Pension freedoms and debts

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Use this fact sheet to:

- find out what ‘pension freedoms’ are;
- understand how taking money from your pension pot could affect your current or future benefit income and tax position;
- find out where to get more information and advice about how taking money from your pension pot could affect you;
- find out where to get information about your ‘defined contribution’ pension options; and
- find out how taking money out of your pension pot to pay off your debts might affect your options.

What pension freedom means

Before 6 April 2015, when reaching retirement age, you would normally have used your pension pot to buy an annuity, which provided you with a regular income from then on. You also had the option of taking up to **25%** of the value of your pension pot as a tax-free lump sum.

From 6 April 2015 onwards, changes in the rules - often called ‘pension freedoms’ - mean that you can:

- take up to **25%** of the value of your pension pot as a tax-free sum; and
- take out more if you choose to - up to the remaining value of the pot - but, if you do, this will be subject to income tax.

Pensions affected by pension freedoms

There are two basic kinds of pension: **defined contribution** pensions and **defined benefit** pensions.

Defined contribution

Defined contribution pensions are affected by the ‘pension freedom’ changes. In this kind of pension, you pay money into your pension pot and your employer might also pay money into it. You might get tax relief on the payments that you make. The pot is usually invested, with the aim of increasing the overall value. You can get access to your pot once you reach **55 years old**, or earlier in special circumstances. This kind of pension is sometimes called a ‘money purchase’ pension scheme. It includes workplace and personal pensions, including stakeholder pensions.

Defined benefit

Defined benefit schemes are not affected by the ‘pension freedom’ changes. They are sometimes called ‘final salary’ or ‘career average’ schemes. This kind of pension pays you an income based on your salary and how long you have worked for your employer. You can get access to your defined benefit pension once you reach **55 years old**, or earlier in special circumstances. These schemes are usually only available in large organisations or through being employed in some public sector roles, for example as a teacher.

Taking money out of your pension

You might be thinking about getting access to the money in your pension pot to help you sort out your financial situation. But taking money out of your pension pot could leave you in a worse position than you expected. **Before you take any money out, you need to know what the effects might be now and in the future.** Three important things to think about are:

- the impact on your benefits now and later;
- the impact on your tax position now and in the future; and
- the impact on your pension now and in the future.

The impact on benefits

If you choose to take money out of your pension pot, it may reduce the money you can get from social security benefits both now and in the future. Some benefits are based on the income that you have coming in and are affected by savings that you have. These benefits can also be affected if you have taken money out of your pension and no longer have it because you have spent it.

Age UK has a very helpful fact sheet about the main issues called: **Pension Freedom and benefits**. The Department for Work and Pensions (DWP) has also published a fact sheet called **Pension flexibilities and DWP benefits** which gives general information.

Benefit decisions can be very complicated, so you may want to discuss the issues further with an adviser. See the later section **Where you can find information and advice** for organisations that may be able to help you.

The impact on tax

Taking money out of your pension pot can have an impact on how much tax you pay and the tax relief that you get.

Tax that you pay

If you take **more than 25%** of your pension pot, you may have to pay tax on the part which is more than the **25%** amount. This could give you a large tax bill, reducing the payment you get from your pension pot. You might get paid a lot less than you expected. See the Pension Wise page **Tax you pay on your pension** for more information.

Tax relief

If you take money out of your pension above the 25% element, it could mean that you are affected by the Money Purchase Annual Allowance (MPAA).

If you are affected by the MPAA, the Government has:

- limited the amount you can pay back into a pension to **£4,000** each year; and
- limited the amount you can get tax relief on pension contributions to up to **£4,000** each year.

If you are not limited by the MPAA, you may be able to get tax relief on pension contributions up to **£40,000** each year, depending on your level of earnings and the value of your pension pot.

See the GOV.UK page **Tax on your private pension contributions** for more information.

The way that tax affects you in your situation might be complicated. Two free services may be able to help you with further information.

- **TaxAid** gives help and advice to people on low incomes about tax and related matters.
- **Tax Help for Older People** gives help and advice to older people on lower incomes who cannot afford to pay for professional tax advice.

See the section **Useful contacts** at the end of this fact sheet for contact details.

The impact on your pension

Taking out money from your pension pot early means that you won't have that money in your pension pot when you decide to retire. Your pension pot will be smaller and you will be able to get less income from it. Your options about how to use your pension may be more limited. You need to weigh up the usefulness of taking money out of your pension now against keeping the money for later, when you might also need it.

The effects of reducing the size of your pension pot can be complicated. You will usually need to get regulated financial advice to understand them fully. See the section **Where you can find information and advice** for organisations that may be able to help you.

Where you can find information and advice

Information: INFO

advice and guidance

The Financial Conduct Authority has published a page called **Understanding 'advice' and 'guidance' on investments** which may help you to tell the difference between what is advice and what is guidance.

