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PAAS
Pension Annuity Advisory Service

RETIREMENT ANNUITY GUIDE

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YOUR PENSION

Your pension - background

In the 1995 Finance Act, the government made the concession of allowing personal pension plan members to delay annuity purchase until they reach age 75.

Prior to the 1995 Finance Act, retirees with 'money purchase' policies were restricted to buying a compulsory purchase annuity. At the time, low interest rates prevailed, and pension plan members had no alternative but to lock themselves into an annuity at poor rates of income. (Note that annuity rates are seen as bearing a relationship to interest rates, so when interest rates are low, then annuities give poor returns).

The 1995 Finance Act allowed pension plan members to 'drawdown' an income from their pension fund, which remained invested. This drawdown was between 35% and 100% of the amount that would be provided, had the annuity purchase gone ahead. Insurance companies spawned a host of new product ranges, which provided much more choice, but this increased the complexity of the decision making process for retirees.

This new opportunity was welcomed, as pension plan members were now able to keep their pension fund invested, enabling their pension fund the opportunity to continue to grow. Additionally, the pension plan member would be able to pick a more suitable time to purchase their annuity.

In recent times (2000 – 2007), equity markets have been in recovery and interest rates after dropping very low, appear to be rising. The most salient point for those looking at retirement options is the fact that people are living increasingly longer.

Pension Simplification
The Finance Act of 2004 introduced a completely new tax regime which went live on the 06/04/2006 (known as A-day) and which covered all approved pension arrangements introducing important changes to retirement options .

Retiring soon?

If you are thinking of retiring shortly you need to think about your pension fund and where it is currently invested. If you are investing in a range of equity linked investments it would be wise to consider consolidating your funds and switching to cash whilst the advisory process is taking place. This would avoid any volatile stockmarket swings having a significant impact on your pension fund just as you are ready to buy your annuity. Over recent years the stockmarket appears to be reacting with great volatility and therefore a switch to cash once you have decided to take benefits can be advantageous.

Buying an annuity or taking other types of retirement product can take around 6 to 8 weeks to complete and therefore switching to cash during this period provides a considerable amount of stability in the run up to retirement.

1 year before retiring

a) Check pension funds, obtain valuations, make sure you have a State pension forecast.
b) Consider the amount you have in your fund, would a top up be appropriate ?   Immediate vesting might be appropriate contact your adviser for further information.
c) Work out your probably income requirements in retirement.
d) Consider phased switching to cash over the coming year

3 months before retiring

Its important that you get the process started at this point as delays from existing insurers can cause serious problems. Researching and advice can take at least 5-8 weeks depending on how complicated your pension, financial and personal affairs are. Clients have also been caught up in postal strikes which can severely dealy the process as original signatures have to be obtained and information from insurers has to be exchanged.

a) Obtain independent financial advice. Make sure authority is placed with the new advisor so that details of the existing policies can be studied.
b) Consider switching to cash fund to consolidate pension gains if not already done.
c) Consider your spouses requirements in retirement and in case of being widowed.
d) Consider the importance of leaving pension monies to dependants /children.
e) Consider immediate vesting.
f) Consider income requirements and inflation during retirement.
g) Consider your risk tolerance - if you're unsure about your risk tolerance we can provide a risk questionnaire.
h) Ensure that your paperwork for State Pension is in order and that your claim is being processed etc.
i) Consider debts, mortgages, credit cards - should these be paid off early with tax-free cash ?
j) Consider if part of your tax free cash is to be spent on an earmarked item.
k) Ensure enough contingency cash available.
l) Consider how much tax free cash you want from your pension.

Getting the most from your pension fund

When you reach retirement it is vital to get help with your pension options. For some people, this decision is very important as the pension fund might be large and many decisions that are subsequently made are irrevocable and so care and planning are paramount.

Many websites urge you to get the best annuity rate and provide comparative shopping sites. Whilst obtaining a competitive rate is important (annuitants can improve their income by up to 18% by shopping around) - you should also remember that there are a lot of other considerations to bear in mind. Recent newspaper articles have revealed that the majority of annuities are single life annuities - and this might reveal that insufficient thought is given to the remaining spouse on death. There are also many options and features which need to be considered and also your attitude to risk may point to your need for more than just a conventional annuity.

Smokers and those with lifestyle or health issues may enjoy better rates from specialist annuity providers. Many people should consider the benefits of draw-down or ASP as these products could be more suitable. By failing to consider these options you are effectively missing out on a range of options which could be highly beneficial.

Our service is advisory and therefore we consider your, personal and fianancial situation as well as your plans for the future. This then gives us insight into which would be the most useful products for your individual needs. We think this is more important that just being a comparative annuity rate shopping site; and as mentioned above you owe it to yourself to have advice about one of the most important financial decisions that you'll ever make.

Staying working whilst drawing pension

The new simplification regulations have, to some extent, provided greater flexibility for those reaching retirement. For instance, its an increasing trend to wind-down slowly to retirement and this might mean working less, say, half the week, rather than a full week. In this case, it might be preferable to repay any debts or redeem the mortgage whilst taking only a limited amount of income from your pension.

One solution to this might be to take draw-down. Draw-down allows the retiree to take full tax-free cash from the policy and then take no income or a small or infrequent amount of income which can be used to complement salary or selfemployed drawings. Once the decision to take full retirement is made then draw-down can continue or an annuity can be purchased. This situation allows prospective retirees to ease themselves into full retirement over a number of years, whilst keeping tax manageable and drawing a sufficient amount of income to maintain their standard of living.

This could also be achieved by using phased retirement, however, access to a big lump sum of tax-free cash isn't possible with this method, as part of the tax-free cash is used as income each year. However, for those struggling with higher rate tax, phased retirement might be a preferable option from a tax angle.

