

YOUR RETIREMENT OPTIONS



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1.

INTRODUCTION

Planning for your retirement

If you are planning to retire in the next few years, you are no doubt starting to think about how to take an income from the pension fund you have accumulated and also the tax-free lump sum that is available to you. There are a number of options now available to you. In fact, pension investors now have greatly increased flexibility at retirement and this guide explores the options so that you can see which ones might appeal to you. It is our job as your advisers to recommend the option that is most suitable to you. In order to assess this, we will take into account your objectives and your existing circumstances.

Whichever option you choose, it is essential that you obtain the best deal available and look at what else is on offer. It is our job to do that for you.

This guide is designed for people with a “money purchase” or “defined contribution” pensions, such as a Personal Pension, a Stakeholder Pension, a Self-Invested Personal Pension or a Free Standing AVC. This guide is not relevant to final salary pension schemes.

This guide is written to provide you with information so that you can make your own investment decisions. Please be aware that this guide is based on our current understanding of tax and pensions rules which can change. Tax benefits are dependent on your own personal circumstances.

State Pensions

At state pension age, you will normally receive a basic state pension. The amount you receive will depend on your National Insurance record. If you have been employed and contracted into the State Earnings Related Pension Scheme (SERPS) or State Second Pension (S2P), you will receive an additional second pension. People over 60 with a modest retirement income may also be entitled to an additional Pension Credit.

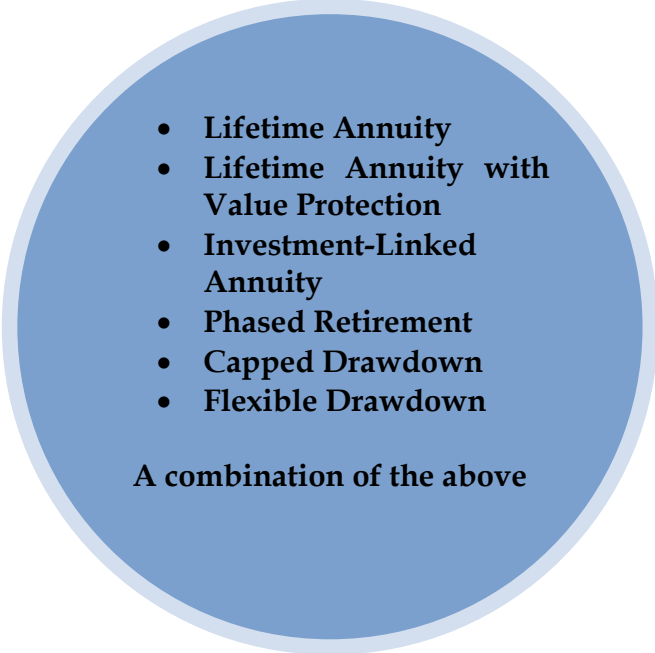
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What exactly are your options?

When you retire your pension fund does not always automatically start paying you an income. Instead, after taking any tax-free cash, your pension is normally converted into a separate contract which then provides a taxable income - even if that happens to be with the same company with which you have built up your pension.

The earliest you can take retirement benefits is from age 55. One popular option is to set up a lifetime annuity, which pays a secure income for life. An annuity remains a sensible option for many individuals, particularly those with smaller pension funds. There are also alternatives to an annuity. These can be higher risk and can be more expensive, but are also more flexible.

The main options at retirement are:

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- **Lifetime Annuity**
 - **Lifetime Annuity with Value Protection**
 - **Investment-Linked Annuity**
 - **Phased Retirement**
 - **Capped Drawdown**
 - **Flexible Drawdown**

A combination of the above

These are outlined on the next few pages.

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Pension Commencement Lump Sum

On retirement, you will normally be given the option to take the pension commencement lump sum which was previously known as the Tax-Free Lump Sum. You can normally take 25% of the accumulated fund as the lump sum and as at present this amount is completely tax-free.

If you are a member of an occupational pension scheme, then in certain circumstances, it may be possible to receive a pension commencement lump sum in excess of 25% of the fund and this is a matter that will need to be analysed on an individual case by case basis.

Conventional Lifetime Annuity

An annuity is the simplest retirement option and is a secure, taxable income which is payable for the rest of your lifetime. Once set up, an annuity cannot normally be changed, so you can rest safe in the knowledge that your annuity income will never run out.

