GUIDE TO ANNUITIES

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.

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

WHAT IS AN ANNUITY?

An annuity is a regular fixed income that you buy with a lump sum. Its term may end 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 you have built up over the years through a company or private pension scheme is used to buy an annuity and thereby provide you with a lifetime income. However, annuities can be bought with a cash lump sum from any source by any person who requires income.

WHAT ARE THE CURRENT 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 certain costs and risks associated with each - but they all deserve at least some consideration before you make your final decision.

This guide therefore provides an outline of the basic points while a visit to your professional adviser will help you consider each in more detail.

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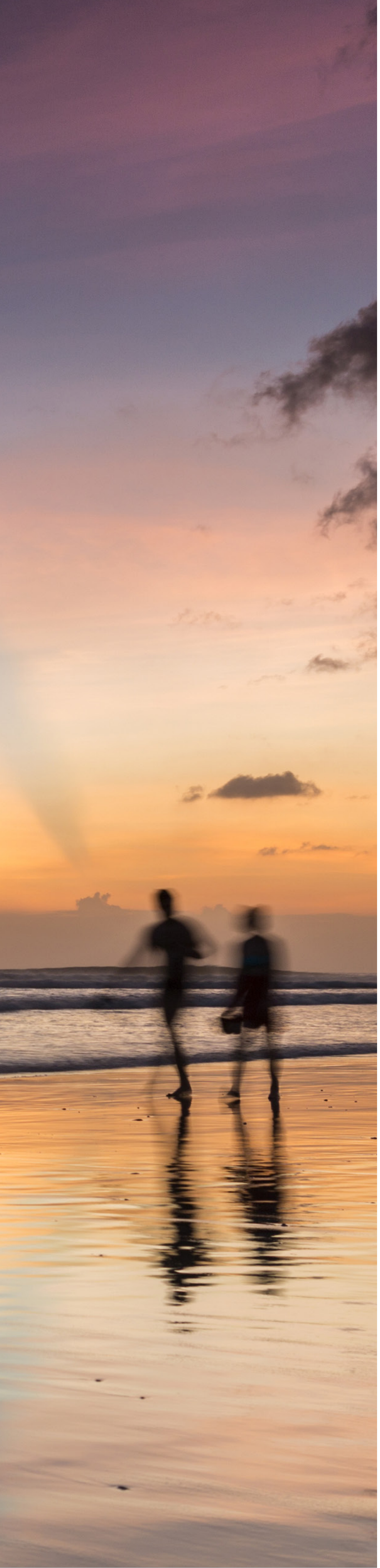
BUYING AN ANNUITY
THE PROCESS



The first and most important question you have to ask is whether you want to buy an annuity at all. A number of alternatives are outlined overleaf.

Always remember that, once you have purchased a specific annuity, you have it for life – you cannot go back on your choice – so it is important to get that decision right. Annuity rates will change with the interest rate climate so, for example, if you are buying at a time when interest rates are particularly low, you may decide not to invest your whole retirement fund immediately and retain some of it instead.

In addition, when considering whether to buy that annuity, remember doing so will consolidate the value of your investment – unless you buy an investment-linked annuity (see below), there is no possibility of benefiting from future growth. In addition, unless you write in certain guarantees, you will not be able to pass any of that value on to your heirs. If you then die earlier than expected, the full purchase of an annuity would mean much of the fund would be lost.

SELECTING A PROVIDER

It can be tempting simply to look for the highest rate you can find and take it. However, the long-term security of the annuity provider should be of greater consideration, as should the safeguards you include to protect yourself against inflation. Increasing life expectancy means retirement could now last 20 years or more.

Comparison information on annuities is widely available, so make sure you shop around. We can help you look at the entire market of annuities and select the one that is right for you.

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WHAT TYPE OF ANNUITY SHOULD YOU BUY?

1) Single life or joint life?
This will depend on whether you have a partner for whom you need to provide after your death. If you have a single life annuity, the income you receive will stop if you die before your partner. If they have no income provision of their own, this could leave them in a difficult situation that a joint life annuity would have helped to alleviate. However, as the joint life annuity will be based on your combined life expectancy, the income you receive from this option will be lower than that of a single life annuity.

2) Would you like protection against inflation?
Since December 2009, the annualised rate of inflation - as measured by the Consumer Price Index - has remained above the Government's target rate of 2%. This demonstrates the constant potential for increases in the cost of living. However, even with inflation at a low rate, a fall of just 2% every year in your disposable income could have a substantial impact over the long term. Protecting your annuity against inflation will cost you more in the short term but may provide peace of mind in the long run.