It's important to get advice on these products as they are complex and getting the correct product can be difficult and there are many pitfalls for the unwary.

About your Open Market Option

Your pension fund will have built-up over your years of employment and as you get nearer to retirement age, you are faced with getting to grips with your pension options. One of the terms you may see mentioned is the Open Market Option.

Open Market Option (OMO) basically means that you are free to buy your pension annuity from a wide range of insurance companies, not just from the current company where your pension fund resides.

Why should I bother going to other pension annuity providers?
Because you may well get a better deal, and consequently a higher rate of pension income. Insurance companies are vying with each other to get your business, therefore you could end up with a better annuity rate. This difference can be as much as 25%, so it is well worth your effort.
The Pension Annuity Advisory Service is able to assist you in obtaining quotations from pension annuity providers by searching the marketplace and advising you on the most appropriate package.

Tax Free Cash

Tax Free Cash is the money you are able to take from your pension fund from age 50. You do not have to pay tax on the amount withdrawn (under current regulations). The amount of Tax Free Cash (TFC) that you can take from your pension fund is typically up to 25% of the fund value. Note that the amount of Tax Free Cash can vary from 25%.

Protected Rights

If you decide to contract out of SERPS (during your working lifetime) then Protected Rights are the part of your NI contribution, which normally goes into SERPS. This segregated contracted out pension pot is known as Protected Rights. If you have a Protected Rights pension scheme, then your annuity must be paid in a set format. If you have a spouse, then protected rights must provide a pension for them.

Your Pension Options

There are a number of options available when you approach retirement age as follows:
You can remain fully invested and leave your pension fund until a more suitable time.
You can remain fully or partially invested but take some income by arranging one of the following:

a) Unsecured income.
b) Phased Retirement.
c) Flexible annuity.

You can arrange the purchase of your Compulsory Purchase Annuity (see "Annuity Types").
It is important to note that the FSA guidelines recommend that you require a pension fund of at least £100,000 before considering the options in (2) above. This is because certain factors would impact on smaller pension fund sum. The main factors are follows:

a) Charges.
b) Risk.
c) Company minimum fund values (after Tax Free Cash).
d) Impracticality.

Questions & Answers

What is an annuity?

It is an arrangement where the capital value of your pension fund, less any tax-free cash, is paid to an insurance company, which in return, will pay a set level of income to you for your lifetime (this is a conventional annuity). There are other types of annuity available (see "Annuity Types").

When do I have to buy an annuity?

Depending on your retirement age, you can purchase your annuity from age 50 to age 75. At age 75 you now have either the option to buy an annuity or to take out alternatively secured pension (ASP).

Are there any alternatives to buying an annuity immediately?

Yes – your pension fund can remain invested until you decide to buy your annuity.
Alternatively, you could choose from one of the following:

a) Phased Retirement
b) Unsecured Income
c) Flexible annuity – e.g. 5 Year Rolling Annuity (see "Alternatives").

What reason would I have for choosing one of the above options?

It could be that the rate of income being offered by insurance companies on annuities may be particularly low at the time and you would prefer to wait (the rate of income may rise in the future, although equally, it could fall). Alternatively, one of these options may better suit your personal financial scenario at the time. (See "Alternatives").

Why are there different types of annuity?

Because some people may wish to have an element of investment built into their annuity in case they can achieve a better return. However, there is no guarantee with investments, which could cause your income to fall as well as rise. This is why many people opt for a conventional annuity, as there is no element of investment – and therefore no uncertainty. However, investment annuities have the potential to protect your standard of living throughout your retirement.

When can I obtain my tax free cash – and how much will it be?

You normally get up to 25% of the non-protected rights fund from your pension fund. Currently, the earliest age that you can take tax free cash is at 50.

Is it possible to change my annuity later on?

No, you can only buy your annuity once. When you have purchased your annuity, you are stuck with it till death although you can in some instances switch out of a with-profits annuity into a conventional one.

Annuity terminology

Terms not already covered under our menu options, hopefully are covered below.

Additional Volutary Contributions (AVC)
These are contributions arranged by your employer for the purpose of providing supplementary benefits from the employer's pension scheme (you can also have
Free Standing AVC - where the contributions are not arranged by your employer).

Compulsory Purchase Annuity
This type of annuity is termed 'Compulsory Purchase' because you have to buy the annuity by age 75 (under current regulations).

Indexation
If you specified that you require your annuity to be indexed, then this basically means that your income would increase every year by the same amount as the Retail Price Index.

Unsecured Income
This allows your fund to remain invested, although units (taken from your fund) are encashed to provide income. Note unsecured income is also called 'Income Drawdown' or just 'Drawdown'. Click here for more information on this subject.

Pension Simplification

You might be aware that there are some major changes happening in the pension world at the moment, and although a lot of the legislation is to do with funding levels of pensions, there are a lot of changes to how benefits can be taken.

The new legislation came into force from the 6th April 2006 (known as A-day) and so if you are nearing retirement you need to consider how these changes may affect your benefits and your options. One of the major changes will affect when you can retire. Currently, most pension benefits can come into payment from age 50 (except for protected rights benefits). Under the new legislation the government has confirmed that they are to raise the age for retirement from 50 to 55 (there will be transitional arrangements for this change up to 2010). Individuals with an existing contractual right to retire before 55 may continue to do so under transitional arrangements. Despite recent attempts by the House of Lords to make amendments, benefits must come into payment not later than age 75.

Another big change will affect those with protected rights who can now take 25% tax free cash from this fund. Another interesting change will affect those who don't have large pension funds. If an individual's total pension savings (including any pensions in payment) are valued at no more than 1% of the annual lifetime allowance (£16,000 in 2007/08) then they will be able to take all their fund as cash, subject to a tax charge on the excess over the tax free cash entitlement.

