Making pension fund choices

Think before you choose

Your pension scheme allows you to choose the funds in which some or all of your pension contributions are invested. Your choices are set out in your scheme literature. This guide aims to help you with the decisions you need to make. It has been written by the Pensions Regulator. It will help you to understand some of the things you need to think about before deciding how to invest your contributions.

> Your fund choices are important. They will affect your income in retirement. Think carefully before you choose.

About the different types of fund

You have probably already seen warnings about investments 'going down as well as up'. If the price of a particular type of investment is likely to go up and down it is said to be volatile and it will have some degree of risk associated with it. It could be risky for other reasons, for example, sometimes you may not be able to cash in your investment quickly. Some investments are more volatile or more risky than others. Share prices (like house prices) go up and down, so are volatile. By investing in an asset that is volatile you are taking an investment risk.

It's helpful to group together similar types of investments with similar levels of volatility. Generally the funds offered to you will tend to fall into one of four broad types (sometimes referred to as asset classes): cash, bonds, property and equity. Many funds (eg managed funds or with-profit funds) will offer a mix of these. If you are unsure how the funds offered by your scheme fall into these types you should check with your normal scheme contact.

* **Cash** - means money saved on deposit, for instance in the bank or building society.
* **Bonds** - are loans to the government or to a private company which generally pay a rate of interest until the loan is repaid.
* **Property** - means money invested in land and buildings.
* **Equities** - means shares in private companies.

> It's important to know which type your funds come under because that gives you an idea about how volatile the fund is and what its potential for growth is like. Ask your normal scheme contact if you're not sure.

Why some funds may be better for you than others

In a defined contribution (or money purchase) arrangement, the pension you get when you retire will be related to the performance of your investments and the value of your savings. Think about which funds will allow your savings to grow enough to buy the pension you want and think about your attitude to investment risk.

You could reduce your investment risk by choosing less volatile funds, although bear in mind there may be other factors that might affect the value of your fund such as inflation. Over the long term, the less volatile investments tend to produce lower returns. Your money might generally be safer but your pension pot is likely to be somewhat smaller and it will be more at risk of being eroded by inflation.

Charges that are deducted from your investment will also affect the amount of your benefit and you should look to see if these are higher or lower depending which fund you choose. If a fund has higher charges, you should check to see whether it offers greater growth potential to make the additional cost worthwhile.

Less volatile funds generally mean lower long-term growth potential and are more at risk of being eroded in value by inflation, but generally offer more safety for your savings.

Pension saving is a long-term commitment. To give your pension savings a better chance of growing more over the long term, you should think about investing in a more volatile fund. Think about how much investment risk you are prepared to take. The basic trade-off is:

* choose a less volatile fund where the long-term returns are likely to be lower; or
* choose a more volatile fund where the potential for long-term returns could be very good but the risk is likely to be greater (eg there could be falls in the price of the fund at the time you come to cash in your investment).

Pension saving is for the long term. With more volatile funds you are more likely to get better growth in the long term, but generally your savings are not as safe.

Choosing your funds

Here are some things to think about when you make your fund choices. Carefully choosing your funds may help you to balance the investment risk and the growth. You could choose to split your pension savings between a mix of funds, or change your fund choice over the course of your working life. For example, you might choose more volatile funds when you are young and then switch to less volatile funds as you get older and closer to retirement. Your choice might also be influenced by the level of charges and if a fund has higher charges, you should check to see if it offers greater growth potential to make the extra cost good value.

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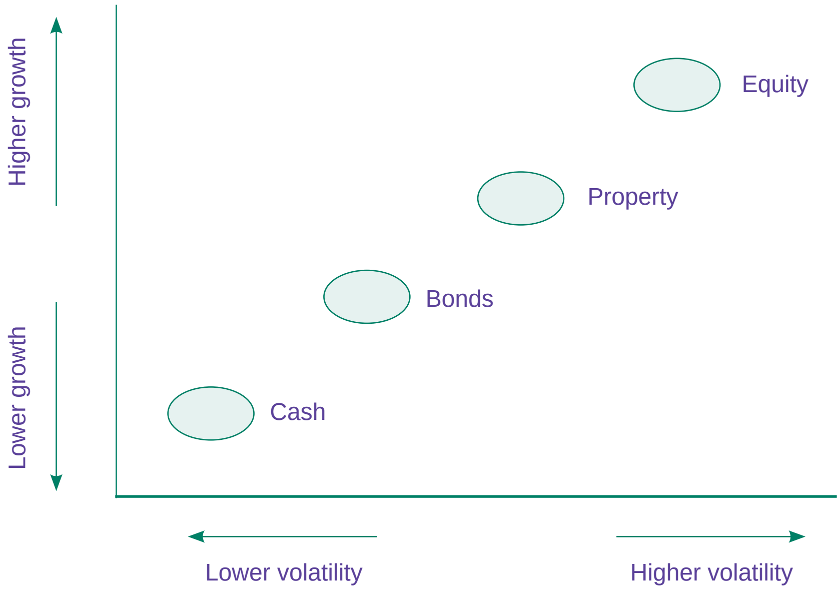
The chart below shows at a glance how as volatility increases so does the long-term potential for growing your pension savings. This is because there is usually a price to pay for the additional safety associated with less volatile investments. Remember that the way a fund has performed in the past is not necessarily the way it will perform in future, but fund types do tend to perform as shown in this chart over the long term.