3) Would you like a guarantee period?
Having saved for years for a decent retirement fund and then purchased an annuity, it is unfortunately possible you might die earlier than expected. This means the annuity will cease and most of the funds accrued over the years will ultimately be wasted. This encourages some retirees to put off buying an annuity for as long as possible (see overleaf). An alternative, however, is to buy an annuity with a guarantee. This ensures a guaranteed income will be paid for the rest of your life or for a specific period, which means, even if you die earlier, your heirs will receive some benefit.

4) Could you accept some investment risk?
Investment-linked annuities invest your money into stocks and shares on the premise that investment growth could increase the potential for higher income payments in the future, without the need for you to buy inflation protection (see '2' above). There are risks to this approach, however, as your investment might not grow – indeed it might actually fall. Alternatively, even if the investment does grow, it might not grow in line with your expectations. In these circumstances, either your income will have to be cut or it will have to be maintained

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at the expense of the capital value of your investment. If that possibility troubles you at all, you should stick to conventional annuities.

5) Do you want to buy from more than one annuity provider?
Although the income from annuities is fixed, retirees still have to take something of a chance on the provider. As the near-collapse of Equitable Life 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 could also make other choices easier. For example, you could 'inflation-proof' just part of your income or put a proportion into a joint life annuity if you need to provide for a dependant.

6) Do you qualify for an 'impaired life' or an 'enhanced' annuity?
If you are suffering from a life-shortening condition, such as heart disease or cancer, you can qualify for an 'impaired life' annuity. Alternatively your lifestyle - for example, if you smoke, are overweight or have worked in a hazardous occupation - might mean you qualify for an enhanced annuity In general, the term 'impaired life' annuity is used where there is a reasonable expectation the person will die within a few years. An 'enhanced' annuity is for someone whose life expectancy is reduced, but perhaps not to such an extent.

HAVE YOU CONSIDERED THE 'OPEN MARKET OPTION'?

Over the years, you will have amassed a retirement fund through a company scheme and/or a private plan. At retirement, your pension provider will write to you offering a range of annuity options, one of which will be an 'Open Market Option'. This is important as it allows you to move your retirement fund to a different provider from the one with whom you have actually built up your fund. Your pension provider is now legally required to spell out your choices and to ensure you are made aware of the Open Market Option.

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ARE THERE ANY ALTERNATIVES?

DEFERRING PURCHASE

Deferring the purchase of an annuity to older age might mean the rate of income you can obtain increases. If you have the flexibility, you might also be able to choose a more favourable time in the interest rate cycle and therefore benefit from any further growth in your pension pot. Of course, you should always be aware that the value of your retirement fund could be eroded by poor investment performance, lower interest rates or difficult markets – or even a recalculation of life expectancies – and you should weigh these risks against the potential gains.

INCOME DRAWDOWN

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. You can then choose the amount of income you want (subject to maximum limits set by HM Revenue & Customs) so, for example, those who want to continue working could initially draw a smaller pension and increase the amount slowly until they retire completely. Alternatively, you could take just the tax-free lump sum and leave any income until further in the future. This option is flexible, but it can be expensive, so is generally only worth considering if your pension fund is of a significant size.

PHASED ANNUITY PURCHASE

Phased retirement is really a series of 'mini retirements'. It allows you to buy an annuity or draw down income in stages, rather than all at once. You decide the level of income you need each year and take that amount from the plan. However, you must already be in receipt of a secure pension income of at least £20,000 per year from other registered pension schemes. Clearly, the level of annuity rate will vary - factors such as your age and interest rates will change every year and could either prove beneficial or work against you, depending on the prevailing environment. The rest of your pension pot remains invested and any growth will depend on how it is invested. It should also be noted that, once you have started a phased annuity purchase, you cannot change your mind.

OTHER OPTIONS

There are other options, such as short-term annuities and lifetime cashflow products. The former, for example, is an agreement between you and an insurance company in which you pay over part of your pension fund and the insurance company pays you an income for a fixed period of no more than five years. This option might be suitable for an individual who wants to defer buying a lifetime annuity because they believe annuity rates might improve in future.

WHATEVER YOUR THOUGHTS, TO ENSURE YOU TAKE ACCOUNT OF THE FULL RANGE OF AVAILABLE OPTIONS, WE WOULD SUGGEST YOU CONSIDER OBTAINING PROFESSIONAL FINANCIAL ADVICE.

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