From A-day the retirement options will be Secured Income, Unsecured Income and Alternatively Secured Pension (ASP). Secured income is the income that you derive from your pensions scheme or purchase of an annuity. Unsecured Income is similar to Pension Fund Withdrawal option currently offered under personal pensions as well as rolling 5 year annuities. ASP is available from age 75 as a new concept aimed at individuals who choose not to participate in the pooling effects of annuities. The Unsecured Income option has major differences to pension fund withdrawal in as much as there is no need to take a minimum income. The maximum income is determined with reference to new guidelines which are prescribed by the Inland Revenue. Both Secured Income and Alternative Secured Pension options must be taken out from age 75.

The new legislation offers more choice for individuals in retirement and it is even more important that you seek advice on these options so that you can appreciate the advantages and also be aware of the potential pitfalls that might lie behind them. These include issues such as risk tolerance and investment advice and also relate to the practicalities of needing on-going advice as you go through retirement. The new rules will effectively allow draw-down to continue after age 75 and this will be known as an "alternatively secured pension" or ASP. ASP is similar to draw-down, but it has some key differences. Firstly, ASP will be subject to annual review rather than 5 yearly review under drawdown. Secondly, ASP has a much lower upper limit of maximum income in order to prevent the fund from exhausting too quickly. Finally, nothing can be paid outside of the pension fund on death, unless to a charity. Any remaining ASP fund must first be passed to a spouse or dependant within the pension wrapper and the spouse or dependant can the use the funds to buy an annuity, take unsecured income (if they are under 75) or take ASP (if over 75).

As annuity rates have been depressed for some time, many people in retirement want to avoid annuity purchase and many commentators have seen an opportunity for IHT planning in relation to ASPs and there has been a great deal of speculation about using ASP for IHT planning, especially in view of the fact that it is virtually impossible now (after the recent rule changes) to move your property outside of your estate. However, the Revenue and the government are resolute in not wanting pensions to be used as an estate planning tool.

Using a SIPP allows the retiree, after death, to potentially transfer the fund to any other pension members (ideally family members). ASPs were designed to provide an alternative to annuitisation for those with religious objections to risk-pooling not as an IHT planning vehicle. This statement has now clarified the mounting speculation with regard to ASPs and IHT and it is clear that those who use ASPs will now face IHT. ASP may be a valid choice for some people, but there are many issues surrounding this new product.

A key factor must be the retiree's tolerance of risk and ability to understand the risks as he or she goes forward into their 80s and 90s. Replacing security for investment risk might not be the best choice, on a personal level for elderly people, and annuities should continue to play an important part of retirement planning. ASPs should not be considered by anyone with a small pension fund or who does not have a considerable amount of other assets beside their pensions.

Pensions Act 2004

There are some substantial changes taking place at the moment in the pensions arena, particularly in terms of pension funding levels. You need to be aware of these changes, and how you may benefit. The term used for these changes is Simplification.

From the 6th of April 2006, this new legislation will come into being.

A major change will be the date at which you can retire. At the moment, benefits from your pension can be taken from age 50 (apart from protected rights). The government has provided the new legislation in order to raise the minimum retirement age from age 50 to age 55, with a transitional period running out in 2010.

Those having existing contractual rights to retire before age 55 are to be allowed to do so under the new transitional arrangements. Benefits must be set up for payment no later than 75.

Protected Rights are set to change. The DWP (Dept of Work & Pensions) have proposed that tax free cash should be made available out of protected rights policies, with the requirement for escalation on pensions in payment removed.

Another interesting change will affect those who don't have large pension funds. If an individual's total pension savings (including any pensions in payment) are valued at no more than 1% (£15,000 in 2006/07) of the annual lifetime allowance then they will be able to take all their fund as cash (subject to a tax charge on the excess over the tax free cash entitlement). Currently, you have to have a smaller fund than this to be able to commute on the grounds of triviality and this might become a preferred options for those with small funds. After the 6th April 2006 the retirement options will be Secured Income, Unsecured Income and Alternatively Secured Income (ASI). Secured income will be the income that you derive from your pensions scheme or purchase of an annuity. Unsecured Income will be similar to Pension Fund Withdrawal option currently offered under personal pensions as well as rolling 5 year annuities. ASI will be available from age 75 as a new concept aimed at individuals who choose not to participate in the pooling effects of annuities. The Unsecured Income option will have some major differences to pension fund withdrawal in as much as there will be no need to take a minimum income (subject to provider or Department of Work & Pension requirements). The maximum income will be determined with reference to new guidelines which will be prescribed by the Inland Revenue. Both Secured Income and Alternative Secured Income options must be purchased from age 75.

The new legislation is going to offer more choice for individuals in retirement and it is even more important that you seek advice on these options so that you can appreciate the advantages and also be aware of the potential pitfalls that might lie behind them. These include issues such as risk tolerance and investment advice and also relate to the practicalities of needing on going advice as you go through retirement.

Obtaining a State Pension retirement forecast

You can currently obtain a state pension forecast if you reach state retirement age before 6th April 2010. The link below takes you to this government service.

http://www.thepensionservice.gov.uk/resourcecentre/e-services/home.asp

Taxation issues

For some people taxation might be an imortant aspect of their pension planning.

Income tax could be an issue for some people whereby taking income could cause them to be higher rate taxpayers. The new simplifciation regime does offer some level of flexilbity with income which could be useful and also flexibility of when income can be draw, which might help with timing and thus avoid large tax bills.

Investment planning in retirement

Planning your total retirement income can also be part of your retirement options, and arranging investments tax-efficiently for income requirements can provide a boost to income. Even those on small pensions can benefit by reducing their tax liability by using a number of tax-efficient withdrawal mechanismes or tax-efficient products in retirement.

