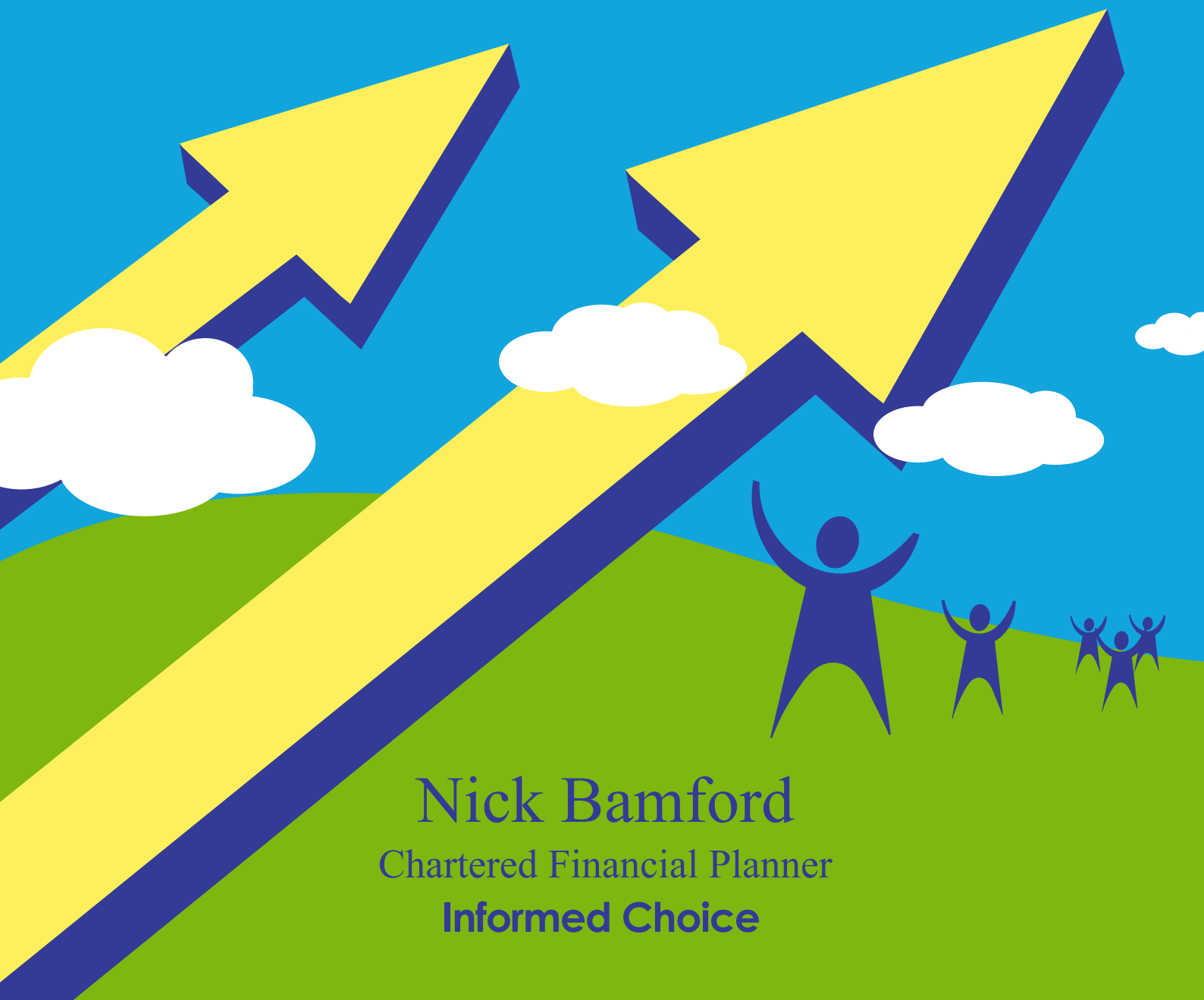


How to REVIEW YOUR PENSION

Give Your Pension the Power
to Fuel Your Retirement



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About the author

Nick Bamford is a very experienced Chartered Financial Planner who was the previous chairman of the Society of Financial Advisers (SOFA).

He is an Associate of the Personal Finance Society (APFS) and an Associate of the Institute of Financial Planning (AIFP) by examination. In 2006 he graduated from Napier University with an honours degree in Financial Services.



Nick has been an independent financial adviser since 1989. He has spent his entire working life in the financial services profession.

Nick holds the Advanced Financial Planning Certificate, including the advanced pension qualifications.

He is regularly quoted in the national press and writes for the trade press, including Money Marketing. He appears on television and radio as a personal finance expert.

About Informed Choice

Informed Choice is a family owned and managed firm of Chartered Financial Planners, established in 1994 by Nick and Andrea Bamford. We work with individuals and small business owners in Surrey and the surrounding counties to help them to build, manage and protect their wealth.



Informed Choice is one of only five IFA firms in the UK to hold the Gold Standard for Independent Financial Advice. This is the toughest award in retail financial services. We have been awarded the Gold Standard for three years in succession - 2006, 2007 and 2008.

We offer a friendly and professional advisory service. Our clients come from many different walks of life and typically have investable assets (including pension funds) between £200,000 and £1m. As a professional firm we charge fees for the advice, implementation and review of the solutions we provide.

Informed Choice is a firm of Chartered Financial Planners which means we have satisfied rigorous criteria relating to professional qualifications and ethical good practice. This means you can be confident that you are dealing with one of the UK's leading firms that is wholly committed to providing you with the best possible advice, service and support.

Who should read this guide?

- You should read this guide if you have a personal pension plan to which you currently contribute.
- You should read this guide if you have a “paid-up” personal pension plan (one to which you do not currently contribute).
- You should read this guide if you have a Retirement Annuity Contract, Stakeholder pension plan, Section 32 Buy Out policy or Executive Pension Plan (these are product titles commonly used by product providers but in essence are “money purchase” pension plans which are invested funds).
- You should read this guide if you used to be employed and have an ex-employers pension scheme where you have accumulated a pot of money*
- You should read this guide if you want to make sure that your pension plan remains competitive, that you are making the best investment choices and you want to understand the benefits that you might receive from your pension plan at retirement

If you read this guide you will have a clear understanding of the actions that you might need to take to make sure that your pension plan works well for you.

* if you were a member of an employer's pension scheme and that scheme has benefits based on length of employment and salary (a “final salary” scheme - also more properly known as a ‘defined benefits’ scheme) you may need much more complex advice and you should seek that from a qualified financial planner.

Welcome to this guide

Welcome to this guide from Informed Choice. We wrote this guide because each day we meet and talk with people who have a pension plan or plans, but have little real understanding of what that plan is going to do for them.