Annuities are provided by insurance companies, such as Prudential, Aviva, Standard Life and Legal & General. Different insurance companies offer different annuity rates and these can change frequently. This means some companies are more competitive than others.

What is the “Open Market Option”? And what difference could it make?

Your current pension provider may not offer the best retirement income. If you do take the income they offer without first checking how competitive it is, you risk being locked into a poor deal *for the rest of your life*.

The “Open Market Option” is your legal right to shop around and buy your annuity with a more competitive provider. Using the Open Market Option produces a better income in the vast majority of cases, and at no extra cost. It could boost your income by thousands of pounds.

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What are your annuity options?

There are a number of options you can choose when setting up your annuity. These are decided at outset and, once set up, cannot normally be changed.

Choose an income that benefits your spouse or partner (joint life annuity)

If you are married or have a partner, one of the decisions you need to make is whether you want your spouse or partner to receive an income if you die before them. This is known as a joint life annuity. After your death, your surviving spouse or partner will continue to receive an income for the rest of their life. The person named as your spouse or partner on your application form at outset will normally be the person who receives the spouse's pension on your death, unless you specify otherwise at the start.

If you are married (or in a civil partnership) you should strongly consider a joint life annuity and discuss this with your spouse or partner before making your decision. You can arrange for the whole of your income to continue to your spouse, or, alternatively, choose a reduced amount such as half or two-thirds. The decision will depend largely on what assets they have available to them.

Choose an income that pays out for your lifetime only (single life annuity)

Here the income is paid for your lifetime only and does not continue to anyone else on your death. The income you receive each year will be higher than a joint life annuity. It is possible to attach a minimum guaranteed payment period, frequently five years but this can be extended to ten years.

Choose an income that remains a constant amount each year

If you select an income that does not increase, you will generally receive a much higher initial income than an annuity that does increase. However, as time goes by, the real value of your income will be eroded by the effects of inflation.

Choose an income that keeps track with inflation, or increases by a set amount each year.

You can choose an income that moves in line with the Retail Prices Index (RPI), thus keeping track with inflation. This means your income will retain its buying power. You can also choose an income that increases by a fixed amount, such as 3% or 5% a year. Over time you might receive a higher total income, but your starting income will be lower. In our experience, a level income is generally more suitable because a higher income initially is more valuable to most clients.

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Choose an income that is guaranteed to be paid for a minimum of 5 or 10 years, even if you die before then.

All lifetime annuities will pay out for at least the whole of your life. However, you can also choose for the income to be guaranteed for a minimum period of time from when it was set up (usually 5 or 10 years). If you die before the end of the guarantee period, the remaining income payments left under the guarantee will normally be paid as continuing instalments to your estate or to the person or people you have nominated in your Will, if you have made one.

Protected rights

Your fund will contain protected rights if you have used your pension to contract out of SERPS (State Earnings Related Pension Scheme) or the State Second Pension (S2P). The income from this part of your pension fund must include a 50% spouse's pension if you are married or in a civil partnership, and will be paid to the person who is your spouse or civil partner at the date of death. The rates are unisex and the maximum guarantee period is 5 years. You can take up to 25% tax-free cash and take benefits from age 55, providing the rules of your pension scheme have been changed. We are pleased to say that this distinction between protected rights and non-protected rights will disappear in April 2012 when protected rights will cease to be classified differently.

Special annuity rates

If you smoke, have certain health conditions or live in certain postcodes, you may be able to obtain a higher income. This is because statistics show that smokers and people suffering from certain medical conditions have a shorter than average life expectancy. You do not have to be seriously ill to obtain a better income every year for the rest of your life.

If you suffer from very serious ill health, you should seek advice. If your life expectancy is very short (under 12 months) you may be able to take the whole fund as a lump sum.

Choose an annuity with Value Protection

You can choose an annuity that protects the value of all or some of the amount you paid for your annuity if you die before age 75. If you die before the total gross income paid out exceeds the amount of the fund used to buy the annuity, the balance is paid, less a 55% tax charge. Value Protected Annuities tend to be

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more expensive than conventional lifetime annuities because of the cost of providing the protection. Currently a limited number of providers offer value protection.