IHT (Inheritance tax) planning can often be a subject that needs considering in the early years of retirement. Organising gifts or establishing trusts or taking out a life assurance policy written under trust could be important at this stage. However, consideration must be given your on-going requirements for income and possibly long term care in the future - so make sure that you retain sufficient of your assets.

Use of CGT (Capital Gains Tax) allowances can also be useful in boosting investment income in retirement. This exemption is worth £9,200 per individual in the current tax year and a couple could make use of a tax free allowance of £18,400.

If you want help with your investment income as well as your pension options please let us know.

FACTORS THAT AFFECT YOUR ANNUITY

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background

When buying an annuity, there are factors which will govern the sort of deal you get from the annuity provider i.e. how much income you will receive in return for giving them the lump of cash which is your pension fund.
As a business, the insurance company is hoping to make a profit out of this deal. The longer you live, the less they will make as the insurance company pays income to you over a greater amount of time. Conversely, if you died the day after taking out the annuity, the insurance company would profit handsomely (although early death helps subsidise the people who live longer). The insurance company will utilise a range of statistical information such as historical mortality trends to calculate the amount of income they can afford to pay you, whilst remaining profitable.

Main factors that affect the annuity rate offered to you and consequently the amount of income you will receive are:

a) Age & gender
b) State of health and medical history
c) The effects of inflation
d) Terms offered by provider company
e) Timing issues
f) Economic conditions
g) Add on enhancements e.g. escalation, widows pension, etc.

age & gender

The amount of income that you will receive from your annuity is governed by your current age, gender, health, and any other factor that will ultimately affect your life expectancy.

The older you are now, the less time you have to live (based on statistical information) and as a result, the annuity rate offered to you should be higher because the insurance company providing the annuity will have to make fewer payments to you. Women live longer than men, men therefore receive higher annuity rates than women of the same age. Your lifestyle and therefore health will also have an effect on your life expectancy and consequently the annuity rate will vary accordingly.

Generally, the older you are, the better the annuity rate should be that your receive (although it is interesting to note that, the older you are – the greater your life expectancy becomes – again based on statistical information).

health

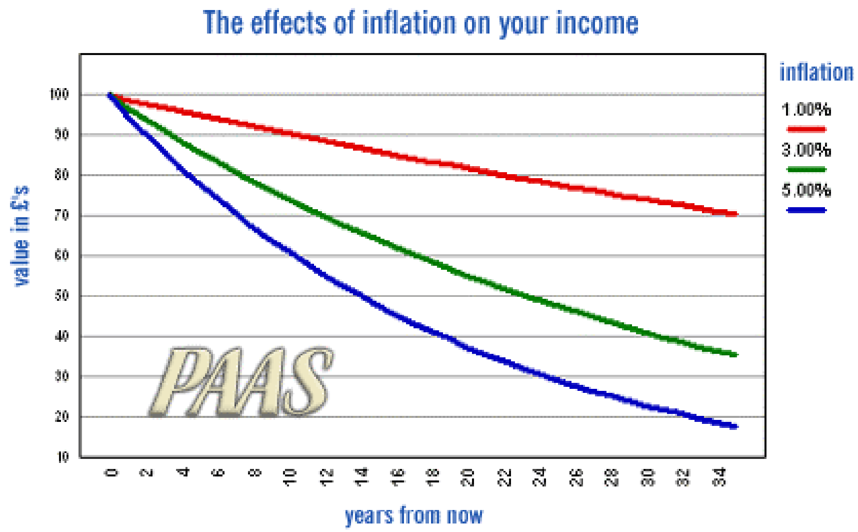
Your life expectancy can vary according to your current state of health, and consequently this will have an impact on annuity rates offered to you.

Illness
If you currently have a serious medical condition then you may be able to obtain enhanced annuity rates. You need to enquire about "Impaired Life" annuities (see menu under 'Annuity Types').

Lifestyle
If you smoke cigarettes regularly over a number of years, you will probably be able to receive enhanced annuity rates, as smoking can significantly affect your life expectancy. You need to enquire about "Lifestyle" annuities. Also a combination of other factors such as weight problems, high blood pressure, high cholesterol etc. could improve your annuity rate.

inflation

Inflation can have a dramatic impact on your retirement income, particularly if you retire at a relatively early age. Consider the following graph :



The effect of inflation is easily demonstrated above. Note that the above scenario illustrates an arbitrary £100 annual pension income at retirement. You can see that at 3% inflation, the £100 annual pension your receive is actually worth £36 in terms of spending power in 34 years after retiring.

Negating the effects of inflation by escalation

To negate the effect of inflation, you could consider purchasing an annuity that is RPI (Retail Price Index) linked, although this will invariably have a lower starting annuity rate. Alternatively, you could opt for an Escalating Annuity, again this can prove expensive depending on the amount of escalation you choose. Obviously a 5% annual escalation of your income will be more expensive than one at say 2%.

Negating the effects of inflation by investment

Another way to approach the problem of inflation could be to investigate those annuities that have an element of investment contained within, such as with-profit or unit linked annuities. The thinking behind this is that the investment element would increase in value with time, although you must bear in mind that investment gains can just as easily decrease as they can increase. The term for this type of annuity is "Investment Linked Annuity".

Inflation can also have a more obscure effect on your pension income. In times of low inflation, insurance companies will offer lower annuity rates because the value of the money that they pay you as income is higher and therefore has a greater cost. If inflation is high, the payments they make to you get devalued more rapidly (assuming constant inflation), so the payments made by the insurance company are comparatively cheaper.