That, by the way, is rarely their fault. Pension plans are hardly the most exciting subject even though they are important. Also the financial services sector tends to use words which are alien to most normal people! This jargon can be very off putting indeed.

We have written this guide in plain English, to ensure that it is understandable. Where we have used a technical word we have tried to explain what we mean by it in simple terms.

Each section of the guide contains some "top tips" for you to consider. We also ask a lot of questions throughout the guide which we hope will help you. You can use those questions when you speak with a plan provider or your adviser.

By asking lots of questions you should be able to get a good understanding of what your pension plan will do for you.

Things people say about pensions

We often hear people say things such as they "don't like pension plans" because;

- *"They are not good value for money"*
- *"The pension plan investments perform poorly"*
- *"They are inflexible because you have to buy an annuity at retirement"*
- *"I'm not going to live long enough to get the benefits back"*

Of course some of this may actually be true. However, sometimes these statements can also be an excuse for inaction. The answer to each of these questions depends upon the individual plan owner and indeed the plan itself.

In this guide we hope that you will find the answers to some of the questions you have. If the answers are not in the guide then email us at hello@icl-ifa.co.uk and we will do our best to help you with your individual questions.

This guide concentrates upon four key areas in respect of your existing pension plan:

- What **charges** are taken from your pension plan;
- Where your pension plan is **invested**;
- What **benefits** you might get at retirement; and
- What happens to your pension plan if you were to **die**?

These tend to be the most important four areas to consider when reviewing existing pension benefits, but they are not comprehensive. If you have other financial priorities in respect of your pension provision then it is important to seek professional independent financial advice.

We hope you find this guide useful and that it will act as the catalyst you need to take control of your retirement planning.

Should I review my pension plan?

Take a look at the following questions and if your answers are similar or the same to the ones given, you are likely to need to review your pension plan.

Question: How much income will you receive from your pension plan when you retire?

Answer: I don't know / Not much / Not enough.

Question: Where is your pension fund invested?

Answer: I don't really know the details, in a fund somewhere.

Question: How well has your pension plan performed in the last year?

Answer: I'm not sure about that, it hasn't done well I believe.

Question: What charges do you pay to your pension plan provider?

Answer: I really have no idea.

Question: What will happen to your pension plan if you die?

Answer: I hope my family will get the benefit - they will, won't they?

Question: Should you be reviewing your pension plan?

Answer: It rather sounds like I should, doesn't it?

Top tip: It need not be expensive to review your pension plan. You may well be able to do this yourself (with the help of this guide). Alternatively you might employ a competent financial adviser to do this for you. Our advice would be to use a suitably qualified and experienced adviser to help you and one who will charge you a fee rather than be paid by commission.

Examining my pension plan charges

There is no such thing as a “free lunch” If you have a pension plan you will be paying plan charges.

Those plan charges can really be split into three types. Firstly, the charges that you pay to the plan provider for the administration of your plan. Secondly, the charges that you pay to the investment fund manager who invests your plan contributions. Thirdly, the charges that you pay to any financial adviser.

The problem is that very often these charges will be “bundled” together so that it is quite difficult to see who is getting paid and how these payments are being made.

One charge

Pension plan charges come in a variety of forms and some plans have multiple charges. The good news is that modern pension plans are often ‘mono-charged’. They have just one charge expressed as a percentage of the value of your plan each year. This tends to make them easier to understand but not necessarily the best value for money.

Since the introduction of Stakeholder pension plans in 2001 the financial services sector has tended to move towards this single charged environment. For example modern stakeholder plans have a maximum yearly management charge of 1.5% for the first ten years of the plan and then 1% per year thereafter. In other words if in the first year that you invested your contributions the pension plan investment fund grew at 7% you would actually only benefit from 5.5% of that growth.

Top tip - One way of checking the impact of charges on your pension plan is to ask the plan provider to let you have an illustration. One of the numbers that you will find in the illustration is a “reduction in yield” figure. This will be expressed as we have done above and shows you the amount of the growth that you receive and the amount that you lose through plan charges.

From this very simple example you can see that charges on a pension plan reduce the ultimate value that you will receive. This is important because the charges that you pay ultimately reduce the benefits that you receive. All things being equal (they never are in the real world!) the lower the charges the more you are likely to get (but see the section in this guide on investments).

Do not use pension plan charges as an excuse for not planning for retirement. That would be “cutting off your nose to spite your face”. All investments have a cost. The key is finding a plan with a set of charges which represent good value.

Charges and performance

Low cost is not the only feature that you should look for in a pension plan. After all you may be paying low costs and getting poor investment performance. It is the combination therefore of low charges and good investment performance that makes for a good pension plan. Equally though paying higher plan charges does not automatically mean that you will get superior investment fund performance. It doesn't quite work like that.

Some advisers will recommend a higher charged personal pension plan (rather than a lower cost stakeholder plan) because it offers a greater range of investment fund choice. That is fine if you use that wider choice of investment funds but if you don't you may be paying more than you have to.

The Financial Services Authority (FSA) who regulates both advisers and plan providers requires the adviser to demonstrate, in a “suitability letter” to you, why they have chosen a personal pension plan rather than a Stakeholder pension plan. Make sure that they can justify their recommendation.

That said some personal pension plans have mono-charging in the same way as Stakeholder pension plans. One of the positive things that has happened as a result of the introduction of Stakeholder pension plans is that the price generally of pension plans has been driven down.

Old style plans

Some plan providers changed the charging pattern of their old plans so that when Stakeholder plans were introduced existing plan holders paid no more for their existing plan than they would have paid had they switched to a Stakeholder plan.

Top tip - Switching (or transferring) between one pension plan and another is not always the best thing to do for reasons that will become apparent shortly. However for some pension plan owners this can be highly advantageous as you will see.

However some plan providers did not do this and therefore there are many quite expensive pension plans that need reviewing. Indeed in September 2002 the FSA published an interesting paper¹ which examined the advantages and disadvantages of switching from old style, possibly higher charged plans to lower charged modern plans. We are not suggesting that you read that paper although it is available from the FSA website if you wish to do so www.fsa.gov.uk.

Old style charges

Old style pension plans may have a variety of charges taken from your contributions and your pension plan fund. The worst case the author has seen of this was some years ago where there were no fewer than eleven separate plan charges that might be applied. Is it any wonder that consumers get confused?!

Policy fees

These are typically expressed as monetary amounts (for example £2.75 per month). This might sound quite modest but it is a charge of 2.75% of each contribution of £100 that you pay into the plan. It is a staggering 5.5% if you are only paying £50 per month. Policy fees are also often inflation linked so they tend to rise over time in line with inflation (RPI or even in line with increases in National Average Earnings- which typically increases at a faster rate than RPI).