Investment Linked Annuities

Investment Linked Annuities are designed to give you the opportunity to obtain an income that increases during your retirement. Unlike conventional annuities, these are linked to an underlying investment fund so they contain an element of risk.

Investment Linked Annuities are linked to a specific fund or funds within the provider's range. Your future income will increase as the fund grows - but conversely, if the fund value falls, your income will decrease.

You may be able to switch between the funds to suit your needs or changing market conditions. Income is calculated according to the current value of units held. As your annuity investment is directly exposed to stockmarket forces, income will fluctuate in times of volatility.

Investment Linked Annuities do not give the high security offered by conventional annuity plans. You should be aware that the income can decrease as well as increase.

When purchasing an Investment Linked Annuity, you will normally have to select something called an anticipated growth rate. This determines your starting income and the potential for growth in future. A higher anticipated growth rate will give you a higher initial income than a low anticipated growth rate, but if this growth is not achieved the income could drop. If the actual growth is higher than the anticipated growth then the income could increase.

Some annuity providers offer With-Profits Annuities. These are investment linked annuities based on the With-Profits Fund of the annuity company concerned. With Profit Annuities do have some underlying guarantees attaching to them, such as a minimum income level, and are therefore lower risk than investment linked annuities.

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Hybrid products

Several new products have been developed which aim to tackle the shortfalls of the different retirement options so that, for example, Livingtime offers a plan with the flexibility of a drawdown, but with a greater level of guarantee and Canada Life and Lincoln Life offer alternatives to traditional annuities, which may appeal to some clients. Details of these products are too specific to outline in this booklet, but our advisers will be considering these options for you when analysing your needs. It is hoped that by using this booklet you will be better able to understand the principle options open to you and in a more informed position, to decide on what elements appeal to you.

Income Drawdown

This is a very flexible option which may be a consideration for more substantial funds, or if you have other sources of income.

Income Drawdown allows you to take a taxable income each year directly from your fund, leaving the remainder invested. The real advantage is its flexibility and potential for growth. You can control your income requirements, yet continue to manage and control the remaining fund.

Should you die whilst in income drawdown, one of the options is for the remainder of the fund to be paid as a lump sum to your beneficiaries, subject to a 55% tax charge. The death benefits can, thus, be more attractive than those available under a lifetime annuity.

There are limits on the amount of income you can take each year, and this is reviewed every three years before the age of 75, (and every year thereafter). There is no minimum income requirement which means that in theory, you could take tax-free cash and leave the remainder fully invested. The maximum income you can take is roughly equivalent to 100% of the income you would receive from a single life, level annuity at the time. (However, see the section below on flexible drawdown where there is no limit on income)

The fund is invested with the aim of providing further growth. Typically, you might have one or two years income invested as cash, and the rest invested in fixed interest and funds that are linked to stocks and shares. The investment choice is extremely wide when income drawdown is taken out in conjunction

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with a SIIPP (Self-Invested Personal Pension). This offers maximum flexibility and performance potential.

The charges for setting up and administering Income Drawdown can be higher than for a lifetime annuity. It also requires ongoing attention and reviews.

The value of the underlying pension funds can fall as well as rise and it is possible therefore that you could end up with a smaller fund than you expect if you come to purchase an annuity. If you opt for higher risk funds, then you have to accept that these will be more volatile and could potentially reduce the ultimate benefits available to you in retirement. Extremely low risk funds however, are unlikely to provide the returns that you would need to improve your overall benefits over and above the conventional annuity route.

The principle risks to be aware of are:

1. **High income withdrawals may not be sustainable during the deferral period.**
2. **Taking withdrawals may erode the capital value of the fund, especially if investment returns are poor and a high level of income is being taken. This could result in a lower income when the annuity is eventually purchased.**
3. **The investment returns may be less than those shown in the illustration.**
4. **Annuity rates may be at a worse level when annuity purchase takes place.**

On 6th April 2011, the rules to Drawdown contracts changed and the above information relates to what is now called **Capped Drawdown**. One other matter that was introduced in this legislation was the new concept of **Flexible Drawdown** that could be applicable to some individuals. Under this arrangement, there will be no limit on the amount of income that can be withdrawn from the plan, and indeed the whole of the fund in excess of the tax-free lump sum could be withdrawn at outset. One point to note is that it will be added to the individual's income for that year and taxed accordingly.