It is also important to understand that inflation affects people in different ways, depending on your age, lifestyle, etc. You can find out more about this by visiting the following page: inflation at the National Statistics Offices.

terms offered by provider

When you purchase an annuity, you will be eager to obtain the highest level of income possible.
Be aware that annuity rates fluctuate, not only from company to company, but also over a period of time. Companies will come in and out of the marketplace with competitive rates when they want to take on annuity business.

Shopping around – your only chance to get it right
When buying your pension annuity (also known as Compulsory Purchase Annuity) you are advised to shop around to obtain the most competitive rate. You only have one chance to buy your annuity, after which you are stuck with your choice for the rest of your life. Many people fail to shop around and simply take the annuity provided by the insurance company where the pension fund resides. You could lose up to 25% of the potential income possible from your pension pot by not shopping around.

timing issues

If your pension fund comprises of equities, then these can be highly volatile. Within a short space of time, your fund could either fall or rise in value dramatically. The danger is that within the short space of time up to your retirement, your pension fund could suffer a dramatic drop in value, which would be catastrophic to your future retirement.

By the time you reach retirement, it is advisable that your pension fund has been moved into either cash, fixed interest or a safety fund. This move (known as a switch) can be staged over a period of time (say 5 years) so that dramatic fluctuations in the equity markets can be smoothed-out.

Market Value Adjuster (MVA)
If you have either a with-profits personal pension or retirement annuity (the old style personal pension) then you should be aware that currently (at 05/2007) certain companies may still be operating MVA's on with-profits funds. It is important to take advice on this aspect before taking pension benefits.

economic conditions

When interest rates are low and the long term gilt yields are very low then annuity rates rates are normally low as well.

Other issues can also effect annuity rates, including inflation, mortality rates and stockmarket volatility.

The change of annuity rates due to economic conditions is decided by actuaries and the changes will vary from company to company.

TYPES OF ANNUITIES AVAILABLE

Annuity types – background

Annuities available range from being very simple and transparent (Conventional Annuities) to the more complicated and risky (annuities containing an investment element).

NOTES
Annuity schemes where there is no contingency for inheritants generally give better annuity rates because the scheme can benefit from the Mortality Bonus*.

In times of low gilt and interest rates, an equity content may help to give you a greater return on your pension fund capital (providing the equity markets follow long term performance trends – there is no guarantee that this will happen). Annuity types are as follows:

Conventional annuities
These are straightforward – provides initial highest annuity rate.

Lifestyle / enhanced annuities
Straightforward – for people at higher risk of reduced life expectancy.

Impaired life annuities
Straightforward – for people with serious illnesses.

Purchased life annuities
Not a compulsory purchase annuity, but has uses.

Flexible annuities
These tend to be complicated – investment related.

With-profits annuities
Complicated – investment related.

Unit-linked annuities
Complicated – investment related.

Self-invested annuities
Complicated – investment related

Conventional annuities

These are the safest type of annuity, they guarantee you income regardless of investment conditions. They contain no investment element and therefore are not subject to market conditions.

The downside to Conventional Annuities is that you are locked in to the annuity rate prevailing at the time, and if rates go up, you will miss out.

This type of annuity offers level income which means that it can be attacked by inflation over the period of your retirement. An escalating annuity (see here) can limit the effects of inflation but it is costly and generally not very good value for money.

Enhanced annuities / lifestyle annuities

This type of annuity is essentially a conventional annuity paying an enhanced annuity rate because your life expectancy may be shorter due to your lifestyle or state of health. A medical examination would generally not be required in this instance.

You would be eligible for this type of annuity if you have one or several of the following conditions:

a) Diabetes (insulin dependant)
b) Liver condition
c) Emphysema
d) Heart attack
e) High blood pressure
f) Overweight
g) Cancer
h) Parkinson's Disease
i) Regular smoker (over a period of years)
j) High Cholesterol levels

Impaired Life annuities

Again, this type of annuity is basically a conventional annuity, but the annuity rates are dramatically enhanced due to the significantly reduced life expectancy. Typically you would have less than 5 years to live. This type of annuity usually requires full medical underwriting.

Purchased Life Annuities

A Purchased Life annuity is a basic annuity providing a guaranteed regular income either for life or for a specified number of years. Note that a Purchased Life annuity is not used as a compulsory purchase annuity.

Purchased Life annuities are generally used to obtain income from capital, where you do not need to preserve capital for inheritance purposes.

Purchased Life annuities – what is Capital Content?
A portion of the income from Purchased Life annuities is considered as a return of the capital that you paid originally to the insurance company. More importantly, this return of capital is not subject to taxation. The amount of capital allocated to your annuity is dependent on your age at purchase of the annuity.

Flexible Annuities

Flexible annuities, as the name indicates, allows flexibility in the levels of income taken by you. They contain an investment element, which adds to the complexity of this type of annuity.

There are two variations as follows:

1. Short term annuity (Rolling 5 year annuity)

   This is a retirement option for those with larger pension funds. With this option, after drawing tax free cash, the bulk of the pension fund remains invested, but a portion of the fund is used to buy a temporary annuity which lasts 5 years. The plan is reviewed every 5 years. Please note that with this option there are investment risks involved and the plan needs constant monitoring to achieve success.

2. Flexible annuities

   This option is only available with larger pension funds (£100k plus) and allows the retiree to take varying amounts of income (between limits). Another feature of this option is that the retiree can exercise some investment control on the fund, either through a choice of risk graded strategies or a selection of unit linked funds up to age 90 at which point you have to convert your investments to conventional annuity.

   Early death cross subsidy is distributed using bonuses to age 90. This option carries an investment risk but also provides the potential to protect your income from inflation.

With-profits annuities

The basic principle of With-profits type annuities is that the income you receive from your invested fund is smoothed, so that instead of experiencing wide fluctuations that you would with the Unit-linked annuity, your income stream is more constant.