Where policy fees are really quite damaging is where they are applied to a policy which is "paid-up" (no further contributions being paid) because if fund performance is not good the impact of the increasing policy fee can really erode the value of the pension plan quite quickly.

The worst example of this seen by the author was such that a current fund value was reduced to £0 at the anticipated retirement age of the plan holder!

To be fair some pension plan providers do reduce or even stop the policy fee if the plan owner makes the pension plan "paid-up". It is important to check for the presence of policy fees and understand the impact these could have on the eventual value of your pension.

¹ (To switch or not to switch that's the question- An analysis of the potential gains from switching pension provider. Occasional Paper Series 18)

Bid/Offer spread

When contributions are paid into a plan they will generally be used to purchase investment units in the selected investment fund or funds. The purchase price of the units in some funds is known as the “offer” (or buying) price. When the units are valued to calculate benefits to be paid to the pension plan holder they are valued at the “Bid” (or selling) price. There is often a ‘spread’ (difference) between the Offer and Bid prices and this is typically in the order of 5%.

Each time a contribution is paid this pricing mechanism is applied. In other words if you purchased investment units on day one and sold then the very next day the value of your pension plan would actually be 5% less. Over time the prices of the units are expected to rise but both the offer and Bid price will tend to rise so it is always 5% that you the plan holder pay in charges.

Annual Management Charge

We mentioned these before when we were talking about Stakeholder plans. An annual management charge is applied to the investment units held in your pension plan. The amount of the annual management charge will tend to depend upon the particular investment fund that your contributions purchase. Alternatively, there may be a consistent annual management charge applied to the entire range of funds.

Typically the annual management charge will be in the range of 0.5% to 1.5%. The lower end of the range normally applies to what are known as ‘passive’ or ‘tracker’ funds and the annual management charge is usually lower because there is less work for the fund manager to do. In a ‘passive’ or ‘tracker’ fund the manager simply buys a range of shares to match or replicate an index (like the FTSE 100 or the FTSE All Share Index).

In an ‘active’ managed investment fund the manager applies his skills to select particular investments and this is much more labour intensive. As a result, the annual management charge is typically higher.

Once again you should note that the annual management charge will have the affect of reducing the value of your pension plan. Of course you will be quite happy to pay that charge if the investment fund manager produces superior investment fund performance.

You will be less happy to pay that charge if the investment results are poor.

Capital Units

Capital units sound really good don't they? Everyone likes the sound of "capital". However this is simply financial services speak for another form of charges. Some pension plan policies apply higher management charges to the investment units that are purchased during the first one or two years of contributions being paid and the first one or two years of any increase in contributions.

Capital units do not usually apply to contributions that are paid as one off, or single, contributions.

One of the damaging impacts of capital units is that they are likely to result in a smaller pension fund being available to the plan holder who either retires early or transfers to another plan provider. A capital unit penalty works by bringing forward the charges that would have applied to the plan in the future had the plan holder not had the temerity to want his benefits earlier or been so disappointed with the performance of the plan that he wanted to move his money elsewhere!

Allocation rates

Question - when is £100 really £105? Answer - when the allocation rate applied to the pension plan is 105%. This is a marketing device used by pension plan providers to make the charges on a pension plan policy appear to be less severe than they actually are. Your contributions are artificially inflated to the higher sum as if by magic!

This is actually achieved by a form of cross subsidy in that the pension plan provider is using some of the annual management charges that they will take from your plan in the future to add to the value of your pension plan at the start.

If you try to move your money elsewhere sometimes the higher allocation rate is "clawed back" by the plan provider so that you do not take away more than you paid into the plan.

Exit charges

We accept that pension plans are usually designed to be kept for the longer term but in this day and age why should the customer be particularly loyal to the pension plan provider? If they under perform sack them and move on to a better plan provider. To discourage you from doing this however some pension plan providers impose exit charges or transfer penalties.

"Really, you want to take your money away from us? Well, here you go. Here is 10% less than the value we last told you, you had in your pension fund."

Exit penalties can be a real barrier to transferability of pension plans. That said just because there is an exit penalty it does not automatically mean that you should **not** transfer away. It rather depends upon the future charges that will be applied by your current pension plan provider compared with the future charges of the replacement pension plan provider.

Sometimes the exit charges are applied at policy level by which we mean the charge is applied regardless as to which investment fund or funds are selected. Other times the exit charge is applied at investment fund level and this is particularly true of with-profits funds where sometimes so called *market value reductions* are applied. Market value reductions are a device to make sure that investors do not take away more than their fair share of the with-profits fund.

Market value reductions are not normally applied when the pension plan reaches the selected retirement age.

Top tip - Ask your pension plan provider (or ask you adviser to do this) to provide you with a current valuation of your pension plan and then ask them to tell you what the transfer value is. The difference between the two will represent any exit charge.

Exit charges - should I stay or should I go?

If the exit charge is quite substantial and you have a relatively short term until you wish to receive pension benefits (say an exit penalty of 15% or more and under 10 years until benefit age) then typically it will not be suitable to transfer to a different pension plan even if future charges are lower. Unless of course there are special circumstances for example you may be in a with-profits fund that is currently paying no annual bonus and has little prospect of doing so in the future.

Where you have a longer term to retirement (say more than ten years) and the exit penalty is small (say less than 10%) there might be a more compelling argument for considering a transfer particularly if the investment fund in your current pension plan has not performed well, or you are in an expensive pension plan with high charges.

What information do I need to gather?

Ask your pension plan provider for an illustration showing you the current and transfer value of your plan. Also ask them to produce an illustration of possible benefits at your selected benefit age. Ask for this illustration assuming that you carry on paying contributions (if you are doing so) and also on the basis that no further contributions are to be paid.

As product providers have to use their own charges for illustrative purposes it is possible to use the illustration that your current pension plan provider produces to see if it is worth considering transferring to another pension plan with lower future charges. Simply compare their projections to projections you have obtained from other providers, using the same fund values.

As mentioned earlier the illustration will also show you the “reduction in yield” the amount of reduced investment performance that you actually receive from your pension plan as a result of the plan charges.

Top tip - You should know exactly what you are paying your pension plan provider for the services that they are providing. Remember though it is about value for money not just price.

Investing my pension plan

A pension plan is an investment plan. Think of it that way and it becomes less confusing. The jargon associated with pension plans really does put people off doing anything about retirement- but it need not be that way.

