July 2010

Our Moneymadeclear™ guides – here to help you

This guide is part of our Pensions and retirement series.

Available from our helpline or website

www.moneymadeclear.org.uk

No selling. No jargon. Just the facts.

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

Plain Language Commission Clear English Standard Winning Document

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No selling. No jargon. Just the facts about income withdrawal.

Moneymadeclear™

from the Consumer Financial Education Body (CFEB)

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

Just the facts about income withdrawal.

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

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

cfeb consumer financial education body

This guide is for you if

You are

approaching or have reached retirement age; and

You have

a pension fund and want to take a tax-free lump sum or an income from it, instead of buying an annuity.

It's about income withdrawal and:

- explains how it works;
- the advantages and disadvantages; and
- answers some of the questions you may have.

Contents

What is income withdrawal?

Income withdrawal is an alternative to buying a lifetime annuity when you retire.

It allows you to draw an income from your pension fund while the fund remains invested.

See the *Jargon buster* on page 14 for an explanation of some words you may come across.

Your pension fund

There are several ways of turning your pension fund into a regular income for your retirement. The government sets rules about how you can do this.

The usual way is to take a tax-free lump sum and then use the rest of the fund to buy a lifetime annuity from a life insurance company. This turns your pension fund into a pension income for the rest of your life.

But if you decide you don't want to buy a lifetime annuity straight away, one option is an unsecured pension.

Unsecured pension

An unsecured pension gives you an income from your pension fund by using income withdrawal or a short-term annuity. The rest of your pension fund stays invested.

Retirement

We use 'retirement' to mean the time from when you start to take your pension benefits. If you have a personal or stakeholder pension, you could do this from age 55.

You don't have to stop work to start getting your pension.

For other retirement options and information on annuities, see our **Retirement options** guide – see *Useful contacts* on page 16.

Key points

- **This booklet covers income withdrawal from personal or stakeholder pensions only.**
- Income withdrawal plans are complex and not suitable for everyone, for example if you have a small pension fund and no other assets or income to fall back on.
- Even if you have a large pension fund, and other assets or income, income withdrawal may still not be suitable.

Income withdrawal plans are complex. It's a good idea to get professional advice because what you decide now will affect your pension income for the rest of your life.

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

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How income withdrawal works

You can take up to 25% of your pension fund as a tax-free lump sum. You then draw a regular income from what is left and this is subject to tax.

The maximum level of income you can draw is 120% of the amount you would get from a level single-life lifetime annuity. There is no minimum amount.

Meanwhile, the rest of your pension fund stays invested in a favourable tax environment. Bear in mind that you will be taking an income from a fund that remains invested in asset-backed investments, such as the stock market, property or gilts.

Every five years, your pension provider must review the amount of income you withdraw. This amount must be set below the limit set by HM Revenue & Customs (HMRC). Your pension provider calculates this limit, using the standard tables prepared by the Government Actuary's Department.

You can withdraw any level of income from your fund, as long as it's below this limit. If your pension provider calculates that the new limit is lower than before, you may have to draw a smaller income to keep within this limit.

What are the risks?

The hope is that your invested fund grows enough to pay for all or most of the charges, any mortality drag and your income.

But if investment returns are lower than expected, your fund may fall in value. This may mean you receive a lower income in future.

As you don't have to draw an income from your pension fund straight away, you may be tempted to use income withdrawal if you need a cash lump sum for a one-off expense.

Before you do this, get professional advice and find out the risks.

Remember that:

- the fund could fall (as well as rise);
- you may have to pay set-up and annual charges on the investments in your fund; and
- if the income you take plus these charges exceed any growth in your fund, the value of your fund will decrease.

Regular reviews

Five years is a long time, so you and your adviser should also review your income withdrawal plan each year to check that your fund is growing enough to make up for the income you're taking from it.

You can stop the arrangement at any time and use your remaining fund to buy a short-term or lifetime annuity.

Changing or transferring your income withdrawal plan

Once you've chosen income withdrawal, you can still make the following changes. You can:

- vary the amount of income you withdraw;
- change the funds your pension is invested in; and
- stop the plan at any time and buy a lifetime annuity with the rest of your fund.

It is possible to transfer your plan but be aware that not all providers accept transfers. You may also be charged for transferring it, and the provider may set conditions that you have to meet before and after transfer.

If you die and haven't yet bought an annuity, you can leave your pension fund to your partner and any dependants. They will have various options, some more highly taxed than others.

These options include:

- taking some or all of the remaining fund as a lump sum, which is taxable, currently at 35%;
- carrying on withdrawing income; or
- buying a lifetime annuity with the whole fund.