You are required to pick a bonus rate (Anticipated Bonus Rate (ABR)), which usually ranges from 5% down to 0%. The greater the ABR selected, the more income you receive, though you need to bear in mind that if you select a high ABR (and consequently a high income) and the investments of your fund do not perform adequately, then your income will be lower in the subsequent year to reflect the shortfalls. Note – if you select a zero ABR, then you will only receive the income from the actual return that your investments have made in that term.

The investments within your with-profits annuity are selected and managed by the insurance company's fund manager. Several insurance companies will allow you to convert your fund to a conventional annuity.

The advantage of the With-profits annuity is that it allows you to participate in the investment arena, whilst giving a smooth income stream. It could be a good option if you don't wish to get locked into a Conventional annuity at a low rate of income, although you have to be aware of the risk element of participating in investments.

This type of annuity has the potential to protect your standard of living against inflation. However, there is a limited downside risk.

Unit-linked Annuities

Unit linked annuities allow you to partially invest your pension fund capital into the insurance company's own managed investment fund. They are not dissimilar to With-profits annuities, the major difference is that you do not benefit from the smoothing effect to your income stream. Income is derived from disposal of units, and because these can vary in value, hence your income will vary also.

Self-invested Annuities

This type of annuity allows you to use a stockbroker or someone authorised by you to manage the investments of your pension fund in equities. This is a specialist product where PAAS are able to provide expert advice. Some self invested annuities will allow investment into commercial property.

Additional benefits that can be included when you purchase your annuity

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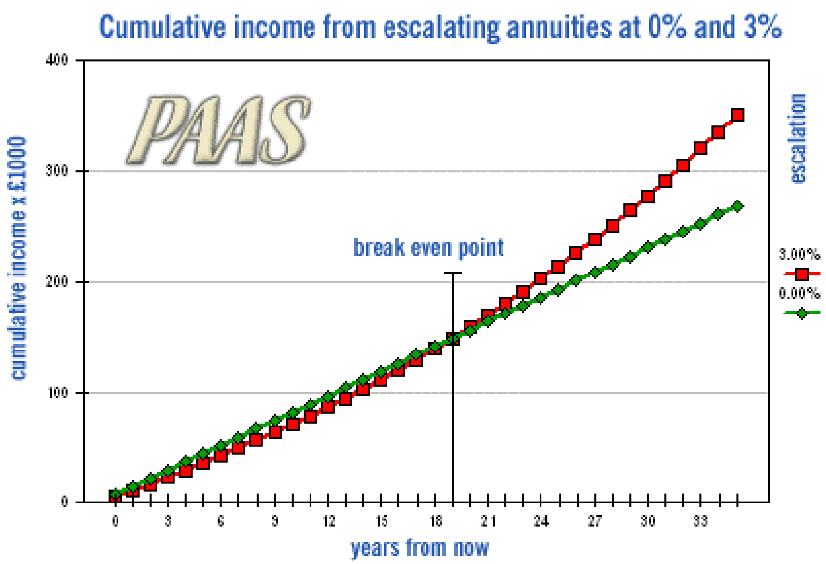
Background

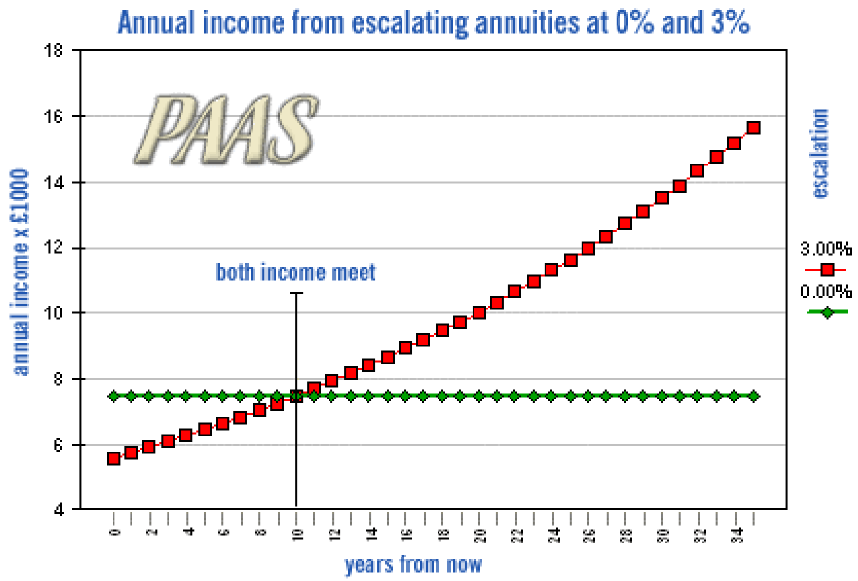
Rather than purchasing an absolutely bog standard annuity from an insurance company, you can elect to have additional benefits added to your annuity package, although the cost of having these additional benefits is likely to be reflected in the annuity rate that you are offered, i.e. taking additional benefits as part of your annuity package usually results in a lower pension income amount.

Escalation

You can elect to have your pension income escalating each year, to reduce the effect of inflation on your pension income. This is normally quite expensive, the higher the escalation amount you select, the greater the cost (i.e. your pension income will be much lower at the start of your annuity). You can also elect to have your pension income linked to the Retail Price Index (RPI).
For a comparison of non escalating and an escalating annuity, please see the graphs below:



The above graph is based on quotes obtained from Prudential in February 03 using a pension fund value of £100,000. Starting annuity income was £5,562 for the 3% escalating annuity and £7,451 for the level annuity (level = non escalating).
You can see that it would take 19 years of income from the escalating annuity, before it caught up with the cumulative amount that would have been received from the level annuity.