Your contributions and those of your employer where applicable (and indeed any tax relief and national insurance contribution rebates) are invested in investment funds selected by you and/or your adviser.

These investments form your pension fund and ultimately the size of your pension fund is the single largest determinant of the amount of retirement income you will receive. Yes, size really does matter!

We very often find that people we meet have a really good understanding of the value of their home. They don't like the fact that it may have fallen in value recently but they have a pretty reasonable "handle" on its value.

If they have been saving in a bank, building society or National Savings & Investments account (possibly through a cash ISA) they will know the value of those accounts. If they have shares or have collective investments (for example equity ISAs) again they may have a pretty good feel for the value of their investments (again they won't like the fact that these values have fallen recently).

But if we ask the typical person "how much is your pension fund worth?" there is a pretty good chance they will be clueless. We think this is wrong after all it is their money and an important part of their long term financial security.

If we ask them "where is your pension plan invested?" then you may not be surprised to know that the majority of people do not know the answer.

Top tip - You should always have a good understanding of where your pension plan is invested. Make sure that where it is invested is suitable for you. Make sure it matches your attitude towards risk, reward and volatility.

Risk - this is the danger of losing money

Reward - this is the reason you invested in the first place!

Volatility - is the ups and downs in value that you may experience with investments over time

Don't mix up volatility and risk; they are two different things.

What choices do I have?

There is a very wide range of investment choice available to you within a pension. If you wanted to put this on a scale, it could be as extreme as having your entire pension plan fund invested in cash or all of it invested in emerging market small companies! Please don't treat that last statement as advice; I am just trying to paint a picture of extremes.

Most pension plans offer you a range of investment funds. I have just come off the phone speaking to a client whose pension plan allowed him to invest in the following funds;

- Cash;
- Commercial Property;
- UK Equities ('tracker');
- International Equities; or
- Fixed interest;

How should he go about choosing which investment fund or funds?

Term to retirement

One of the factors that should be considered is the length of time that you have to go until you need the benefits from your pension plan. A simple model to use might be that the longer you have to go until retirement the more risk you might be prepared to take with your pension plan investments.

This is because as the investments rise and fall over time (volatility) you have time on your side and if they fall in value they may well recover in future years. The closer you are to the point in time when you want to take the benefits the more cautious you might be.

Extreme examples might be that a 25 year old retiring at age 65 (40 year term to retirement) might invest 100% in shares (equities) whereas a 63 year old retiring in two years time might be 100% in cash.

Attitude to risk

All people are different. Some are natural risk takers others are much, much more cautious. That is why we say that your pension funds should reflect *your* attitude to investment risk. That way you will be able to sleep more soundly at night. Below I have given some examples of how we might define a range of attitudes towards risk. It is often the case that people cannot be easily “boxed” into one category but actually straddle the lines.

No Risk— means that your investment should be linked to bank or building society deposits, or other investments that cannot go down in value. This type of investment may be suitable in the short term. However, over medium to longer terms, they have historically given lower returns than equity based investments or bonds.

Cautious— means you are prepared to take only limited risks with your money. Cautious portfolios normally have a high proportion of fixed-income investments, often including company and government bonds. Cautious portfolios might not include shares.

Moderately Cautious— means you are prepared to accept some risk on part of your money to get the potential of returns above inflation.

Balanced— you are prepared to take some risks with your money but you want to limit your exposure to higher risk investments.

Moderately Adventurous—you are prepared for the value of your investments to go down in value, and accept this to get the potential for greater returns in the long term. You accept that you might get back less than you put in, especially in the short to medium term.

Adventurous—you want to aim for the highest possible investment returns available and you recognise that the value of your investment may go down significantly as well as up.

These statements are designed to get you thinking. Do any of them reflect your attitude? We would strongly recommend that you discuss this in more detail with your financial adviser.

One of the tools available to a competent financial adviser is a modeling tool that shows you how you might invest your pension plan contributions to match your attitude towards risk reward and volatility. The following is a list of questions that we use to get an understanding of the attitude of our clients. Different advisers will use different approaches to this subject.

- Do you like to keep up to date with financial matters?
- Are you comfortable with the idea of your investments falling and rising rapidly?
- How would you describe your experience of investment?
- What is your knowledge of financial terms?
- Once you have made an investment, how often do you review it?
- Do you have sound financial experience to help you to make an investment decision?
- Do you prefer to have a long-term financial plan?
- Does the thought of losing your money on an investment make you nervous?
- Do you like the excitement of investing in volatile foreign markets to potentially gain higher returns?
- Do you try to make as much money as quickly as possible?
- Do you read the financial section of your newspaper?
- Are you used to taking financial risk?
- Is the financial press a major influence on your investment decisions?
- Do you prefer savings accounts to stock market related investments?
- Would you like to invest for the long term or to respond quickly to short term changes?
- Are you prepared to take a high level of risk in order to gain high returns?
- Do you think about accumulating huge wealth through investments?
- If you had been unlucky in the past with investments, would you make an investment again?

Investment asset class

Generally speaking all investments can fit into a range of investment asset classes. We have defined the most common classes below. Depending upon your attitude towards investment risk reward and volatility you may wish to have more or less of your pension plan investments in any particular class. There may also be times when it is prudent to have more or less in each class. The mix of investment asset classes we would refer to as a '*strategy*' and choosing to have more or less in a particular asset class we would refer to as a '*tactic*'.

Being spread around the various asset classes generally, although not always, as recent investment market conditions have demonstrated, means that you will experience less volatility.

Fixed Interest

The fixed interest asset class includes both gilts and corporate bonds. Gilts are issued by the British Government and are considered one of the safest forms of investment. Gilts provide a good diversification from equities but returns are generally more modest. Corporate Bonds are issued by companies. They are considered riskier than gilts but pay a correspondingly higher interest rate to investors. Bonds are negatively correlated with equities and so provide diversification.

Property

Property funds enjoy relatively low volatility and provide good, reasonably stable returns over the mid to long-term. They also provide good diversification from equities.

UK Equity

UK Equities have historically provided high returns over the mid to long-term. However equities tend to be volatile over shorter periods and the uncertainty over the future movements of their prices make them a riskier investment than some other asset classes.

US Equity

These potentially offer a more diversified portfolio than UK based equities. Exposure to the world's largest economy can offer the prospect of higher returns, but also a higher level of risk than UK equities. These funds are also subject to movements in currency exchange rates and these factors in combination lead to above average short-term price fluctuations.

European Equity

Not totally correlated to UK markets and therefore providing diversification. Potential exposure to smaller emerging markets can offer the prospect of enhanced returns but a higher level of risk than UK equities. Affected by movements in currency exchange rates and therefore subject to short-term volatility.