Warning: !

be careful

A decision you make about your pension will have a long-term impact, for better or for worse. With such an important matter as your pension, it makes sense to get independent financial advice first, before you take any other steps.

It is very important to get the right information about your situation and options when making choices about your pension. If you don't get the right information, you could end up making a costly mistake, with long-term consequences for you and your pension income.

What to do first

- Look at your pension statement - your pension provider should send you this once a year. This will show you details such as the full value of your pension pot. You might need to contact your pension provider to get an up-to-date balance.
- You may have paid into more than one pension. You'll need to contact each pension provider to find out how much each pension pot is worth.
- If you have lost the details of your pension policies, you can get contact details safely from GOV.UK on the page called **Find pension contact details**. If you search online for a 'pension tracing service', only choose firms which are registered with the Financial Conduct Authority (FCA), which regulates pension advice. You can find out which firms are registered on the FCA's webpage: **Search the Financial Services Register**. Make sure that you understand what services they are offering and for what cost. You could contact old employers to see if you still have a pension with them. Also, you might contact old work colleagues through social media, to see if they can give you information about previous pensions you might have had.
- Make a list of all your income, for example: your wages, benefits, tax credits, savings and any assets you have.
- If we have helped you to work out a **personal budget**, it will be useful to have this with you, together with a list of all your debts.

Where to get information

- Your pension provider will be able to tell you what options you have regarding your own pension.
- Use the following sources of information to understand how decisions that you make about your pension might affect you.

Pension Wise

Pension Wise is a free, impartial, government-backed service which can help if you are aged **50 or over**, have a **defined contribution** pension and want to make sense of your options. They can't make a decision for you, but they can give you up to an hour's specialist guidance about your options. You can **book an appointment** online for a phone conversation or a face-to-face meeting. The **Pension Wise website** has helpful information on a range of pension-related matters. See **Useful contacts** at the end of this fact sheet for details.

The Pensions Advisory Service

The Pensions Advisory Service (TPAS) is a free service, supported by the DWP, which gives expert pension advice to the general public. TPAS is not able to give you regulated financial advice. This means that they are not able to tell you what to do. They can talk you through some of the things you might want to think about, and the possible implications of the decisions you need to make. You can contact them by phone, using webchat or by writing a letter. The **TPAS website** has extensive, detailed information about pension **issues** and **problems**. See **Useful contacts** at the end of this fact sheet for details.

Information: INFO

Single Finance Guidance Body

Towards the end of **2018**, the Government is expected to launch a new organisation, currently referred to as the Single Finance Guidance Body, which will include the following existing services.

- Pension Wise
- The Pensions Advisory Service
- The Money Advice Service.

The Money Advice Service

The Money Advice Service was set up by the government to give a wide range of free, unbiased money advice online, over the phone and face-to-face. See the section of their website which deals with **pensions and retirement** and the page called **Options for using your pension pot** for more information.

Where to get independent financial advice

The Money Advice Service website's page **Finding a retirement adviser** has a directory of financial advisers who specialise in giving advice in this area. These advisers can recommend a course of action that is personal to you and may help you to avoid making an expensive mistake. You can get advice by phone, online or face-to-face. All the advisers are regulated and authorised to give advice by the FCA.

The **Society of Later Life Advisers** has a postcode tool that can help you find local, accredited financial advisers, who specialise in giving advice to older people and their families.

Independent financial advice can be expensive. Check what your adviser will charge **before** you begin any consultation. Ask them how they charge and when the payment has to be made. Ask if they do an initial meeting for free. The **Pensions Advice Allowance** may help towards the cost of financial advice by allowing you to take out **£500** once a year, up to three times, from your pension fund. The money is paid directly to the financial adviser you have chosen. If you think that you might want to use the allowance, contact your pension provider.

Paying off your debts

Contact us for advice about dealing with your debts. We can explain which options are available to you at the moment, and tell you whether taking money from your pension would change the choices available to you.

You could use money from your pension fund to help repay your debts, but you don't have to. Whether it is a good course of action will depend on your circumstances. **Before you take any money from your pension to pay your debts, you should first get advice about what your pension options are, and how these will affect your benefits and tax position now and in the future.**

Extra advice:

no pressure

The FCA has made it clear that your creditors must not put any pressure on you to use your pension pot to pay your debts. Making a hasty decision could mean you lose money because of the tax or benefit rules. **Contact us for advice.**

Next steps

Self-negotiation or debt management plan: you may be able to take out money to pay all of your debts in full, or pay more on a monthly basis. **Contact us for advice.**

Full and final settlement: you may be able to take out money to pay a lump sum off your debts and agree with your creditors to write off the rest. The more you pay off, the more likely it is that creditors will agree. **Contact us for advice.**

See our fact sheet:

Ways to clear your debt.

