Your Guide to Retirement Options and Annuities

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Dear Client

Getting the right information to help you retire is not easy. There are many options and your choices can feel confusing and complex, this combine with many online businesses only offering a ‘non advised’ service this can often mean that you are not fully informed and may lead you to not be making the right choice for you.

We wrote this guide to help you make more informed intelligent decisions and if you have any questions you are invited to call on 01722 717427 and we will be very happy to help.

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Before we delve deeper into strategies, it is probably better to first explain the basics of your options for your pensions.

We will cover the following in the guide:

- Your main options for your pension
- The choices you will have within those pension options
- Strategies you have available for both your pension money and your non pension money.

Your main pension options are:

- ✓ A Life Time Annuity
- ✓ A Fixed Term Annuity
- ✓ A With Profits Annuity
- ✓ A Unit Linked Annuity
- ✓ Income Drawdown
- ✓ Phased Retirement

The options you have with those choices are:

- ✓ Taking part of your pension as a tax free lump sum
- ✓ Guaranteed annuity rates
- ✓ Level or increasing payments
- ✓ Adding a spouses pension
- ✓ Guarantees on your death

Strategies we will talk about are:

- ✓ Getting enhanced annuity rates
- ✓ How to potentially increase you pension income
- ✓ Should you take your pension now? Or wait?
- ✓ How to protect your pension values from market falls
- ✓ How to make 'proper' comparisons
- ✓ Savings and Investment strategies for you non pension money

Lets look at each of these in isolation:

What is an Annuity?

An annuity is a secure, regular income purchased from an insurance provider. The insurance company is then responsible to pay you that secure income.

The Insurance company calculates the amount they can provide you based on an interest rate they are prepared to pay and what they consider your life expectancy to be (your mortality rate).

These annuities can be set for fixed terms or for the rest of your lifetime and the capital invested can come from either a pension fund or money outside of a pension fund. The tax treatment of these differ, this guide will focus on money coming from a pension fund.

Example

Terry invests £71,500 from his pension into a lifetime annuity, this annuity then provides him with £4,045 per annum for the rest of his life. (These figures are an example for a 60 year old, non smoker, in good health, single life, level annuity with no guarantees as at, rates vary and therefore these figures are to show an example only).

Lifetime Annuity

As mentioned the conventional annuity is a lifetime annuity. This means that the payments would continue for the remainder of your life. Depending on the options you select will depend on what happens on your death.

The advantages of a lifetime annuity are:

- Provides a guaranteed amount of income for life.
- No investment risk on returns.
- Can be tailored to suit individual circumstances.
- Simple to understand.

The disadvantages of a lifetime annuity are:

- Unless cover is purchased then the income will cease on your death.
- Cost of spouses pension can be high.

• Inflation can impact on income

• Once you have purchased the annuity then you cannot change your options.

Fixed Term Annuities

Fixed term annuities are designed to provide consumers with greater flexibility with their annuity. This is because with conventional annuities once you have made your decision then you cannot change your mind. You select a specific term (eg. 5 years) and the insurance company will provide you with a set payment for that period of time and then a maturity value at the end. The reasons to consider this include:

• Annuity rates may increase.

• You may have had health problems during that time and therefore now qualify for an enhanced rate.

• Your need for options (such as a spouses pension) may have changed.

This will give you the advantage that when the term ends (or even during the fixed term with some companies) you can change you options and use the open market option to shop around for a potentially better rate.

Example

£100,000 invested in a 5 year fixed term annuity. This provides an income of £4,800 per annum over the 5 years. The maturity value is then £84,170 (these figures are an example based on a 60 year old, non smoker, in good health, single life, level annuity with no guarantees. Rates vary so these figures are for example purposes only).

You should be aware that the payments for the fixed term annuity are less than that of a lifetime annuity and also the maturity value is less than the original value invested. Therefore there is now less money for the new annuity and therefore even if annuity rates have increased you may still be getting less than if you had purchased the lifetime annuity at the lower rate with the original value. However with some providers the death benefits can be enhanced during the fixed terms and also some providers allow you to break the contract early and utilise your open market option.