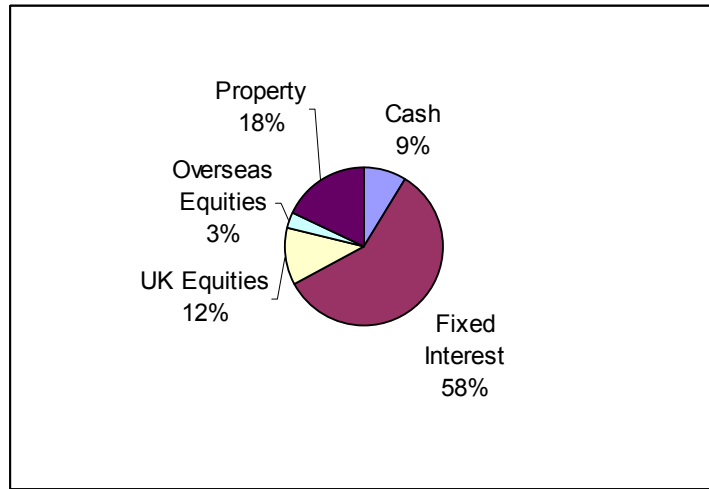
Far East Equity

Exposure to markets that historically have experienced dramatic price movements and higher growth economies provide potential for higher future returns. Consequently there is a corresponding higher level of risk and short-term price volatility. Far Eastern equities also provide diversification from UK equities.

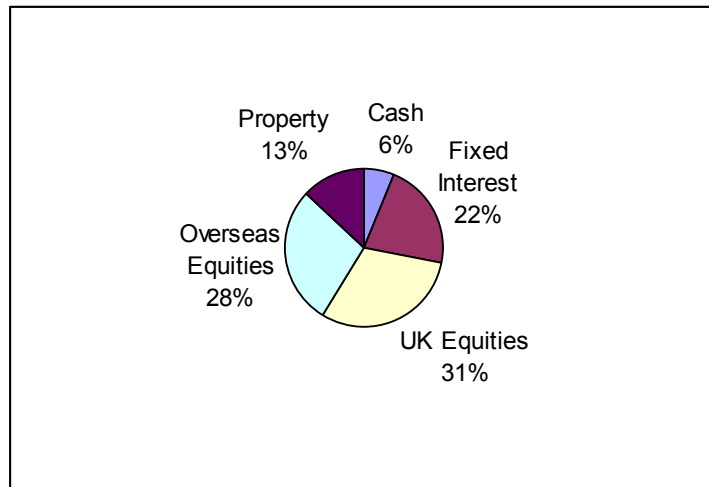
These asset classes are not guaranteed to perform this way in the future.

What do the investment asset class models look like?

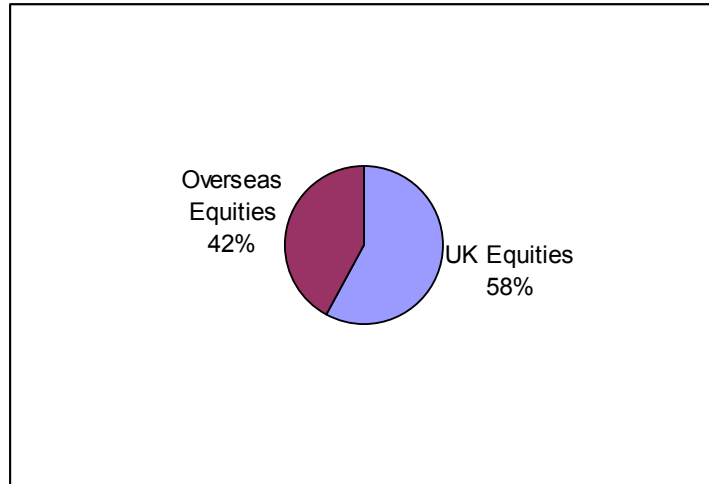
Here are some example asset class models for pension investors with different risk profiles. The first is a suggested portfolio for a cautious investor:



And for a balanced pension investor:



And finally for an adventurous pension investor:



As you can see the more risk averse the client the more of their investment asset class is in cash and fixed interest securities. The more adventurous the client the greater the amount is invested in equities (shares).

How do I choose the investment funds?

Once you have decided on a suitable investment asset class model you can then select investment funds in proportion to match that model. As we said earlier most pension plan providers have a range of fund choices and generally you can match the model to the choice. You may need to ask your financial adviser to help you do this.

We think that there are four main ways in which you can determine the best fund choice for your pension plan and they are shown in the table below.

Investment fund selection	How does this work? Who should use it?
Do It Yourself	You do the research gather the information and select the most appropriate funds. You also carry out your own reviews. Suitable for confident investors who possibly have some experience of doing this type of thing.
Advice	Your financial adviser does the research gathers the information and recommends suitable funds for you. Your financial adviser probably also helps you to complete any investment fund selection forms and checks that the transaction has been correctly carried out by the plan provider. This is usually suitable for someone who wants to delegate the fund selection because of lack of time or expertise.
Portfolio Management	An investment manager or financial adviser has developed a model portfolio of investment funds and matches your attitude to risk, goals and objectives to the selected portfolio. These are typically used with Self invested Personal Pension plans by people who want more active management but less so than for discretionary fund management (see below).
Discretionary Management	You employ a stockbroker or discretionary fund manager and hand over the responsibility for choosing the investments to them. This is usually more suitable for pension plan holders who have a Self Invested Pension Plan and require more extensive and active investment fund management.

You will certainly need to consider the past performance of the selected funds but as the warning says, past performance is no guarantee of future performance. Check out the fund objectives as well and make sure they match with your investment attitude and goals and objectives.

Top tip - Don't select a 'balanced managed fund'. Our research shows us that they typically have a much higher risk profile than most balanced investors can tolerate. It is also questionable as to the degree of active management that is taking place.

Top tip - Stay away also from with profits funds as they tend to be a bit 'smoke and mirrors' in terms of how the rewards are distributed to pension plan holders. We are great believers in clarity and the opaque nature of with-profits funds is not something that we like much.

You will need to get hold of some information from your pension plan provider and ask them for:

- A list of the available investment funds;
- A fund fact sheet, for each of the funds that you believe are suitable for you;
- A copy of the investment fund choice brochure (most pension plan providers have one)

Alternatively you can ask your financial adviser to do this research for you and make a recommendation.

It is also important to find out how much you will be charged for switching funds within your pension plan. The more competitive pension providers do not charge anything for doing this. Some providers may give you a limited number of free fund switches each policy year, before starting to charge.

