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FINANCIAL SOLUTIONS

Providing Financial Education

A guide to annuities and your options at retirement

This guide is designed to provide the basic information you need to start investigating your retirement opportunities.

AN INTRODUCTION AND YOUR OPTIONS

It takes many years of planning, saving and sacrifice to build up a significant pension – and after all those years you want to be sure you are making the most of it. Your pension plan provider will be keen to give you a quote for the income that your pension will provide but it would be sensible to take at least a little time considering what to do. Taking the first offer you get could mean giving up additional income.

What is an annuity?
An annuity is a guaranteed fixed income which you buy with a lump sum.

Its term may end either at a fixed date in the future, when you die or when another named person dies.

The most common reason for buying an annuity is retirement, when the lump sum which you have built up over the years through a company or private scheme is used to buy an annuity and thereby provide you with a lifetime income.

However, they can be bought by any investor requiring income, with a cash lump sum from any source.

What are the retirement rules?
It used to be compulsory to purchase an annuity at retirement.

However, now, you can take a 'pension commencement lump sum' of up to 25% of your pension fund at retirement and defer your annuity purchase, or you can draw an income direct from your fund instead.

Alternatively, you can combine annuity purchase, deferral and tax free lump sums so that you retire in stages over several years.

Not all these options are suitable for everyone and there are costs and risks associated with each. However this guide provides some basic points, and a visit to your professional adviser will help you look at each in more detail.

How is the rate of income determined?
Annuity providers first decide for how many years they will have to provide you with an income.

Therefore, annuity rates are based on a statistical analysis of how long you are likely to live, given your age, lifestyle and state of health. The rate will also depend on current views of long-term interest rates.

This guide is designed to provide the basic information you need to start investigating your retirement opportunities. It cannot make any recommendations or decisions but, armed with the information it provides, you can start to ask questions and, with our help, make sure your retirement is as lucrative as it can be.

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THE PROCESS OF BUYING AN ANNUITY

The first and most important question you have to ask is whether you want to buy an annuity at all.