Advantages

- Gives you the flexibility to change your annuity options.
- Gives you the potential to access higher annuity rates at a later stage.
- You can potentially gain access to enhanced rates if your health declines.
- Provides potential of higher death benefits at a lower cost.

Disadvantages

- Provides a lower initial payment than that of a lifetime annuity.
- You have less fund to utilise for another annuity on maturity and therefore could still provide less income for the future.

There is more to consider here than the conventional lifetime annuity and therefore advice is recommended. It is advisable to obtain quotes on these so that they can be compared against the lifetime annuities.

With Profits Annuities

Unlike conventional lifetime annuities where the income level is guaranteed, the level of income with a With Profits annuity is linked to the performance of a With Profits investment fund.

The investment performance of the With Profits investment fund is taken into account in the bonuses the annuity provider declares. Provided a pre-selected rate of growth is achieved, income could be higher than a conventional lifetime annuity and could possibly even increase over time. However, the income could go down even below that of conventional lifetime annuity if the required growth rate is not achieved. Therefore With Profit annuities are more risky than conventional lifetime annuities as they depend on future investment returns within the With Profits investment fund which the bonuses declared by the with profits annuity provider rely.

You are able to select the same benefits as with the conventional lifetime annuity (such as a spouses pension, guarantees, etc). You will also have to select the rate of increase at the outset, this 'Anticipated Bonus Rate' (ABR) is chosen between 0% and 5%. Providing the declared bonus rate of that particular life office is higher than your ABR then the income of your annuity will increase that year, if lower then it will decrease.

Unit Linked Annuities

These work in a similar way to With Profits Annuities. The monies are invested into underlying investment funds which are usually more volatile than that of With Profits, however present a greater chance of capital growth. You select an income level an outset, this is using an anticipated growth rate (AGR). Therefore your income can fluctuate up or down dependant on the performance of the investment funds. This is therefore a higher risk option than that of a conventional lifetime annuity and a With Profits annuity. It should be stated that the higher you set the anticipated growth rate the greater the risk as the investment may not provide those expected returns.

Pension Drawdown

(Also Known As Income Drawdown)

This is a way of taking your tax free lump sum and certain income levels without locking yourself into and annuity. Advice should always be sought when considering this to ensure suitability.

This allows you to keep your remaining pension fund (after taking any tax free lump sum) invested into underlying investments (whether this is with your existing company or transferring to another provider). The income level that you select is between 0 and 100% of GAD rates (rates set by the government actuary department) and these can be varied each year. This can therefore be a way of consumers to access their tax free lump sums and keep their pension invested without it being reduced by taking income.

It is the purpose of any growth within the pension to replace the selected income you are taking out of the pension and also to provide potential capital growth on top. Of course if the rate of growth is lower than the income taken or there is a capital loss then this will impact the value of your pension pot.

The main aim of drawdown is to provide you with your tax free lump sum and income in retirement without relying on annuity rates. The idea is for the growth to provide your income (or even some growth on the pension pot) so that you can purchase an annuity at a later stage and since you are now older you will be able to potentially access higher annuity rates. Also if your health has deteriorated then you may be able to access enhanced annuity rates. The converse of this is if there is poor growth or even capital loss, this could mean that you have a smaller pension pot to use to purchase the annuity and could put you at a financial disadvantage.

In the event of your death your spouse will have a few options. They can take the value of the fund as a lump sum (minus a tax charge which is currently 55%). They could also buy an annuity or remain in drawdown.

It must be stated that this is still an investment and your needs, goals and risk level should be reviewed and reflected in the underlying funds. This should be reviewed on an annual basis to ensure that your goals are met and changes made where needed.

The advantages of drawdown are:

- You can access your tax free lump sum, without the need to take
- an income straight away.
- You have control over the amount and timing of income.
- You can benefit from potential capital growth on your fund .
- You have greater flexibility on death benefits.
- You have flexibility with your options and when to buy into and annuity to maximise on the suitable rate for you.

The disadvantages of drawdown are:

- Taking too much income in the early years could have a detrimental impact on your fund and the purchasing power
- for the future.