Reviews

Once you have made your pension plan investment fund choice that is not the end of the matter. If we can encourage you to do one thing that would be to make sure you review your chosen funds performance on a regular basis. We don't mean every week (unless you are that way inclined) but certainly on a yearly or possibly half yearly basis.

In our experience the worst thing to do is to make an investment and never revisit it to check on progress.

Reviewing your pension plan annually gives you the opportunity to assess performance, risk and also progress (or lack of it!) being made towards your retirement objectives.

Taking my pension benefits

Eventually you will want to take the benefits from your pension plan. After all, this is the long-term purpose of a pension; to generate cash and income to fund your retirement.

When?

You may well have in mind a date in the future that you have labelled “my retirement date” That date does not have to be age 60 if you are a woman and age 65 if you are a man. Those rigid retirement rules are fast disappearing for any number of reasons. In fact there is no law that says a person has to retire, ever! There may well be a contractual retirement age from your current employer and there is of course a State pension age but neither of these actually means that a person *has* to retire.

That said most of us do aspire to reach retirement at some point; even those of us who love doing what we do!

Earliest age

Personal pension plans have rules however about when you can access the benefits. The minimum age is age 55. If you attain age 50 before the 6th April 2010 you can take benefits before age 55 but for some people if they do not take benefits before that date they then have to wait until age 55. This is a quirk of the legislative change introduced in April 2006.

Latest age

By the time you attain age 75 you must have started to take the benefits from your pension plan.

Top tip - You do not have to retire to take the benefits from your pension plan. It is perfectly acceptable to carry on working and take pension plan benefits. This may or may not be suitable for you and you should discuss the consequences of taking benefits with your financial adviser.

Exceptional circumstances

Some people who are in special occupations are able to retire before the minimum age shown in the previous sections certain professional sportspeople can for example. If you think that your occupation is one of those “special occupations” please email us on hello@icl-ifa.co.uk and we will check that out for you.

Serious ill health

For some people suffering from serious ill health and who are therefore likely to have a shorter life expectancy it is possible to receive benefits from their pension plan before the minimum age. The nature of the serious ill health will however be checked out by the pension plan provider obtaining suitable medical evidence so this becomes a material fact rather than a pension plan owner simply believing they will not live as long as the average.

What are the benefits?

You won't be surprised to learn that one of the benefits that you will receive from your pension plan is a “pension”! This is just one word to describe the income that you will receive. The good news is that this income is payable for as long as you live. The bad news is that the amount you receive will depend upon a number of factors some of which are very difficult to determine in advance. A list of those factors might include:

- Your age at retirement
- Your sex
- Your state of health in particular your health history
- Your smoker status
- The value of your fund at retirement
- Whether or not you take any tax free cash lump sum benefit (now confusingly called a pension commencement lump sum)
- Your marital status at retirement and whether you make any provision for a surviving spouse or partner
- Whether or not you seek a pension that increases in value (escalates) or remains level in payment
- The nature of any short term guarantees (pension income is payable for life but guarantees cover death a short time after starting to receive the pension)
- And finally, the way in which you convert your pension fund into retirement income.

How do I convert my pension plan fund into retirement income?

The details of your choices and options are beyond the scope of this guide so what follows is a simple summary of the choices available to you.

Annuity

An annuity is purchased from a Life Assurance Company. This is either from the provider of the existing pension plan or can be from an alternative provider via the **Open Market Option**.

- The pension plan is used to provide a guaranteed level of income for the remainder of the your lifetime.

The annuity rate depends upon the current yields provided by gilts (fixed interest securities provided by the Government) and mortality assumptions made by the annuity provider.

There are a number of types of annuity available. The basic type is a **level or fixed rate** annuity. This is simply a constant income paid each year for the rest of the individual's life.

One disadvantage of a level annuity is that inflation erodes the purchasing power of the income received. £1,000 received today will not purchase the same level or quantity of goods in the future because of inflation.

To overcome this loss **escalating, index linked & investment linked** annuities are available. An escalating annuity increases at a pre-determined rate each year. An indexed linked annuity is guaranteed to rise in line with inflation, measured by RPI. An investment linked annuity rises (and falls) in line with an underlying investment. These investments are typically the With Profits fund of the chosen provider or a unit linked investment.

Individuals with a lower life expectancy have the option of two alternative types of annuity, **impaired life** and **enhanced** annuities. They provide an increased level of income compared to standard annuities due to the shortened life expectancy of the annuitant.

Impaired life annuities are aimed at individuals with a particular medical condition and usually require medical underwriting. Enhanced annuities offer higher rates for individuals with medical conditions or lifestyles that reduce life expectancy but are not serious enough to warrant medical underwriting such as smokers, diabetics and the obese.

Advantages of an annuity

- Simple to understand
- A known level of income is provided (except for investment linked annuities)
- Options are available to guard against future price inflation
- The option of including a spouse's or partner's income that continues on the death of the annuitant can be included. This option will reduce the level of annuity provided.

Disadvantages of an annuity

- The pension fund is lost on the death of the annuitant (although protection and guarantees can be included to mitigate some of this risk).
- Income can not be altered once the annuity has been purchased
- The maximum income received is limited to what is available from the markets.
- Annuity rates may be low at purchase date
- The purchasing power of income is reduced by inflation, unless an inflation linked annuity is purchased, which is more costly, or an investment linked version is purchased, which can produce lower than expected income.

Taxation of an annuity

A pension commencement lump sum of typically up to 25% of the fund value used to purchase the annuity is available free of tax.

The income received from an annuity is treated as earned income and taxed at 20% below the higher rate tax threshold and 40% above. The provider will normally pay the income net of basic rate tax with the extra 20% for higher rate tax payers being payable via self-assessment.

Unsecured Pension

Also referred to as 'drawdown' or 'income withdrawal', unsecured pensions aim to provide a flexible level of income.

The pension fund built up is converted to an unsecured pension arrangement (also known as crystallised or vested) and a level of income is provided.

The income level is chosen by the individual but is subject to HMRC limits. As of 6th April 2006 these are 0% and 120% of GAD limits. The GAD (Government Actuary's Department) limit is based on the individual's age, gender and long term gilt yields and is required to be reviewed every five years as a maximum. The income received can be altered at anytime and as such can be used to supplement or replace other income sources.

The pension fund built up remains invested which can allow income withdrawn to potentially be replaced with investment growth.

Variations of unsecured pensions are **phased annuities** and **phased drawdown**. With these versions only part of the pension fund is used and either purchase an annuity or provide an income via drawdown. The remainder of the fund remains invested and so benefits from the potential of further fund growth and better benefits on death.