Converting your pension fund into income

You must secure your pension income **by your 77th birthday at the latest**, as an annuity or as an alternatively secured pension – see page 11. The government intends to remove the requirement to buy an annuity or alternatively secured pension by April 2011.

Occupational money purchase scheme

You may be able to use income withdrawal if you are in an occupational money purchase scheme – check with your scheme.

If you're in a scheme that doesn't offer income withdrawal but you want this, you can transfer your pension rights to a personal pension scheme. This will let you use income withdrawal. Your adviser will probably charge you for doing this.

Key points

- The pension fund value could fall instead of rise.
- Some funds apply set-up and annual charges to use income withdrawal.
- If the income you take plus these charges exceeds any growth in your pension fund, the value of your fund will decrease.
- Review your income withdrawal plan each year to check your pension fund is growing enough to make up for what you are withdrawing.

Key things to think about

Getting financial advice

Firms selling income withdrawal plans must be regulated by the Financial Services Authority (FSA), the UK's financial services regulator. This means firms have to meet certain standards which the FSA monitors and it can take action if they don't. Firms' advertisements, product brochures and other promotions 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* on page 16.

You can also use:

- the Financial Ombudsman Service if things go wrong; and
- the Financial Services Compensation Scheme if your adviser stops trading.

See *If things go wrong* on page 13.

FSA-regulated firms must only recommend plans that are suitable for you and give you certain information about the firm, their services and costs.

Information or advice?

When you first ask about income withdrawal, the spoken or printed information will probably be general information – not advice specific to your needs.

Income withdrawal plans are complex so it's a good idea to get professional advice.

Information you will get

Your adviser should give you product information to take away and read, including a personal illustration to show how the plan would apply to you. Check that you read the keyfacts® illustration and ask if anything is unclear.

The illustration may give details of the critical yield, which is how much your pension fund needs to grow either:

- to keep paying you the income you want; or
- for you to receive an income at least equal to the amount you would have received if you'd bought an annuity straight away.

The critical yield will increase with age. For example, a critical yield of 7% means your fund must grow by 7% from its investments over a year, to keep paying the income you've chosen. Remember that, in general, the higher the income you take, the higher the critical yield must be and the bigger the risks you are taking with your money.

Buying without advice

You don't have to take advice, but if you don't and the plan you choose turns out to be unsuitable, you will have fewer grounds for complaint.

Questions to ask yourself

Before deciding on an income withdrawal plan, you should ask yourself these questions:

- How much money do I need to live on now? And how much will I need in five or ten years' time (and so on)?
- How much do I have in my pension fund?
- Do I need to take a lump sum or have I got other income?
- Am I willing to risk some of my money in the hope of a better income in the future?
- Am I happy to keep a close eye on my pension fund and continue to make investment decisions?
- Am I willing to continue paying for financial advice, as I will need to reassess my situation regularly?

Key points

Make sure that:

- your adviser understands your financial and personal circumstances, including your future needs;
- your adviser tells you why they recommend a product and give you written information about this;
- you understand how the product works and the risks involved; and
- you know when you must make a decision, what happens next and when you will see your adviser again.

What you decide now will affect your pension income for the rest of your life (and that of your partner and any dependants). Before you see an adviser:

Check that

You are happy to pay for financial advice on a regular basis as you will need to reassess your situation regularly.

Check

What your state of health, is and that of your partner as this may affect future decisions.

Check

Who else depends on you financially, now, and in the future.

Check that

You receive and read the keyfacts® documents you'll get and ask questions if anything is unclear.

Your questions answered

Question

Is income withdrawal right for me?

Answer

Income withdrawal plans are usually unsuitable if you have a small pension fund, and no other assets or income to fall back on.

Even if you have a large pension fund, and other assets or income, income withdrawal may still be unsuitable. It depends on the risks you're prepared to take.

Question

If I delay buying an annuity, can I expect a higher rate later?

Answer

Annuity rates usually rise with age but you can't assume they will be higher in future. People are on average living longer, and of course annuity rates could fall or rise.

Question

How does income withdrawal affect how much tax I pay?

Answer

You could reduce the amount of income tax you pay by changing the timing of your payments. This depends on individual circumstances. For more information, ask your adviser.

Question

Do I have to use all my pension fund at once?

Answer

No. You can split most personal pension funds into smaller slices and then use just some of them for income withdrawal. You can continue to invest the other slices without drawing an income from them.

This is a combination of phased retirement and income withdrawal. For more information, ask your financial adviser.

Question

I don't want the investment risks of income withdrawal but I don't want to commit myself to a lifetime annuity yet – what can I do?