- A capital loss can happen and this can impact on future income and the purchasing power of an annuity in the future.

Risk Warnings
- High income withdrawals may not be sustainable during the deferral period.
- Taking withdrawals may erode the capital value of the fund, especially if investment returns are poor and a high level of
- income is being taken. This could result in a lower income when the annuity is eventually purchased.
- The investment returns may be less than those shown in the illustrations.
- Annuity rates may be at a worse level when purchase annuity
- takes place.

Phased Retirement

Instead of using the whole of your pension fund to purchase an annuity, you can use part of your fund in phases.

You use part of your pension pot each year to purchase an annuity and also you use the tax free lump sum from that part of the vested pension to top up you income for that part of the year. By doing this you may get better rates each year on the pension you vest (as you are older and annuity rates may have increased) and also as part of your income is from the lump sum you will not get taxed on that part as it is tax free. This will also give you greater flexibility on your options as you choose which options you want (spouses pension, etc) each time you vest part of your pension. It must be stated that your previous options will be locked in.

Example

Pension pot of £100,000
Year 1, £25,000 invested (of which £6,250 is your lump sum and £18,750 goes into an annuity which produces £1,033 per annum). So you first years income is £7,283.

Year 2, another £25,000 invested (£6,250 lump sum and £18,750 into the annuity which produces £1,059 per annum). So income for year two the income is £1,033 + £1,059 + £6,250 = £8,342.

Year 3, another £25,000 invested (£6,250 lump sum and £18,750 into the annuity which produces £1,086 per annum). So for year three the income is £1,033 + £1,059 + £1,086 + £6,250 = £9,428.

Year 4, as you kept money invested it has grown by £12,000. You invested the remaining £35,000 (£8,750 lump sum and £26,250 into the annuity which produces £1,574 per annum). So income for year four is £1,033 + £1,059 + £1,086 + £1,574 + £8,750 = £13,502.

Year 5, as you have used the lump sums you now have an ongoing income of £4,752 per annum.
If you had invested the whole pot on year one the same rate on £75,000 (after your tax free cash) would mean an annuity of £4,244 per annum.

Therefore by phasing you have uplifted your ongoing income. (These figures are an example for a 60 year old in year one rising over the years, non smoker, in good health, single life, level annuity with no guarantees as at, rates vary and therefore these figures are to show an example only).

The advantages of phased retirement are:

• Flexibility on choosing your retirement options each time you invest part of your pension.
• Ability to access potentially higher annuity rates (as you are older and they may have increased).
• If your health has deteriorated you may get access to enhanced annuity rates.
• The tax free lump sum is not taxed, so it reduces your tax during the time you are using it for income.

The disadvantages of phased retirement are:

• You are using up your tax free lump sum over a short period of time to provide the income, you therefore have less capital for the future.
• Annuity providers have minimum levels they will accept (and some uprate their annuity rates for higher purchases), this could then prohibit you doing this or force you to stay with your existing provider which may not be an attractive rate.

So we have talked through the different options, now we will show you various choices you have within those options and points to be aware of:

Tax Free Lump Sum

As part of your decision when taking benefits, you have the option to take a tax free lump sum from you pension. This is usually set at 25% of the fund, however with some pension types this is different. The advantage of taking this lump sum is that it is tax free and will not disappear on your death. This money can be used as capital to spend or to help provide an income by investing it for this purpose.

It should be noted that when looking at the open market option you should check that the amount of the tax free lump sum you can take is the same with your existing company as well as the company you are transferring to, this could potentially be reduced on a transfer with certain pensions.

Guaranteed Annuity Rates

Some older pension policies still provide the advantage of guaranteed annuity rates and with a world of low interest rates these may then be higher than can be offered via the open market. It is therefore important to always get an annuity quotation from your existing pension provider before making a choice on your options.
It should be noted however that in many cases by choosing certain options (such as a spouses pension) this can invalidate the guarantee, if these options are important to you and your family then you may have to sacrifice the

guarantee to get these benefits. If this is the case then the open market option should once again be considered.