Unsecured pensions have to stop at age 75 from which either an annuity or, as of 6th April 2006, an **Alternatively Secured Pension** (ASP) can be purchased. Similar to unsecured pensions they provide a flexible income but with more restrictive limits; between 55% and 90% of the GAD limit of a 75 year old of the same gender. The other difference is that ASPs are reviewable on an annual basis.

On death unsecured pensions can provide a lump sum net of 35% tax or a dependent's pension via an annuity or unsecured pension (or ASP for a dependent over 75). Phased annuities and Phased drawdown policies benefit from the uncrystallised part of the fund being returned to a beneficiary without tax being deducted. ASP is limited to providing beneficiaries with a pension as per unsecured income or a lump sum payable to a charity when there are no dependents.

Advantages of an unsecured pension

- Allows for flexible levels of income
- The remaining fund remains invested
- Pension Commencement Lump Sum (also known as Tax Free Cash) can be paid without an income being paid
- The fund value can increase while income is being received
- It allows for deferment of annuity purchase until a better rate is available
- Once started the plan can be transferred to another provider
- It allows for a greater choice of death benefits than an annuity

Disadvantages of an unsecured pension

- High levels of income received can erode the value of the fund potentially resulting in it running out or a lower annuity being purchased in the future.
- The fund may fall in value also leading to income running out or a lower annuity being purchased in the future.
- Annuity rates may be lower when one is required in the future.
- The growth on the invested funds may not be enough to maintain an income that would have been available via the annuity.
- To compensate for the loss of cross subsidy by not purchasing an annuity the investment needs to grow by an extra amount. This is known as **Mortality Drag**.
- Unsecured pensions are potentially more costly than annuities due to the extra administration and the fact that part of the fund is still invested.
- Unsecured pension funds are generally only suitable for individuals with larger funds.

Taxation of unsecured pension

A pension commencement lump sum of typically up to 25% of the fund value is available free of tax.

The income received from an annuity is treated as earned income and taxed at 20% below the higher rate tax threshold and 40% above. The provider will normally pay out the income net of basic rate tax with the extra 20% for higher rate tax payers being payable via self-assessment.

Variable Annuities

Variable annuities, which have been available in the USA for a number of years and have more recently been introduced into the UK. These products vary but in general terms their purpose is to offer a combination of the benefits of traditional annuities with those of unsecured income; the guarantee of an annuity with the continued investment growth of an unsecured pension.

Advantages of variable annuities

- Guaranteed income for life with part of your pension fund
- The remaining fund remains invested leading to the potential for investment growth
- The ability to alter income being received or convert to a full annuity
- Superior death benefits than an annuity (return of fund less 35% tax rather than loss of fund to the annuity provider)

Disadvantages of variable annuities

- Less protection than an annuity as negative investment growth can diminish the pension fund
- More expensive than their alternatives as the guarantee has a cost that needs to be covered. This can potentially negate any investment growth or lead to extra risk being taken in attempting to generate growth.
- Annuity rates may be lower when one is required in the future
- They are more complicated to understand

Taxation of variable annuities

A pension commencement lump sum of typically up to 25% of the fund value is available free of tax.

The income received from an annuity is treated as earned income and taxed at 20% below the higher rate tax threshold and 40% above. The provider will normally pay out the income net of basic rate tax with the extra 20% for higher rate tax payers being payable via self-assessment.

Pension Commencement Lump Sum (Tax Free Cash)

One of the popular benefits from a pension plan is the much loved “tax free cash lump sum” 25% of the value of your pension plan fund can be taken in this form and many pension plan owners decide to do this.

You can do what you like with this money, spend it, give it away, invest or save it or even use it to pay off debt, the choice is yours.

Top tip - Remember if you take the tax free cash lump sum and do not use it to generate income you may well find that what is left in your pension plan fund is not enough to provide you with the income that you require in retirement.

Tax free cash and no income

Since April 2006 it has been possible to take the entitlement to tax free cash without taking any income at all. Some people have chosen to do this and reinvested the money into a number of projects for example, paying off their mortgage, investing in a new property, investing in a new business enterprise and paying for educational costs for their children or grandchildren.

Bear in mind the top tip above if you do this.

More than 25% tax free cash

In this guide we have concentrated mainly on personal or Stakeholder pension plans but some people have an entitlement to a greater tax free cash lump sum than 25%. If this applies to you be very careful about transferring your plan because you may lose this entitlement. This is particularly true if you have an Executive Pension Plan or Section 32 Buy-Out Plan.

Guaranteed Annuity Rates (GAR)

Some pension plans (particularly the older style- Retirement Annuity Contracts) contain important guarantees in the form of Guaranteed Annuity Rates or GAR. These rates are sometimes very much higher than the rates available today in the open market. If your plan contains a GAR exercise care before you transfer to another provider as you may well lose this potentially important benefit.

Top tip - Obtain a copy of your policy document and as boring as it sounds read through it carefully before you take any action. In particular check and see if you have any Guaranteed Annuity Rates available, if the plan contains any important protections in the event of you not being able to work through sickness or disability and if there is any life assurance attaching to the plan.

If you transfer a plan with any of these benefits they may well then be lost.

What happens if I die?

In this section of the guide we are looking at what happens if a pension plan holder dies before he or she has started to take the benefits from the plan. Most of us would want to make sure that if we were to die before “retirement” that our families would get the benefits of the value of the pension plan.

In most cases this is exactly what will happen but there are some steps to take to make sure that is the case for you. The first step is to get hold of the all important policy document. You will need to plough your way through the policy terms and conditions to the section that tells you what happens if you die before the selected retirement age.

Full fund value

With most modern pension plans the value of the plan is also the death benefit value. If you can't be bothered to work your way through the policy document to discover this ask your pension plan provider to confirm it to you or employ a financial adviser to tell you what the answer is.

Return of contributions

Some very old pension plan policies do not return the full value of the fund on death but only return the contributions that have been paid into the plan. Whilst this is becoming increasingly rare (I am pleased to say) this is most often found with old with-profits policies.

If your existing pension plan only returns contributions on death, this might be a good reason to consider a transfer to a new personal pension.

Plus interest

Some old style pension plans return the contributions on death before retirement with interest. Wow!! That interest might be added on a simple or compound basis.

Who gets the money?

Usually when a pension plan owner completes an application form to buy the plan he or she is asked to “nominate” a beneficiary in the event of their death before retirement. If death occurs the pension plan provider then checks their records to see who they should pay the benefits to.

Unfortunately the pension plan provider doesn't really know that much about you and your circumstances and it may well be that circumstances have changed and a different beneficiary should receive the pension plan value. For this reason in most instances the pension plan provider will return the money to the "legal personal representatives of the estate".