The above graph is based on the same quotes as the ones in the previous graph (Prudential Feb 03 - pension fund value £100k).
Again, starting annuity income - £5,562 for 3% escalation and £7,451 for the level annuity.
The graph illustrates that it would take 10 years before the annual income amount from the 3% escalating annuity reached that of the level annuity, although the cumulative income from the escalating annuity would take another 9 years before it reached that of the level annuity.

Partner's Pension

If you choose to have a Partner's Pension, then upon your death, the pension income is paid out to your partner, be it your wife or the person that you live with.

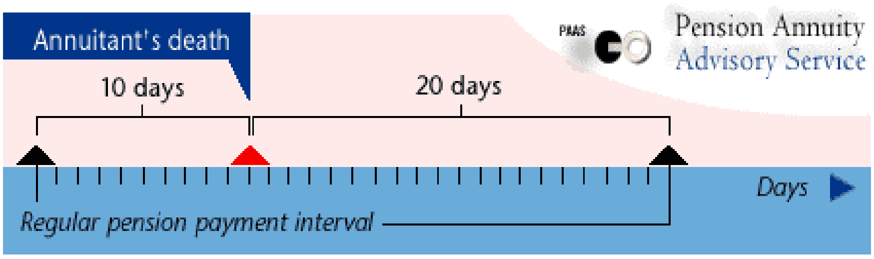
If you are not married, the insurance company will require some proof of cohabitation, such as being financially dependent.

The amount that is paid out to the partner is chosen from outset. You could choose to have the same amount paid to your partner, as paid to yourself. This will be more expensive than a ½ widow's pension and will be reflected accordingly in the annuity rate offered to you.

With or Without Proportion

If you choose to have this option added to your annuity, then your partner will receive a proportion of your regular pension which represents a payment from your last annuity payment up to the date of death.

Please see illustration overleaf:



The above illustration shows the annuitant dying 10 days into the month. The With Proportion would enable the annuitants partner to receive a third of the monthly income payment e.g.

30 day month is shown.

10 days = 1/3rd - 20 days is other 2/3rds.

Additional Benefits - Payment Guarantee Period

A guaranteed period ensures that the annuity is paid for a minimum period. A choice of either 5 or 10 years is usually offered.

The Payment Guarantee Period can be varied according to your requirements. This option is taken at the outset of the annuity purchase.

The Payment Guarantee Period could also be paid out as a lump sum in advance to cover the total amount of regular payments that would have been paid within the term of the Payment Guarantee Period.

Additional Benefits - Income Frequency

You can elect to have your pension payments paid in advance or in arrears. Other payment options are that you can be paid monthly, annually, quarterly and half yearly either in arrears or in advance.

Being paid in advance means that you will receive a lower income, especially if you elect to be paid yearly in advance rather than monthly or quarterly.

Before you are 75 – alternatives to annuity purchase

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background

Some retirees may not want to buy an annuity and prefer to look at the other options that are available. The choices available under this section are relatively complex and invariably more risky as they may include an investment risk.

Most companies require a minimum pension fund of £100,000 (after tax free cash is deducted) before you are able to take up these choices. Additionally, due to the inherent risks involved in these types of choices it is strongly recommended that you take advice. You can do this by registering as a PAAS client.

Please note that the advantages and disadvantages listed for each option are not an exhaustive list and your own personal situation may highlight differing advantages or disadvantages which are unique to yourself.

Income Drawdown

This option allows you to take maximum tax-free cash from your pension pot and invest the balance of the fund from which a regular income can be drawn-down (within government limits). Under current regulations, an annuity must be bought by the age of 75.

This option allows for more investment control by the retiree. However, continuing to invest the pension fund, whilst taking an income from it carries a risk, in that poor returns may threaten to reduce the value of the pension fund and therefore the eventual income that you take as an annuity.

Recent investment conditions have impacted significantly on this product especially since many schemes have a high degree of equity investment in order to provide the growth potential required to achieve the critical yields that are required to protect the eventual annuity income. Low risk/low return assets are not ideally suited to this product because they may not provide the potential to maintain the pension pot for retirement.

Advantages

1. Immediate access to tax-free cash.
2. There is a choice of lump sum or income payments to beneficiaries on death before annuity purchase (lump sum benefits are, however, subject to tax).
3. Flexibility of annuity purchase. This means that you can chose when to buy your annuity which provides the possibility of securing better annuity rates - if rates improve in the future.
4. You maintain investment control of the draw-down fund.
5. Choice of income - the government actuary department set a maximum draw-down level and you can choose any where between these limits.
6. Increased flexibility - in terms of income, investment and timing issues.
7. Death benefits - no need to pre-purchase spouses death benefit with this option. Widows(ers) can inherit drawdown income on death.

Disadvantages

1. Income taken will be taxed as earned income.
2. The cost and complexity of the arrangements are higher than annuity purchase and also possibly phased retirement. The plan is reviewed every five years by the company and at least annually by your adviser.

3. On death the proceeds of the fund are available to beneficiaries by either income or a lump sum. The lump sum is subject to a tax charge of 35%. This situation is less attractive than phased retirement whereby the unopened segments will be available tax-free to beneficiaries.
4. Investment returns during the plan and annuity rates at your desired retirement age may be less than expected.
5. Risk - this is not an option for the cautious investor. The funds under investment need to achieve a good level of growth in order to offset the fact that income is being taken from the fund. Historically, over the long term equity investment has managed to produce the required levels of returns, however, the increasingly poor stockmarket conditions and low returns in other sectors might indicate that it could be difficult to achieve a good level of growth in the future.