Level or Increasing Annuity Payments

When choosing the annuity you will have the option of how to set your payments.

Choosing the Level option means that you will get a higher initial payment than an increasing annuity, however your payments will never alter. This means that over time the ‘purchasing power’ of your annuity income will be eroded by inflation (the rising cost of goods and services).

Choosing the increasing option means that the payment will be lower than that of a level annuity, however it will then increase at set terms, the usual three annual increase options being 3% , 5% or the retail prices index (RPI). This will help guard against inflation.

In order to make a decision on which option is best for you, consideration should be given to factors such as:

- The difference in cost between the two and how long and increasing annuity will take to provide the same income as that of a level annuity.
- Other income sources that you have.
- When you will want the higher level of income (if you are carrying on working you may not need the higher level now. Or if you are completely retiring you may want the highest level in the early years when you are more fit and able to enjoy it).

Single Life Annuities and Joint Life Annuities (Spouses Pension)

A single life annuity means that the annuity will continue during your lifetime, however on your death (unless you have added guarantees or protection) the payments would then stop for good.

A joint life (or spouses) annuity means that you can select an element of these payments to continue for your spouse on your death. The normal amounts chosen are half, two thirds, or full pension. There is obviously a cost to do this and this is paid for by lowering the amount they will pay you compared to that of a single life annuity.

In order to make a decision on which option is best for you, consideration should be given to factors such as:

- The cost of adding the spouses pension.
- What retirement income you spouse has and would continue on your death.
- Other joint arrangements that you both have that your spouse would retain on your death.

Guarantees

Some people find the cost of the spouses pension too much to consider and therefore there is a shorter life cover option where the cost is a lot less. You can guarantee the payments to continue at 100% for either 5 or 10 years. This will provide at least some protection for your spouse without reducing your income dramatically.

So that is the basics for you pensions. We will now look at strategies that you can use to potentially improve the proposition and in turn your life:

Enhanced/Impaired Annuities

Your health and lifestyle can have an impact on the rates that you get for your annuity (as they are based on life expectancy). Some companies offer higher rates for certain health conditions and may therefore pay a higher income.

Smoker Rates

Consumers that smoke could also potentially receive a better annuity rate as their life expectancy is less than that of a non smoker. Again advice is recommended to guide you to the right providers.

So that is your main options and choices discussed, now we shall look at points you should consider, be aware of, misconceptions and potential strategies:

Open Market Option

(Can you increase your income?)

When you have a pension fund with one provider (eg. Prudential), this does not mean that you then have to purchase the annuity with the same provider and in fact in many cases you could actually be putting yourself at a financial disadvantage by doing so. Your right as a consumer is to be able to 'shop around' for the most suitable annuity rate and this is called the 'open market option'.

You should be careful with this as there are a number of factors to take into consideration. The tax free cash you are entitled to could be more with the existing provider and this would therefore reduce the amount of the residual fund to provide and income, also there are a number of options available to you and it is recommended you do receive advice on these options as in most cases once you have purchased the annuity, you will be unable to then change your mind regarding the terms and options chosen.

Do I take my benefits now? Or do I wait?

There are many factors to take into consideration on when to start taking benefits, these include:

- When income is needed.

- What other income you have and how the added annuity income will be taxed.
- You current health.
- What your plans are (eg. Reducing hours at work).

The longer you wait to take your annuity usually the better the rate will be (as you are older), however on the converse every year you wait, that is one years lost income that you could have released from your pension. With current low interest rates, annuity rates are also low and therefore expected to rise in future years, however when and by how much is not know. There is no hard and fast rule on when and how to start taking your benefits.

However you can calculate (based on current rates) the payments for taking it now or waiting to see which option gives you more money and when. We do recommend you seek advice on this.

Financial Advice

There are different types of financial advisers offering advice on these matters and they have different remits of what they can provide you.

Tied Advisers

These are typically advisers working for a bank, building society or insurance company. They offer advice of the most suitable product from their companies range. If you wish to shop around you will need to speak to them individually and this will require more of your time.

Multi Tied Advisers

These are typically brokers or advisers working for an agency. They work from a 'panel' of selected providers and can provide advice on the most suitable product from that select range.