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Flexible Drawdown only applies to those individuals that satisfy a minimum income requirement (MIR), which is as follows:

The individual makes a declaration that his/her relevant income in a tax year is at least £20,000. The relevant income for this purpose includes the following:

- Scheme Pension (including a pension received as a dependant), from a registered pension scheme or from a relevant non-UK scheme.
- Lifetime Annuity (including annuities received as a dependant) from a registered pension scheme or from a relevant non-UK scheme.
- State Pensions
- In all cases, the pension must be in payment. Drawdown Pensions and Purchased Life Annuities are not classed as relevant income.
- The Treasury will review this income limit at least every five years.

10.

“Mortality Drag”

This is a term you might come across when comparing income drawdown to an annuity.

Put simply, annuities work on a principle of cross-subsidy: the people who die earlier than expected subsidise those who live longer. In any one group of annuitants, some of the people will die in the early years. If you delay purchasing an annuity in favour of income drawdown, when you eventually buy your annuity, you have lost out on the cross subsidy of those who have already died. This means the fund has to work harder to catch up. This is “mortality drag”.

Phased Retirement

Rather than convert the entire pension fund into an annuity all in one go, Phased Retirement allows you to set up a series of annuities by gradually drawing on your fund over a period of time.

Each time you take benefits in this way you can take up to 25% tax-free cash, plus a taxable income (an annuity). The remainder of the fund continues to be invested. Phased retirement can be particularly useful if you do not need all the income or tax free cash at the start, or if you are worried about death benefits. It allows you to set up a variety of annuity types, so for instance you could choose

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one with a dependant's pension, and another with yearly increases. It can be tax efficient as income can be supplemented by tax-free cash payments.

Phased retirement provides an increase in flexibility. You can encash different parts of your pension fund at different times to provide income when required. However, this does not solve the problem of possible poor annuity rates in future. The growth on the invested fund may not compensate for the income you could have received had you taken an annuity with the entire fund on day one.

Phased Retirement can also be used in conjunction with Income Drawdown to provide the upmost in flexibility with one's retirement benefits.

12.

What happens when you die?

The following page covers the current situation on death after retirement. This is one of the key areas in which the retirement options differ, so it is important to understand the differences. Where we have made references to spouse's pensions, this also includes civil partners and dependants. Please note the tax charges on death are based on our understanding of legislation which is subject to change. If you are concerned about inheritance tax you should take advice.

Lifetime Annuity (no value protection)

Nothing payable unless:

1. You have selected an annuity that includes an income for your spouse or dependant. In this case, payments will continue to be made until their death.
2. You die within a pre-determined guarantee period. The balance of the outstanding payments will normally continue to your estate or the person or people nominated in your Will, if you have made one.

Benefits normally have to be chosen at outset.

Lifetime Annuity with Value Protection

This will pay out any unused capital if you die before age 75. The amount paid will represent the difference between the fund used to buy the annuity and the gross payments made so far, and will be taxed at 55%. After 75, the position is the same as a conventional annuity.

Phased Retirement (phased annuity purchase)

Where funds have been "vested" (been used to generate income and tax-free cash), the death benefits are as for an annuity or income drawdown (unsecured pension). Any part of the fund that has not been vested will normally be returned to your beneficiaries free of inheritance tax.

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Income Drawdown (Unsecured Pension)

There are several options for the remaining fund. The main ones are:

1. Return of fund. The funds which are vested can be paid to the beneficiaries less a 55% tax charge taken from the fund. Any funds not yet vested can usually be paid to your estate without a tax charge. before age 75..
2. Spouse or dependants can use the fund to purchase an annuity. There is no tax charge on the fund but their continuing annuity is taxed at source under PAYE.
3. Spouse or dependants can continue to draw an income from the fund via Income Drawdown and this income is taxed at source under PAYE.

14.