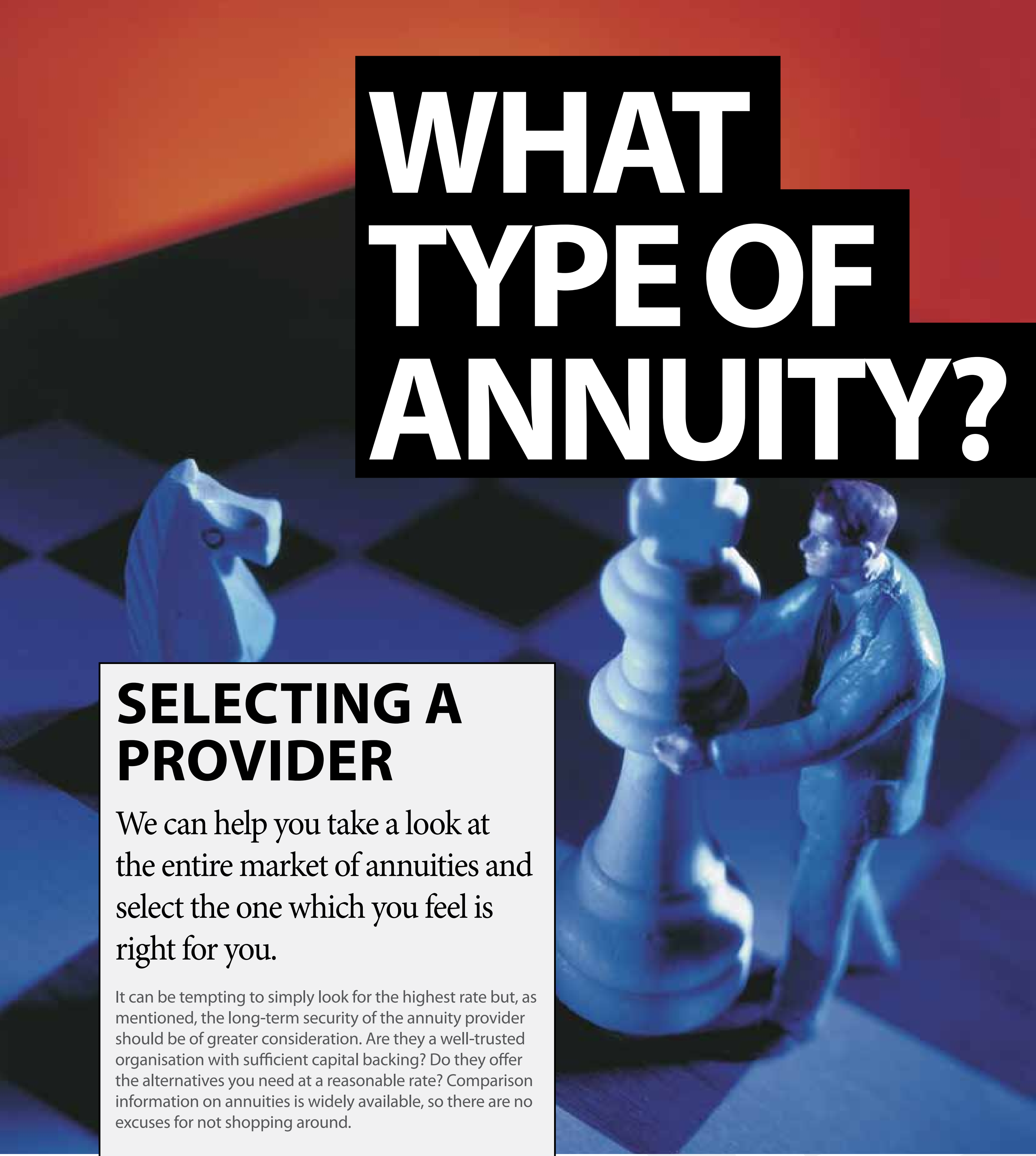
Always remember that you cannot change your choice once it is made so it is important to get that decision right.

Annuity rates will change according to the interest rate climate. Therefore, if you are buying at a time in the market cycle when interest rates are particularly low, you may not want to invest your whole retirement fund immediately.

Also, when deciding whether or not to buy an annuity, you should bear in mind that there is no possibility of benefiting from future investment growth on your fund.

In addition, unless you have written in certain guarantees, you will not be able to pass your annuity income on to your heirs, so if you die earlier than expected, the full purchase of an annuity will mean that much of that fund will be lost.

WHAT TYPE OF ANNUITY?



SELECTING A PROVIDER

We can help you take a look at the entire market of annuities and select the one which you feel is right for you.

It can be tempting to simply look for the highest rate but, as mentioned, the long-term security of the annuity provider should be of greater consideration. Are they a well-trusted organisation with sufficient capital backing? Do they offer the alternatives you need at a reasonable rate? Comparison information on annuities is widely available, so there are no excuses for not shopping around.

What is the open market option?
Over the years, you will have amassed a retirement fund either through a company scheme or through a private plan. At retirement, the pension provider will write to you offering a range of annuity options, one of which will be an 'open market option'.

This allows you the chance to take your retirement fund to a different annuity provider than the one with whom you have actually built up your fund. It is now a legal requirement to ensure you are made aware of what your open market option will be.

Could you accept some investment risk?

Investment linked annuities invest your money into stocks and shares on the basis that investment growth could offer the potential for higher income payments in the future without the need for you to buy inflation protection.

There are risks to this approach, however, as your investment might not grow – indeed it might fall. Even if the investment does grow, it may not be in line with what you expect – so either your income will then have to fall or will be maintained but will eat into the value of your investment.

If that possibility concerns you at all, you should stick to conventional annuities.

Do you want to buy from more than one provider?

