options involve extra costs and extra investment risk compared with buying a lifetime annuity straight away. They are not usually suitable if you have a small pension fund (after taking any lump sum) or you have no other assets and sources of income to fall back on.

If, for whatever reason, you decide that you're not ready to buy a lifetime annuity, you will have the following options:

- an unsecured pension using short-term annuities or income withdrawal; and
- an alternatively secured pension.

An unsecured pension means that **after taking tax-free cash**, the remainder of your pension fund remains invested.

Unsecured pension using short-term annuities

With a short-term annuity, you can use part (or all) of your pension fund to buy a fixed-term annuity lasting up to five years. You can choose your annuity options in much the same way as basic annuities (see page 8). In the meantime, the remainder of your fund continues to be invested.

At the end of the term of the annuity you can buy another short-term annuity. You can also combine income from a short-term annuity with income withdrawal. You can continue in this way until you are ready to buy a lifetime annuity or until you reach age 75. At this point you would need to take out an alternatively secured pension if you wanted to continue to draw an income directly from your pension fund and keep it invested.

Unsecured pension using income withdrawal

You can take a taxable income direct from your pension fund – this is called **'income withdrawal'** or **'income drawdown'** or **'pension fund withdrawal'**.

Income withdrawal is an option with most personal pensions and some occupational money purchase schemes. In some cases if you are in an employer's scheme and want to use income withdrawal, you must first transfer your pension rights from the employer's scheme to a personal pension. There will probably be charges for making this transfer.

The income you take from the fund must be reviewed every five years to make sure it is in line with HM Revenue & Customs limits. You can draw an income from your fund up to a maximum income that is equivalent to 120% of the income you would get from a level single-life annuity for person of your age and sex. There is no minimum amount.

For more detailed information, see the FSA Factsheet **Income withdrawal – a retirement option for you?**

Phased retirement and income withdrawal can be combined.

This means you would start to draw an income from just part of your pension fund on one date, leaving the rest of the fund intact. To increase your income at a later date, you could either increase the rate of withdrawal (provided you did not exceed the maximum limit) or start to draw an income from a further slice of your pension fund.

If you use one of the above unsecured pension options and reach age 75 you will have to make a decision to either buy a lifetime annuity or use an alternatively secured pension.

Alternatively secured pension

At age 75, if you still have some of your pension fund that has remained invested, you can opt to either buy a lifetime annuity or have an alternatively secured pension. It works in a similar way to income withdrawal, but has slightly different rules, such as the maximum level of income you can draw. Like income withdrawal, an alternatively secured pension has no minimum income limit.

An alternatively secured pension may give you a lower overall income than an annuity bought with the same amount of money.

Where to get advice

Some annuity options are complicated, so think about getting professional advice.

Annuities and other retirement options are offered by insurance companies or other financial institutions. You can get advice about them direct or from their representatives or a financial adviser.

Financial advisers may offer products from:

- a single group of companies;
- a limited range of companies; or
- the whole market.

The FSA authorises financial advisers to give investment advice. Authorisation protects you. For example, authorised firms have to meet regulatory standards. And, if an authorised firm gives you the wrong advice for your circumstances, you should have access to a proper complaints system and you may get redress.

Financial advisers may ask you questions about your personal and financial circumstances, so they can give you suitable advice tailored to your circumstances.

Some advisers specialise in giving advice about 'Retirement planning' – see *Useful contacts* on page 33 for how to find an adviser.

For more information about financial advice, see the **FSA guide to financial advice** available from our Consumer Helpline or website – see *Useful contacts* on page 31.

> Check that your adviser is authorised by calling our Consumer Helpline on 0845 606 1234 or visit the Consumer website – see Useful contacts on page 31.

Information you'll get

The firm will usually give you the following documents:

- **keyfacts about our services**

You will be given this on your first contact with a salesperson or adviser. It will tell you, amongst other things, what sort of service the firm can offer and whose pension products he or she can sell or give advice about.

- **keyfacts about the cost of our services**

This will tell you how you will pay for the firm's service (for example, commission, fee or a combination of both) and indicate how much you are likely to pay.

You can use this information to shop around for value for money and to help you decide which firm to use.

- **Key Features document**

You will also usually get a Key Features document describing the main aspects of the annuity, such as its aims and the risks. Make sure you read and understand this information and ask questions about anything you are unsure about.

With basic annuities, you'll usually get a projection showing the amount of income you would get, given the size of your pension fund, your personal details and current annuity rates.

The figures are shown after deducting any sum you have chosen to take as tax-free cash.