This is not particularly tax efficient where the beneficiaries are for example children as the money will be added to the pension plan owner's estate for the purpose of calculating inheritance tax. It is less problematic where the beneficiary is a spouse or Civil Partner where inheritance tax will not apply.

Trusts

An alternative more certain approach to this is to place the pension plan into a trust. A trust is a legal instrument that provides more certainty in that the pension plan owner places the policy into the trust (he or she is then known as the "Settlor") and appoints Trustees to act on his or her death and make sure that the right beneficiaries get the pension plan value.

This is both relatively simple and cost effective to do. You can ask the pension plan provider to provide you with a standard trust deed or discuss this in more detail with your financial adviser.

Top tip - Consider putting your pension plan into a trust to provide certainty as to the beneficiaries if you die before retirement.

What choices and options do I have?

You have many choices and options and that is where a competent financial adviser comes in handy. That said it is perfectly possible for many people to make the important decisions for themselves with or without guidance.

If your circumstances are more complex or you don't have the time or inclination (or knowledge) to do it for yourself that's when the financial adviser might represent value for money.

Do nothing

You may go through the review process and discover that you need take no action at all. You may find you have a competitively charged plan with a good range of investment funds and you may well have selected suitable investment funds that are performing perfectly satisfactorily. Well done.

Do make sure though that the level of contributions you are paying are sufficient to achieve the desired level of retirement income for you and your family. Also do make sure that you review your plan on a regular basis, at least once a year and more frequently as you get closer to retirement.

Recommence contributions

If you have stopped paying into your pension plan then you might now be considering recommencing contributions. You could pay those into your existing plan if the plan provider allows you to re-start it or start a new plan. You might start a new plan if your existing plan has high charges, but too high an exit penalty to make it worthwhile transferring the whole amount out or simply to give yourself a little investment diversification.

Transfer to a new plan

Following your detailed analysis you may have determined that you are going to transfer away into a new plan. If that is the case you might transfer to one of the following;

- A Stakeholder pension plan; or
- A personal pension plan; or
- A Self invested Personal Pension Plan (SIPP)

So which pension plan should I choose?

How much investment choice/control do you want?

None at all, I want one individual investment fund and don't intend to review it too often	Choose a Stakeholder pension plan
Some, I want a range of investment funds that match my investment attitude towards risk and reward	Choose a Stakeholder pension plan
Some, I want a wide range of investment funds that match my attitude towards investment risk and reward	Choose a Personal Pension Plan
Lots, I want a very wide range of funds and possibly buy some shares directly with my pension fund	Choose a Self Invested Personal Pension

How concerned are you about the charges that will be applied to your plan?

Very concerned I want the lowest possible charges	Choose a Stakeholder pension plan
Quite concerned I expect to have to pay a reasonable amount for service and fund choice	Choose a Personal Pension plan
Not very concerned, I understand that to get the widest investment choice and regular review services I may have to pay higher charges	Choose a Self Invested Personal Pension

Obtaining advice

It goes without saying that the adviser will need to be authorised and regulated by the Financial Services Authority (FSA) so that you have the maximum degree of consumer protection.

We are biased of course but hopefully biased in favour of the consumer because we would also say:

- Choose an independent financial adviser because they act as your agent rather than the agent of the pension plan provider.
- Pay fees to your adviser rather than them being paid commission as that should also avoid any incentive for them to recommend a commission paying solution that may be unnecessary.
- Choose a highly qualified adviser because they have been prepared to have their knowledge tested- go for a Chartered Financial Planner or Certified Financial Planner.
- Ask them about their experience in this area and how they will deliver their advice to you. At the very least you should expect a detailed report that is presented to you so that you can ask and have answered any supplementary questions.

Summary

1 - Remember it is not always best to transfer an existing pension plan from one provider to another. Sometimes the plan that you have is the plan that you need.

2 - Obtain a valuation of your pension plan together with an illustration of possible benefits from your pension plan provider- this will help when you start to do the comparison of your plan against other available plans.

3 - Understand which investment funds your pension plan is linked to. Is your pension plan investment suitable for you bearing in mind your attitude towards investment risk, reward and volatility and the time until you retire?

4 - How has your pension plan performed since you purchased it? Compare it to other similar available plans.

5 - Make sure that if your pension plan has any "guarantees" that you consider what will happen to those guarantees if you stop paying contributions or transfer to another plan provider.

6 - If you started your plan before 6th April 2001 has your pension plan provider changed the charges to a more modern approach (mono-charged plan).

7 - Will your existing pension plan provider charge you to move your plan monies elsewhere? This needs to be carefully analysed and considered because any replacement plan will need to work harder in the future and achieve better investment returns to replace those charges.

8 - Does your existing pension plan have additional benefits for example life assurance cover which might need to be replaced if you transfer to another plan provider or if you stop paying contributions?

9 - If your pension plan is part of a company scheme does it offer any guaranteed benefits at retirement that may not be replaced if you transfer to a private pension plan?

10 - Ask your financial adviser for a full comparison report before you make any decision to transfer your existing pension plan to another arrangement. Remember that your existing pension plan may well be the most suitable one for you.

Bonus section – documents required

I hope you have found this guide helpful. Here is a schedule of the various documents you will need to successfully review your pension. It describes the document needed for this review process, what that document will tell you and where you can get it from.

Document needed	What it will tell you	Where from?
Policy document and schedule	This will give you a great deal of information including the pension plan reference number the start date and selected retirement age of the plan as well as information about any guaranteed annuity rates or other benefits within the plan	You may already have this in a safe place with your other papers. If not ask for a copy from the pension plan provider
Annual benefit statement	At least on a yearly basis you should receive one of these from the pension plan provider. It should tell you the value of your plan (current and transfer value) how much you have paid in during the last year and some details of where your plan is invested	Ask for one from the pension plan provider. You may be able to get this detail on-line from the plan provider's website
Illustration	You can ask the plan provider to provide you with an illustration of possible benefits at your selected retirement age. This might be on the basis that you continue or stop paying future contributions	Ask for one from the pension plan provider. You may be able to get this detail on-line from the plan provider's website

Investment Choice Brochure	Your pension plan provider will probably have a brochure or leaflet explaining the investment fund choices that you have. You can also ask for fund fact sheets which will tell you about the goals and objectives of each investment fund	Ask for one from the pension plan provider. You may be able to get this detail on-line from the plan provider's website
Your attitude to risk	You should establish your attitude towards risk, reward and volatility so that you select the most appropriate investment funds	Ask your financial adviser to help you with this and to prepare an investment asset class model for you and recommend suitable investment funds