The options: the pros and cons

Conventional Annuities

<ul style="list-style-type: none">Ü Simple, easy to understandÜ Once set up income is fixed and secureÜ The income will never run out, however long you live.Ü Available for pension funds of all sizesÜ No ongoing reviews requiredÜ No investment risk: not affected by stockmarket falls, or economic slumps. <p>Ü</p>	<ul style="list-style-type: none">X Can be inflexibleX Cannot be changedX An annuity (without value protection) cannot generally be passed on to your beneficiaries as a lump sumX Current annuity rates are perceived to be lowX Spouse's benefits must be set up at outset - so can be wasted on divorce or if spouse dies firstX Not affected by stockmarket rises
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Income Drawdown

<ul style="list-style-type: none">Üü You do not have to make a one-off choiceÜü You retain investment choice and controlü Can potentially pass on benefits to beneficiaries less a 55% tax charge.ü More flexibleÜü Potential for growthü You can plan the income you receive to match your requirements	<ul style="list-style-type: none">X More complex, you may need adviceX Requires regular reviewX Can be expensive: may not be cost effective for smaller fundsX An annuity set up on day 1 may have offered a greater total income over lifetimeX High income withdrawals can strip the fund bareX The income and value of the fund can fall. There is no security of income
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15.

Where to invest your pension fund before retirement

Even if you are not planning to retire for several years, you should consider the structure of your pension fund. Act now and you could make all the difference to your retirement income.

If you are thinking of buying an annuity, you may wish to consider switching to lower risk investments, such as gilts and bonds (known as fixed interest) and cash. This may protect your pension fund from market volatility prior to retirement and can help preserve its annuity purchasing power, although the investment returns may be lower as a result.

If you are planning to keep your pension fund invested during some or all of your retirement, for instance by using Income Drawdown, there is less of a requirement to protect your fund before retirement. You may want some money held in cash for any tax-free cash and/or income you are planning to take when you retire.

The lifetime allowance

The value of your total pension savings will be subject to a lifetime allowance which for the tax year 2011/2012 is £1.8 million. This is reducing to £1.5 million for the tax year 2012/13 and beyond. Any funds over the lifetime allowance could be subject to a tax charge of up to 55% at retirement.

To assess whether your funds are above the lifetime allowance, you need to value all your pensions. You should add **all** your pension funds together, multiplying final salary pensions not yet in payment by 20 (plus any additional tax-free cash) and any pensions in payment by 25. State benefits may be excluded from the calculation. Special rules apply to individuals already in income drawdown.

When you take benefits, (i.e. via an annuity or income drawdown), the new rules require a check to be made to ensure the lifetime allowance is not being

breached. Your pension or annuity provider may need to obtain details of all your pensions for confirmation on how much of the lifetime allowance you have already used up.

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We believe it is very important that you seek independent financial advice as soon as possible if your pension fund is likely to exceed the lifetime limit now or at some point in the future, or if you wish to register for protection.

Triviality Rules

If your pension savings are less than £18,000 in total, including occupational pensions, AVCs and pensions in payment, but excluding state benefits, you may be able to take them as a lump sum. The lump sum in excess of 25% of the fund will be subject to income tax.

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	Conventional Lifetime Annuity	Investment Linked Annuity	Phased Retirement	Capped Drawdown	Flexible Drawdown
Tax free cash	Must be taken at outset	Must be taken at outset	Taken each time funds are realised to provide an income	Must be taken at outset	Must be taken at outset.
Is the income secure? (no investment risk)	Yes	No	No	No	No
Taxation of income	Taxed at source under PAYE (Pay As You earn)	Taxed at source under PAYE	Income from the annuities is taxed at source under PAYE. Tax free cash can form part of the income in early years	Taxed at source under PAYE	Taxed at source under PAYE
Benefit flexibility	Once set up the annuity is fixed and cannot be changed	The annuity type is fixed, but income will vary. You may normally switch funds, or convert to a conventional annuity	A different kind of annuity can be chosen each time funds are vested. Annuities once purchased cannot be altered	Income can be varied, subject to a maximum limit.	Income can be varied, but there is no maximum.
Investment choice	No investment decisions needed	Choose from the provider's range of funds	The remaining fund can be invested in a wide range of investments	The fund can be invested in a wide range of investments	The fund can be invested in a wide range of investments .
Ongoing reviews needed?	No	Yes	Yes	Yes	No
Flexible death benefits	No	No	Yes	Yes	Yes