Independent Advisers

These are advisers that have no links or ties to any specific company and have the whole market to use when advising on the most suitable product. A major advantage of this is you only have to go to one appointment to do the shopping around. Not only that as they have the advantage that they can provide you with the choice to be paid via the policy or a fee directly from you to ensure that the full range is being looked at. These options should always be discussed up front so that you can decide the most suitable option for you.

Financial advice is not just about looking at the best rate. Generally considering your retirement options can be a complicated, confusing area for people to grasp with many options available.

With a subject that is going to affect the rest of your life it is important to deal with someone you trust and can advise you in an ethical manner to help you make and intelligent informed decisions on what are the most suitable options for you.

How to protect the values you have made

Whether you are planning to retire in the next few months or the next few years you should put consideration to the investment funds your current pension pot sits in. The simple rule is the closer you get to your retirement date the less risky you want your pension funds to be.

If you still hold a good portion of your money in equity funds close or at retirement you run the risk that the value of this pot can go down (sometimes very quickly and by more than you expect), this will obviously have a negative impact on any income this can generate by any of the options discussed. It is sensible to transfer your funds into less risk investments gradually over a period of time (10 years is usually suggested), that way it is more of a safeguard on the values that you have created and by doing it over time (say 10% per annum) you still are gaining the benefit of potential capital growth from equity funds with the portion still invested.

How to prepare, potentially save time and be able to make proper comparisons

- Get quotes from your existing provider (one single life with a 5 year guarantee, payable monthly and with maximum tax free cash payable), also (one with a 50% spouses pension with a 5 years guarantee, payable monthly and with maximum tax free cash payable). This will enable a provisional comparison to be made against the open market option.
- Get confirmation if there is any guaranteed annuity rates.
- Get a break down from the provider of protected rights and non protected rights.
- Get current fund value and transfer values.
- In all likely hood you will need to provide an insurance company with two forms of identification (such as a passport and driving licence), usually these can be certified for you by the financial adviser that you deal with.
- For the product types discussed you will also need to send the insurance copy your birth certificate and in most cases it is the original that needs to be sent (not a certified copy).
- Also for married women that have changed their name your original marriage certificate will need to be sent. Ensure you send this recorded delivery so that it does not get lost.
- Request Open Market Option forms and pension transfer forms from your pension provider in case you decide to move the money away from them.

Looking At Comparison Sites?
Are you actually getting a good deal?

This is a decision is likely to affect the rest of your life so it should not be taken lightly. There are online brokerages and advisers that work on an ‘non advised basis’ with only certain options available. This means that they will not provide you with any advice or opinion at all, only purely factual information. By taking this route you will be forgoing any rights that you have by taking advice on this subject. With such an important decision it is more sensible to deal with someone that has access to all the available options and has the skills and knowledge to direct you to the most suitable option for you. Also someone that can provide you with advice on the more regulated side of this (the investment funds your pension is invested in) where needed.

The way in which independent financial advisers are paid for this advice is directly from you or a fee from the policy. Therefore if you chose for them to be paid from the policy then the research will include this, therefore you get the higher income compared to your existing pension, you get the advice and guidance to ensure the options fit you down to the ground and there is no other fee due. You can't say fairer than that.

Your Other Capital

So we have looked at your pension options and choices, some strategies and how to prepare yourself. Now let's take a quick look at strategies for your non pension money.

This can be a very important point to get right, as in many cases the pension in isolation may not be enough to cover your expenses either now, or when inflation impacts it at a later stage. Therefore advice on your capital to provide an additional income, guard against inflation, or both can be an important part of the whole retirement advice.

This guide won't go into the options as there are too many and would turn this into 'war and peace'. However it will highlight a strategy that is employed for retirement planning to provide you with accessible money to enjoy and money that is guarding against inflation or providing an income.

You see many people make the mistake of seeing their capital as one thing, a more efficient use can be to split this into defined needs with a specific goal for each.