This chart is general and you should look at the documents your pension scheme has sent you when you think about your fund choices. If you are unsure about where the funds offered by your scheme fall in this chart you should check with your usual scheme contact. They will explain the funds available including, for example, the differing levels of risk of different equity funds.

In choosing your funds you should also think about the personal factors that can influence your attitude to investing. A key factor is your age. The longer the period you expect to leave your pot invested, the more likely it is that the growth potential of a more volatile fund will be attractive to you. If you have other investments, pensions and sources of income which are lower risk, this is likely to mean that you can accept more volatility. Your attitude to financial risk is important, but remember that the growth potential of equity and property fund types means that they are likely to be suitable for most people, provided they can accept fluctuations in the value of their pension fund. These fluctuations may become less acceptable as you get older.

You should also think about your options in the context of the general economic situation. For example, in times of high inflation it may be even more important for you to monitor the performance of your funds. This is because the real value of fund returns (that is the return over and above the rate of inflation) will be lower.

Think about your personal circumstances and the economic situation before choosing your funds.

About default funds and lifestyle funds

Your scheme may allow you to invest your contributions in a default fund where you leave it to the people running your scheme to choose how to invest your pension contributions. A default fund may be a good way to invest but you should still bear in mind that although it may be chosen to suit many people, it may not be suitable for everyone. You should think about how closely the default fund matches your investment needs and if its long-term investment aims match your own.

Some default funds may have a lifestyle option. In a lifestyle fund, generally, as you get closer to retirement your savings will be moved automatically into funds that are less volatile. That can help to protect you from unexpected falls in fund prices that could reduce the pension you get. However, it can also mean that your funds are moved at a time when you may lose out on future investment growth, meaning you do not maximise the investment growth potential of your fund as you approach retirement. So you are still taking an investment risk.

If you decide to invest in any default fund or lifestyle fund offered by your scheme it is important you make sure its aims match your own. Even where you decide it is right for you, you should review your choice from time to time to make sure its aims continue to match your own.

Before you choose the default fund or lifestyle fund offered by your scheme, make sure its aims match your own. If you choose the default or lifestyle fund, keep your choice under review.

Reviewing and changing your fund choices

Pension saving is a long-term commitment and things will change as you get older. Over time your funds may not have grown as much as you hoped and your personal situation, your attitude to risk and the economic situation can all change. As things change you should consider if your fund choices are still right for you.

When you think about changing your fund choices, you should check whether there is a charge (sometimes called a ‘switching charge’) for moving your pension savings from one fund to another. If you make a lot of fund changes these costs can mount up.

Things change over time and you need to keep your investments under review. Be prepared to change funds, but also remember that changing funds can cost money.

Your pension scheme will send you an annual benefit statement which should show how your funds are performing. That will be a 'snap shot' of how your funds look at a given date (it might be your scheme's year-end date). You can form a view about how your funds are growing over time by comparing annual benefit statements and checking how the fund prices and values have changed. Your scheme or the insurance company may also have a website that shows you how your funds are doing.

Take a long-term view and watch trends over time. And think about changes in the personal factors important to you before you decide to switch funds. When you compare how funds have grown it is important to make fair comparisons, for example a cash fund is unlikely to offer the same growth potential as an equity fund.

> Make use of annual benefit statements and scheme or insurance company websites to monitor the performance of the funds you have chosen.

If you're not sure which types of fund are best suited to your situation and most likely to provide you with the pension or cash sum that you want at retirement, you should think about getting financial advice from a suitably authorised financial adviser.

> Think about the messages in this guide, read through your scheme literature and carry out a review of your current fund choices now.

Further information

We have consulted a number of organisations in the production of this guide, including the Financial Services Authority and representatives from the pensions industry. Further information about pensions and investments can be found at:

* **Moneymadeclear**
  www.moneymadeclear.fsa.gov.uk
* **The Pensions Advisory Service (TPAS)**
  www.pensionsadvisoryservice.org.uk