Although the income from annuities is guaranteed, retirees still have to take a risk on the provider. As the Equitable Life incident demonstrated, no company is 100% safe. That said, changes in legislation following the problems at Equitable Life mean that annuity providers are now better capitalised, so investors have greater protection than before.

However, as with any investment portfolio, you may feel more comfortable spreading your risk across a number of different providers, which may make other choices easier.

For example, you could inflation-proof part of your income or put a smaller amount into a joint life annuity to provide for a dependent.

Would you like protection against inflation?

The inflationary environment has been benign for a number of years. However, since December 2009, the Consumer Price Index figures have been above the Government's target rate of 2%, demonstrating that the potential for increased inflation still exists.

Even with inflation at a relatively low rate, a fall of just 2% every year in your disposable income could have an important impact. Protecting your annuity against inflation will cost you more in the short-term, but may give you piece of mind in the long run.

Single life or joint life?

This will depend on whether you have a partner you need to provide for after your death. If you have a single life annuity, the rate of income you get will be based on your age and state of health.

If you have a joint life annuity, it will be based on both of your ages and states of health.

If your partner is materially younger or healthier than you, you will find that the rate of income available is much lower than it would be for your own single life.

Would you like a guarantee period?

Having saved for years for a decent retirement fund and then bought an annuity, there is the unfortunate possibility that you will die early, the annuity will then end and much of that fund will go to waste.

This encourages some retirees to put off buying an annuity for as long as possible. The alternative is to buy an annuity with a guarantee.

This guarantees the income will be paid for a set period even if you die earlier, meaning your heirs will get some benefit.

Do you qualify for an 'enhanced' annuity?

If you are suffering from a life-shortening condition, such as heart disease or cancer, you can get an 'enhanced' or 'impaired life' annuity.

Some life offices also provide these annuities for 'lifestyle choices' like smoking. In general, the term 'impaired life' annuity is used where there is a reasonable expectation that the person will die within five years.

An 'enhanced' annuity is for someone whose life expectancy is reduced but not perhaps to such an extent.

We can help you take a look at the entire market of annuities and select the one which you feel is right for you.

WHAT ARE THE ALTERNATIVES?

It is very important that you understand that all the alternative options involve an element of investment risk.

They are only suitable if you are prepared to accept some investment risk in retirement.

If you do not think that a conventional annuity is the best way for you to take pension benefits, then there are alternative options open to you.

Deferred annuity purchase

Deferring the purchase of an annuity to older age might mean the rate of income you can get increases. If you have the flexibility, you may also be able to choose a more favourable time in the interest rate cycle and benefit from any growth in your pension pot for longer.

Of course, always be aware that it also means that your retirement fund can be eroded by poor investment performance, lower interest rates or difficult markets or even recalculation of age expectations, the risk of which must be weighted against the potential gains.

If you defer the purchase of an annuity you can arrange an unsecured pension (drawdown) scheme for the interim which allows you to draw an income direct from your pension fund.

The rest stays invested until you want to use it to buy an annuity. Investors can vary the amount of income, subject to HMRC maximum limits. Those who want to continue working could initially draw a smaller pension but increase the amount slowly until retiring fully. Or, take the tax free lump sum but leave taking any income until further down the line. This option is flexible but can be expensive so is generally only worth considering if your pension fund is at least £100,000+.

Tax-free lump sum

At retirement, you would get part of your tax-free lump sum, plus a mini-annuity or a mini drawdown plan, which would use up part of your overall fund (up to 25% under current rules).

You would then have the option to take more of your tax-free amount and convert more of your pension pot to an annuity or drawdown plan as your needs change.

Other options

There are other options such as short term annuities and lifetime cash flow products.

For example: the latter is designed to guarantee a certain percentage as an income each year for life. Investors retain control of the assets and have access to the remaining capital at any time. To ensure you consider the full range of options, we would suggest you consider getting professional advice.

If you would like to take a closer look at your own circumstances and discuss the best options to meet your needs, call us and speak to your professional financial adviser.

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