Answer

There are some new hybrid products which pay a regular income and offer the opportunity of either:

- investment growth; or
- the amount of pension fund you can expect to have left to buy an annuity later.

For more information, ask your financial adviser.

Question

Do I have any options other than buying an annuity when I reach 77?

Answer

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

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

The government intends to remove the requirement to buy an annuity or alternatively secured pension by April 2011.

Next steps

Starting income withdrawal

Step 1

What you decide now will affect your income for the rest of your life so it's a good idea to get professional advice.

Step 2

Make sure your adviser understands your financial and personal circumstances, and your future needs. Use the questions on page 8 to prepare yourself.

Step 3

Ask your adviser how they will be paid for their advice and how much it will cost you, including the cost of any regular meetings.

Step 4

Find out from your adviser when you have to make a decision, what happens next and when you need to meet with them again.

Don't sign up for income withdrawal until you're sure it's right for you.

If things go wrong

If something goes wrong, contact your financial adviser or your provider to put matters right. They have a procedure to follow when dealing with complaints.

If you're not satisfied with their response, you may be able to take the matter to the Financial Ombudsman Service – see *Useful contacts* on page 16.

The firm will give you the details of this service. See also our **Making a complaint** guide – see *Useful contacts*.

If the adviser or provider has stopped trading and can't (or is likely to be unable to) pay claims against it, the Financial Services Compensation Scheme (FSCS) may be able to help you – see *Useful contacts*.

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Jargon buster

Some key words and phrases explained.

Alternatively secured pensions
A way of getting an income from your pension fund without buying an annuity.

Annuitant
The person who is receiving annuity payments.

Annuity
An investment product that converts your pension fund into a pension income, which is taxed.

Annuity rate
The amount of monthly income you get from your pension fund, depending on several factors, such as interest rates.

Commission
The payment that a financial adviser gets from an insurance company for arranging your plan. This is deducted from your investment.

Critical yield
For income withdrawal plans, the amount your fund must grow to keep paying your chosen income.

Five-year review
HMRC rules state that the scheme administrator (your 'provider') must review the maximum amount you can take from your income withdrawal plan each year.

GAD
The Government's Actuary Department – responsible for setting some rules for pensions and life assurance schemes.

HMRC
HM Revenue & Customs – responsible for collecting taxes and paying tax credits.

Hybrid products
An alternative to lifetime annuities, without the investment risks of income withdrawals, and with a regular income and some guarantees.

Mortality cross-subsidy
The process by which lifetime annuities can pay people an income for life – by using the funds of others who die earlier than expected.

Mortality drag
To compensate for losing the mortality cross-subsidy (see above) if you delay buying an annuity, your investments must grow by an extra amount.

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

Pension income
The income you get from your pension savings by buying an annuity, or using income withdrawal or phased retirement. Pension income is taxed.

Phased retirement
A way of using small segments of your personal pension as income while leaving the bulk of the fund.

Short-term annuity
A type of unsecured pension that allows you to use part of your pension fund to buy an annuity lasting up to five years, while leaving the rest of your pension fund invested.

Single-life lifetime annuity
An annuity that will not pay out to your spouse, partner or dependant after your death (unless there is a guarantee period – but it will only pay for a fixed number of years).

Tax-free lump sum
A one-off sum of money that you can take from the pension fund. HMRC rules allow you up to 25% of your pension fund.

Unsecured pension
Allows you to draw an income from your pension fund up to age 77 while leaving the fund invested – either through income withdrawal or short-term annuity.

Useful contacts

Consumer Financial Education Body (CFEB)

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

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

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- Making a complaint
- Managing in retirement
- Pensions
- Retirement options
- Retiring soon

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

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

- A **Pension calculator** to work out how much income you might get when you retire.
- **Comparison tables** to help you compare annuities.

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

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

Financial Services Authority (FSA)

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

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

Queries about pensions

The Pension Advisory Service

0845 601 2923
www.pensionadvisoryservice.org.uk

An independent organisation providing help with pension and annuity queries.

Finding a financial adviser

Unbiased.co.uk

www.unbiased.co.uk

For independent financial advisers in your area.

Institute of Financial Planning

www.financialplanning.org.uk

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

MyLocalAdviser

www.mylocaladviser.co.uk

For a mortgage, insurance or investment adviser in your area.

Personal Finance Society

www.findanadviser.org

Will provide a list of up to six financial advisers in your area.

Complaints and compensation

Financial Ombudsman Service

South Quay Plaza
183 Marsh Wall,
London E14 9SR

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

Financial Services Compensation Scheme (FSCS)

7th floor, Lloyds Chambers
Portsoken Street
London E1 8BN

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