Debt relief order: if you have an unclaimed pension, it could have an impact on whether you can apply successfully for a debt relief order. **Contact us for advice.**

Individual voluntary arrangement (IVA): you will need to check what, if anything, your IVA proposal says about your pension. Some creditors may take into account the money that you have in your pension pot when they are deciding whether to accept your IVA or not. **Contact us for advice.**

Bankruptcy: you cannot be forced to take money out of your pension to pay your bankruptcy debts. But, if you have made very large payments into your pension while unable to pay your debts, the person who administers your bankruptcy may try to reclaim these payments from your pension for creditors. If you take money from your pension while you are bankrupt, some or all of it may be used to pay your bankruptcy debts. If your pension pot is larger than your debts, you may not be allowed to make yourself bankrupt. **Contact us for advice.**

Converting a defined benefit pension

You may have a **defined benefit** pension scheme with safeguarded benefits. Some companies might suggest that you should convert it into its cash value. This means you can put this money into a **defined contribution** scheme to take advantage of the change in pension rules. The FCA, which regulates pension advice, in its **Conduct of Business Sourcebook** (COBS: 19.1.6) is clear that this is generally **not a good idea**.

In most cases, any possible advantages of transferring from a **defined benefit** pension scheme to a **defined contribution** one are outweighed by the costs, risks and loss of benefits involved. A further reason for thinking about whether this is a sound move is that not all financial products are covered by the protection of the Financial Services Compensation Scheme (FSCS). This cover means that your money should be protected if the pension provider stops trading. See the FSCS's webpage: **How is your money FSCS protected?** for information about what is covered.

If you are considering converting your **defined benefit** pension into cash or another form of pension, you should seek regulated financial advice first. If the value of your defined benefit scheme is **£30,000** or above, you will have to take advice from a regulated financial adviser before you can transfer. It is **very important** that you understand the particular features of your pension scheme and that you make an informed decision about whether or not to proceed. See the earlier section **Where you can find information and advice** for contact details for independent financial advisers.

Pension scams

Because pension pots can be large amounts of money, they are targets for criminals and firms which may try to make themselves a profit at your expense. For example, a fraudster might try to get you to transfer the money in your pension to them. Fraudsters may contact you offering a free pension review and say that they can use a 'loop hole' to help you release your pension before age 55. They may also offer you a special 'one-off' investment opportunity to increase your pension if you transfer your funds quickly. You could lose your pension and in some cases also be left with a tax bill.

If you need urgent advice, contact The Pensions Advisory Service on **0300 123 1047**.

Extra advice:

early exit fees

The FCA's rules cap the fees that can be charged if you take money out of your pension early. From **31 March 2017**, early exit charges:

- are capped at **1%** of the value of pensions entered into before that date;
- currently set at less than **1%** cannot be increased; and
- cannot be part of new personal pension contracts.

- **The Pensions Advisory Service** webpage **Pension scams** has helpful information about common scams and a tool which helps you to identify a possible scam. See **Useful contacts** below for details.
- **The Money Advice Service** webpage **How to spot a pension scam** explains how to spot a scam, some simple rules to follow and what to do if you think you may have been targeted. See **Useful contacts** below for details.
- **Action Fraud** is the national centre for **reporting a fraud** which has occurred or might happen. See **Useful contacts** below for details.
- **The Pensions Regulator** has a webpage **Protect yourself from scammers** giving good advice for how to protect yourself against being scammed and what to do if you think that you may have been scammed. See **Useful contacts** below for details.
- **Citizens Advice consumer service** may be able to help and might refer you to your local Citizens Advice office for face-to-face support. See **Useful contacts** in the next section for details.

Useful contacts

Action Fraud
Phone: 0300 123 2040
www.actionfraud.police.uk

Age UK
Phone: 0800 055 6112
www.ageuk.org.uk

Citizens Advice
Phone: 0345 404 0506
England: **www.citizensadvice.org.uk**
Wales: **www.citizensadvice.org.uk/wales/**

Financial Conduct Authority – Financial Services Register
register.fca.org.uk
www.fca.org.uk

Financial Ombudsman Service
Phone: 0800 023 4567
www.financial-ombudsman.org.uk

Financial Services Compensation Scheme
protected.fscs.org.uk

GOV.UK
Pension Tracing Service: 0800 731 0193
www.gov.uk/find-pension-contact-details

Pension Wise
Phone: 0800 138 3944
www.pensionwise.gov.uk

TaxAid
Phone: 0345 120 3779
www.taxaid.org.uk

Tax Help for Older People
Phone: 0845 601 3321
www.taxvol.org.uk

The Money Advice Service
Phone: 0800 138 7777
www.moneyadviceservice.org.uk

The Pensions Advisory Service
Phone: 0300 123 1047
www.pensionsadvisoryservice.org.uk

The Pensions Regulator
www.thepensionsregulator.gov.uk