

# A GUIDE TO BUYING AN ANNUITY

SCALE NEW HEIGHTS  
AND BUILD A BIGGER  
RETIREMENT INCOME



# A GUIDE TO BUYING AN ANNUITY

## SCALE NEW HEIGHTS AND BUILD A BIGGER RETIREMENT INCOME

You've spent years putting money aside into a pension scheme, but what actually happens once you retire? Sadly, it's not as simple as just withdrawing the money. You must now convert your pension pot into an income that will last you for the rest of your life, which is typically done by buying an annuity.

You'll need to buy an annuity with funds from any personal pensions, stakeholder pensions and most defined contribution (money-purchase) employer schemes that you've been saving into throughout your working life.

### WHAT FACTORS AFFECT YOUR ANNUITY RATE?

An annuity is a financial product where you exchange a lump sum for income. How much you get will depend on a number of factors. These can include:

**Your savings** - how much you have managed to save in your pension 'pot' throughout your working years

**Where you live** - annuity providers sometimes base annuity rates on mortality rates in different parts of the UK. If the area you live in has low mortality rates, you may get a higher rate as the insurer assesses that you're likely to die sooner and therefore they need to make payments to you for a shorter period.

**Your health** - similar to postcode pricing, if you're in poor health, annuity providers will assess that you have a lower life expectancy and, thus, a shorter period for them to pay out for. This could increase the rate that you receive, or qualify you for an enhanced annuity.

**The annuity rates offered by individual annuity providers** - there are lots of different annuity providers and competition in the annuity market, so rates can vary between providers. When you're looking to buy an annuity, it's essential that you shop around for the best rates, taking advantage of the open market option.

### WHO SHOULD BUY AN ANNUITY

Annuities are only suitable for members of defined contribution (DC) pension

schemes. If you belong to an employer's defined benefit (final salary) scheme, your pension is usually paid directly from the scheme, so you don't have to buy an annuity.

Also, with some money purchase pension schemes from employers, the pension trustees may buy an annuity for you.

You'll be prompted to buy an annuity from your pension provider between five years and six months before you retire, with a wake-up pack sent out four to six months before. If you express interest in buying an annuity, you'll get a follow-up pack six to ten weeks after your retirement date.

### ANNUITY RATES

There are a number of factors that affect the annuity rate that providers can offer, beyond your own personal circumstances. These can include:

- The value of government bonds, or gilts, which insurance companies buy to fund annuities
- The Bank of England base rate, which has an influence of the level of interest the government will pay on its bonds.
- Demand for gilts - when they are in high demand, interest payments fall, depressing annuity rates. When they are in low demand, rates may rise
- Other monetary policy - quantitative easing (QE) has also affected annuity rates, as this pushes gilt yields down further, as the purchase of gilts in mass quantity by the Bank of England has reduced interest payments.

### ANNUITY OPTIONS

When you buy a pension annuity, you exchange a lump sum for an income

payable for the rest of your life. However, the type of income you decide to have will make a big difference to the amount you receive.

#### The main factors to consider are:

- Whether you want protection against inflation during retirement
- How much risk you are prepared to take
- Whether anyone else is dependent on you
- How much flexibility you need to change your pension after it has started to be paid
- How much control you want over your investments
- What charges you will need to pay
- Whether you want to provide an inheritance for your survivors
- What your general state of health is and whether you are or have been a smoker

### LEVEL OR INCREASING ANNUITY?

You'll need to decide whether or not you want your income to increase each year. You can buy an annuity that increases with inflation, or one that's set to rise by a fixed percentage each year. Alternatively, opt for a level annuity, which will provide exactly the same income each year.

### LEVEL ANNUITIES

Level annuities are the most popular type, probably because they offer

the highest starting income, but they do leave you vulnerable to inflation. Remember that a 4 per cent rate of annual inflation will halve the buying power of an annuity in 18 years.

However, if you buy an annuity with protection against inflation, you'll have to accept a lower starting income. Although your income increases over time, it might be many years before it catches up with a level annuity.

### INCREASING (ESCALATING) ANNUITIES

You probably need to think about your plans for retirement before deciding whether or not you want an increasing annuity. Do you want to maximise your income during the early, healthiest years of your retirement, or do you want equal purchasing power over the years?

### ANNUITY GUARANTEES

Where an annuity has a guarantee period, it will be paid out for a set time period, usually 5 or 10 years, even if you die during that time. If you do die during the guarantee period, the payments may continue as an income to your survivor(s) for the remainder of the period, or can sometimes be rolled into a lump sum.

An annuity with a guarantee is sometimes seen as a substitute for a joint life annuity. But it's not the same, as the maximum guarantee period is only 10 years. As a result, it won't fully protect your dependants in the long term.

### BUYING AN ANNUITY

Once you've bought an annuity there's no going back, so you've got to get it right first time.

If you're in poor health, you may be eligible for an enhanced or impaired annuity. These pay better rates because the annuity providers expect to pay the annuity over a shorter period. The rate enhancement can be as much as 60 per cent.

### ENHANCED ANNUITIES

At least one in three of us could be eligible for a higher income when we retire. All you have to do is buy a type of annuity that pays out a higher income if you're in a poor state of health. The trouble is that most of us don't realise it.

An enhanced annuity works on the basis that you will have a shorter lifespan than someone in a better state of health - essentially using up your pension fund more quickly by giving you access to more money each year. ■



**IF YOU ARE SINGLE WITH NO DEPENDANTS, CRITICAL ILLNESS COVER CAN BE USED TO PAY OFF YOUR MORTGAGE, WHICH MEANS THAT YOU WOULD HAVE FEWER BILLS OR A LUMP SUM TO USE IF YOU BECAME VERY UNWELL.**



## Income for life with an annuity

Buying an annuity will allow you to convert your pension savings into a regular income for life – however, it's all about shopping around for the best annuity rate so you get the highest income you can in retirement. To help you make an informed choice, please contact us today - we look forward to hearing from you.

Content of the articles featured in 'A guide to buying an annuity' are for your general information and use only and is not intended to address your particular requirements. They should not be relied upon in their entirety and shall not be deemed to be, or constitute, advice. Although endeavours have been made to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No individual or company should act upon such information without receiving appropriate professional advice after a thorough examination of their particular situation. We cannot accept responsibility for any loss as a result of acts or omissions taken in respect of any articles. The pension and tax rules are subject to change by the Government. Tax reliefs and State benefits referred to are those currently applying. Their value depends on your individual circumstances. The performance of the investment funds will have an impact on the amount of income you receive. If the investments perform poorly, the level of income may not be sustainable.