This is the three pot approach:

When looking at investing capital for people in retirement we can break this down to three sections:

- Emergency funds.
- Short term capital for spending needs.
- Medium to longer term capital to provide capital growth over and above that of inflation, income to supplement you pension income, or both.

Emergency/Immediate Funds

The main important factors of emergency/immediate capital are that it is very accessible and that it is capital secure so that the funds are there when needed. Therefore it is advisable to consider savings such as high interest instant access accounts.

Short Term Funds

The main important factors of short term funds are that it is only invested for short periods of time and that it is capital secure, this is to provide a potentially better rate of interest than the emergency/immediate fund and also still be accessible in a short period of time in case the emergency/immediate fund gets used up. Therefore people consider such savings as notice accounts, fixed term bonds, cash individual savings accounts and national savings.

Both emergency and short term funds usually do not guard against inflation as the rate of inflation (the increase of costs and services each year) can be higher than the interest you are earning on the capital. If this is the case then the purchasing power of your money is reducing year on year and just because you are not matching the cost of inflation means you are getting poorer each year. This is called ‘inflation risk’ and effects many retired people.

Medium Term Funds

It is important to firstly consider the objective of the funds. This could be capital growth to guard against inflation, to top up income, or a combination of both. This is typically capital you are not expecting to touch (except for any income generated) for at the very least 5 years.

As it is going to be invested for the longer term it is more subject to the ravages of inflation and therefore if left solely in cash investments your ‘purchasing power’ of that money will reduce every year. Therefore you need to consider investments outside of cash to increase the potential of growth and this will then subject the capital to some ‘capital risk’.

In retirement one large consideration people have is the safeguarding of their capital (as they are no longer working and cannot replace that capital) and therefore your risk level should be properly investigated and discussed. In many cases people investing at this stage of life invest into cautious or balanced investments where the equity content of the investment is less and therefore there is less fluctuation in capital with more stable returns. Types of investments usually considered are investment Individual Savings Accounts, Unit Trusts, Open Ended Investment Companies and Investment Bonds.

Some investors have a different risk level for each of the pots (or even percentages of the pots).

By splitting your capital up in the three following ways you can retain access to capital that you need and also provide a potentially higher return. Also by doing this you are ‘diversifying’ your capital. This means that you are spreading your money into different assets so that if one type of asset is performing badly (eg. Cash) then it could potentially be offset by returns from another asset (eg. Fixed Interest Securities). This is a way of ensuring that you haven’t got all your eggs in one basket.

Time is a big consideration when looking at capital risk (the fluctuation in value of capital). The longer period of time that money can be invested then the greater chance it has to even out any fluctuation. Therefore usually the short period of investment the lower the risk taken.

It should also be noted that inflation risk is also as much a real issue for retired people as capital risk is. As there are these two very real risks at either end of the risk spectrum, many people consider a middle ground between the two a safer overall strategy for them.

So What Are Your Next Steps?

I expect the next question you have is; How much income will my pension give me with today's rates?

We have already put together the top annuity rates that you could qualify based on your health, age, personal details, where you live and the size of your pension fund in our **Free Pin Point Pension Income Report**. All you have to do is give us the relevant information so that we can show you who would provide you with the highest level of income.

With this report we will help you:

- ✓ Increase your pension income to the maximise possible
- ✓ Check your existing policy for any guaranteed annuity rates
- ✓ Help you understand what benefits are right for you (such as a spouses pension or guarantees)

And if you wish to proceed with the recommendations then we will then:

- ✓ Complete all the paperwork for you to make it simple
- ✓ Also you have nothing to pay directly for this service as we are paid by the pension company

Our Guarantee:

If we can't increase your income from that of your existing pension we will not only send you £200 M&S vouchers but also complete all the paperwork on your behalf for your existing provider to ensure you get the highest level of income and a service to match.

2 simple ways to get your report:

- ➢ Call us on 01722 717427
- ➢ Email your request to gavin@pfp-ltd.com

We will then gather the relevant information from you to provide you with the report to provide you with quick but 100% accurate information.

The information in this guide is for information purposes and does not constitute advice, if you don't understand any of its contents we recommend you seek Independent Financial Advice.

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