In most cases the projection for a with-profits or unit-linked annuity will include examples of how your annuity income might vary in future years. These projections will probably be based on standard assumptions about the growth of the underlying investment fund – the fund will not necessarily grow at these rates.

If you choose a with-profits annuity, you should ask about the company's approach to setting bonus rates.

If you are considering an unsecured or alternatively secured pension, the illustration could include 'critical yield' figures.

These may show:

- how much your pension fund needs to grow to let you withdraw an income equal to what you would have got if you'd bought an annuity straight away;
- how much your pension fund needs to grow to maintain the level of income you have chosen.

Complaints

There are procedures to help you if things go wrong.

Employers' scheme pensions

If you have a problem concerning a pension from an employer's scheme, first contact the pensions administrator at work.

Your employer's scheme must by law offer a formal complaints procedure. If this cannot settle the matter, contact the Pensions Advisory Service. It will attempt to mediate between you and the scheme and, if necessary, will help you take your case to the Pensions Ombudsman – see *Useful contacts* page 31.

Personal and stakeholder pensions

If your complaint is about the advice you received for the marketing or selling of the pension, then first take up any complaint with your adviser or the personal pension company.

If the dispute is still unresolved, contact the Financial Ombudsman Service – see *Useful contacts* on page 31.

If your complaint is about the way your pension fund is run, contact the Pensions Advisory Service – see *Useful contacts* on page 31.

For more information, see the **FSA guide to making a complaint about financial services.** This booklet takes you step by step through the process of making a complaint and getting matters put right – see *Useful contacts* on page 31.

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.

For consumer publications or to check a firm is authorised

FSA Consumer Helpline
tel: 0845 606 1234
Minicom/textphone: 0845 730 0104
website: www.fsa.gov.uk/consumer
Follow the link to the Firm Check Service

For details of pensions from employers' schemes

The pensions administrator, pensions manager or pension scheme trustees. You usually get in touch via the Human Resources or Personnel Department.

To trace pensions you've lost track of

The Pension Tracing Service
(at The Pension Service)
tel: 0845 6002 537
website: www.thepensionservice.gov.uk

To get an estimate of your State Pension

The Future Pension Centre
tel: 0845 300 0168
website: www.thepensionservice.gov.uk

To find out about deferring your State Pension

See the Pension Service leaflet: **Your State Pension Choice – Pension now or extra pension later: A guide to State Pension Deferral** (SPD 1).
tel: 0845 7 31 32 33
website: www.thepensionservice.gov.uk

To check the tax aspects of pensions

Your local tax office (look in the phone book under 'HM Revenue and Customs')
website: www.hmrc.gov.uk

To check current annuity rates

FSA Comparative Tables website
www.fsa.gov.uk/tables

Organisations that can help you find a financial adviser

IFA Promotion
tel: 0800 085 3250
website: www.unbiased.co.uk

Can help you find some advisers specialising in certain areas, such as retirement planning.

The Personal Finance Society
website: www.thefps.org/findanadviser

Can help you find advisers in your local area who have attained the Advanced Financial Planning Certificate.

MyLocalAdviser
website: www.mylocaladviser.co.uk

Can help you find advisers specialising in certain areas, such as retirement planning.

General pensions information, advice and disputes

The Pensions Advisory Service
The Pensions Helpline: 0845 601 2923
website:
www.pensionsadvisoryservice.org.uk

The Pensions Ombudsman
tel: 020 7834 9144
website:
www.pensions-ombudsman.org.uk

Disputes about the marketing or selling of personal pensions

Financial Ombudsman Service
South Quay Plaza
183 Marsh Wall
London E14 9SR
tel: 0845 080 1800
website:
www.financial-ombudsman.org.uk

Asking the right questions

Other FSA publications that could help you

May 2006

Pensions

FSA guide to pensions 1: Starting a pension

FSA guide to pensions 2: Reviewing your pensions

FSA guide to the risks of salary-related occupational pension transfers

Retiring soon – what you need to do about your pensions

Unlocking pensions – make sure you understand the risks

General

FSA guide to financial advice

FSA guide to making a complaint about financial services

Challenging unfair contract terms

Paying for long-term care

Raising money from your home

Savings and investments

Buying a funeral plan

Capital-at-risk products – products where you could lose some or all of the money you invest

Share investment scams

This is only a selection. You can see our full list and order free copies on our online order form at: www.fsa.gov.uk/consumer – or you can ring our Consumer Helpline on 0845 606 1234 (call rates may vary).