A retirement income you can rely on for life

All you need to know about annuities

Retirement is a time of life to look forward to, especially now you have the freedom to spend your retirement savings as you choose. The priority for most individuals is to use their savings to generate an income. One option you have is to use your pension fund (in full or in part) to purchase an annuity, a product which provides you with a guaranteed income for life.

Here we explain what annuities are and why they might be a good idea. We also explain their disadvantages. It's really important to consider all the pros and cons carefully prior to buying an annuity. Your adviser can help you determine whether it's the right option for you and if so, select the best one for your needs.

Pension wise
Your money. Your choice.

In addition the government also offers a free and impartial guidance service to help you understand your options at retirement. This is available via the web, telephone or face-to-face through government approved organisations, such as The Pensions Advisory Service and the Citizens Advice Bureau. You can find out more by going to pensionwise.gov.uk or by calling Pension Wise on 0800 138 3944.

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What is an annuity?

An annuity pays you a guaranteed income for life. The exact amount you receive depends on a number of factors. These include:

- Your age – the older you are, the higher the annuity rate will be
- Your health – if you are in poor health you should receive a higher rate
- The type of annuity you buy (we cover the options in more detail over the next two pages)
- Where you buy the annuity from – some insurance companies offer better rates than others. Some pay you up to 30%[1] more (this can amount to thousands of pounds over your lifetime). It's therefore very important to shop around and your adviser will be able to help you find the best deal

An annuity is purchased from your pension savings, although you don't have to spend your whole fund when you buy one. The income paid to you is taxable.

Can I take a tax-free lump sum before purchasing an annuity?

Yes, you can normally take up to 25% of your pension as a tax-free cash sum prior to buying an annuity. You can invest or spend this amount as you wish.

Why might an annuity be a good idea?

As they pay a secure income for life, annuities can be a good choice if you are looking for security and peace of mind. We are living longer today – the average life expectancy for a 65 year old is currently 86 years for a man and 89 years for a woman[2] – and having an annuity ensures your income won't ever run out. Another advantage is you don't have to manage your pension income on an ongoing basis. Annuities are also fully protected by the Financial Services Compensation Scheme. This means that if anything should happen to the company you bought your annuity from, your pension income will not be affected – you will continue to receive 100% of your income.

It's also worth remembering you don't have to use all your savings on just one option. You could, for instance, use some of your savings to buy an annuity which covers your day-to-day living expenses. The remainder of your pension could then be used to fund optional items like holidays, eating out and replacing the car every few years.

1 Source: Annuities explained, Which?, June 2016. 2 Source: ONS, May 2016

What types of annuity are there?

There are many different types of annuity and we've listed the main ones below. However, selecting the right one for you and your family is very important and so we recommend you talk to your adviser before making any decisions.

- **Flat rate or 'level' annuities** – these pay you the same amount of income over the course of your life. However, this does mean your income will be affected by inflation (you'll have less 'purchasing power' as you get older)
- **Increasing annuities** – these pay you an income which gradually rises over the course of your retirement and so you have some protection against inflation. This could be a yearly fixed increase, say 2% a year or in line with a measure of inflation. However, the starting income is usually much lower than for a level annuity
- **Single life annuities** – these pay you an income for your lifetime only and no provision is made for your spouse or dependants. Payments usually stop on your death, unless you have chosen to add extra features to your annuity
- **Joint life annuities** – these pay an income to your spouse or civil partner when you die, although this option will affect the rate that you get when you make the purchase
- **Impaired or enhanced annuities** – these pay you a higher rate if you are suffering from a medical condition. You may qualify, for example, if you have high blood pressure, high cholesterol, smoke or are overweight. It's surprising how many people miss out on higher rates simply because they think a life-threatening condition is required to qualify. This is not the case and we recommend that you complete a medical questionnaire whenever you buy an annuity
- **Investment-linked annuities** – these pay you an income linked to the performance of investments managed by the annuity provider (you will typically be able to choose from a range of investment approaches). The starting income will depend on the anticipated returns of the investments. However, your future income may rise if they perform better than expected, although the income may also fall if the investments perform poorly. Reassuringly, the annuity will pay you a guaranteed minimum income, although this is likely to be less than for a level annuity
- **Fixed term annuities** – these pay you a fixed income for a set period (this could be for as little as three or as long as 25 years). A guaranteed sum may be returned to you at the end of the period depending on the income amount and number of years selected. The advantage of a fixed term annuity is that you can reassess your options at a later stage. At that point you will be older or may have health problems, for instance, which could mean you'll be able to secure a higher income from the sum that is returned to you (although this isn't guaranteed). They can also be useful if you wish to fill a specific income gap you may have over a set period of time. For instance, if you need a certain level of income before your State Pension becomes available

What are the potential drawbacks?

A annuity isn't right for everyone. There are a number of issues to consider so please speak to your adviser if you need to talk these through:

- If you die relatively early, the income paid to you may be less than the cost of the annuity. Whether the surplus funds are passed on to your loved ones depends on the options you select when you first buy the policy
- Annuities are not flexible – you can't usually switch to a different contract or provider once you've bought one
- Unless you buy an increasing annuity, your income will remain the same each year and so it will be worth less in real terms as the years go by
- While your income is guaranteed, you won't benefit from improved economic conditions or future stock market growth (unless you buy an investment-linked annuity)

Some things you should keep in mind

Before you buy an annuity, it's worth remembering some key points:

- Make sure you get the best deal – never simply accept the annuity offered to you by your pension provider without shopping around for a higher rate. Talk to your adviser about what deals are available in the market
- Some older pension policies come with some valuable benefits. So, while shopping around is a good idea, taking a higher rate elsewhere may not necessarily be the best option. You should always check your policy first before making any decision
- If you have any health problems – or are taking regular medication – make sure you declare this to your insurer or adviser before you make your purchase. You may be entitled to an enhanced annuity which pays a higher income
- Think about the features you want built into your contract – do you want it to pay a spouse's pension, for instance or offer some protection against inflation?
- When you need some help, make sure you talk to your adviser. Some advisers only recommend annuities from a restricted range. Some will look across the whole market and offer you a range of quotes to choose from. It's worth remembering that annuity providers change their rates and conditions all the time. The top provider today may not pay the best rate tomorrow

Want to talk about annuities?

Have a chat with your adviser today.

Important information

Please remember that the value of investments and the income from them can go down as well as up, so you may not get back as much as you invest. Whether you are eligible to invest in a pension depends on your personal circumstances. All tax rules may change and the value of tax savings depends on personal circumstances. You cannot withdraw money from your pension until you are 55.

This information is not a personal recommendation for any particular product, service or course of action. Pension and retirement planning can be complex. If you are unsure about your options please speak to your adviser.

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