Phased Retirement

This option would mean transferring into a phased personal pension scheme. The pension plan is set up with many segments and you could select to open some segments (taking tax-free cash and annuity) or none of the segments. Any unopened segments would continue to grow in a tax beneficial environment until you wanted to open them. "Income" is derived from the annuity income and the tax-free cash taken and is built up gradually as more segments are opened.

Advantages

1. Greater flexibility - you choose when to open the segments and how many to open.
2. Unopened segments continue to grow in tax friendly environment.
3. Investment control - continuing investment control available on the unopened segments.
4. On death before annuity purchase, unopened segments can be paid out to chosen beneficiaries tax-free. Widows/dependants pension is available on opened segments.

Disadvantages

1. This is a complex arrangement which needs continual monitoring in terms of opening segments, investment decisions, and tax implications.
2. Eventual income will be dependent on investment returns during the plan and on the annuity rates at retirement.
3. Since your tax-free cash makes up some of your "income" each year, there won't be a large tax-free cash fund available.
4. Charges could be higher than with stakeholder or annuity purchase.

5 year rolling annuities

This is a relatively new product on the market which is an alternative to Income Drawdown and available from a limited number of providers.
Tax-free cash is usually taken at inception and then over a 5 year period a temporary annuity is purchased to provide income, which can be the equivalent of a life time annuity or you may select an income between 50-100% of this figure.
Since temporary annuities (these are annuities which cease without value at the end of a fixed term) are cheaper to purchase than lifetime annuities, a surplus can be invested. The surplus is invested in a similar manner to Drawdown i.e. in an area with the potential to produce high enough growth rates to protect the pension fund.
Although this may be a flexible choice for some retirees the plan is reasonably complex and carries a high degree of risk, in that returns and its ultimate success will rely on investment performance over the term of the plan.
There is also a risk of diminishing your fund if investment performance is very poor. This is one of the riskiest options available and you should be absolutely certain that this is compatible with your situation.

Advantages

1. Flexible income in retirement.
2. Retained investment control of residual funds.
3. Timing of annuity purchase possible.
4. Full tax-free cash available at inception without the obligation to buy an annuity.
5. Survival bonus available if you (and where a spouse's pension has been selected, your spouse) survive until the end of a 5 year period.

Disadvantages

1. Risk - the fund value will be linked to investment performance which could be volatile and worse than expected.
2. The contract is unable to receive protected rights.
3. The lifetime annuity must eventually be bought from the same provider - whose rates might not be the most competitive at the time.
4. The lump sum death benefits are limited to the normal 5 year period during the first 5 year term. Thereafter, only pension benefits are payable.
5. The plan will cease without value upon the death of the single annuitant.
6. The level of income after the first 5 years might go down if investment performance has been poor.

Alternative Flexible Annuities

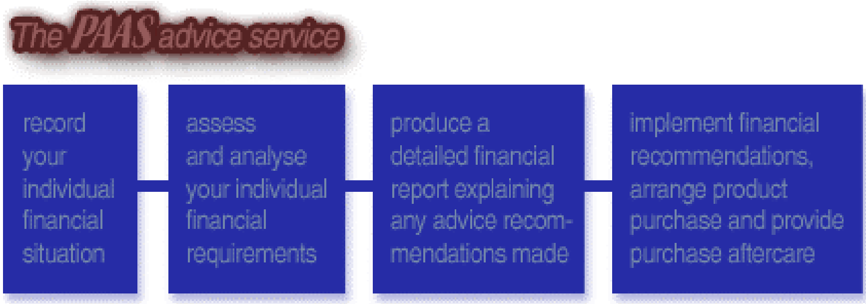
If you take out some flexible annuities you will be able to continue to draw off the fund rather than being forced to buying an annuity at age 75, providing that you appoint someone to manage your investment decisons. In this case you don't have to buy an annuity until age 85.

Because of the wide range of new products flooding onto the market, we are not able to give full details on this website.

PAAS SERVICES

Why use the PAAS retirement advice service?

It is imperative for your financial wellbeing that you take time out to investigate the possibilities open to you at and in retirement. As you are probably aware, you can use your pension fund to purchase your retirement annuity from a range of companies, not just from the company where your pension fund is currently sitting.



If appointed by you, we act on your behalf to obtain the best package for you as an individual. We definitely have no involvement with insurance company marketing departments, or have any tie-ups whatsoever, and as a result, there is absolutely no bias when researching and sourcing products on your behalf.

Other than purchasing your annuity at retirement, you may wish to investigate phased retirement, income drawdown, flexible annuities, etc. You can find out more about these options by visiting the rest of this site.
If you opt to take a conventional annuity at retirement, then the overall determining factor will be the annuity rate being offered by the company. It is essential to use an independent company, which will obtain annuity quotes in order to determine the most favourable rates on offer.

It is important to understand that there are other factors which cannot be dismissed whilst comparing annuity rates, such as insurance company financial strength. This is particularly important when you consider the recent Equitable Life situation, and also weaknesses and financial problems have been identified in several of the large insurance companies. Although you cannot predict what will happen in the future with these insurance companies, you can take measures to ensure that you are as well informed as possible at the time of annuity purchase. This is where independent advisers can research on your behalf, using a wide range of systems and information sources.

Q - You may ask "how much will this independent advice service cost me?"

A - well, the surprising fact is that it will cost you not a penny more than if you buy your annuity directly from the insurance company - they will definitely not give you independent advice on what's available from the marketplace.

Q - How is it possible to obtain independent advice at no extra cost than if I go direct to an insurance company.

A - Well, the insurance companies have to sell their products otherwise they would be out of business. Insurance companies understand how expensive it is to employ a sales force, and as a consequence are happy to pay an independent adviser commission as it removes the need for them to pay a sales force and to have the associated liablities involved in employing sales forces. The benefit if you use an independent annuity advisor, is that you will receive advice and help in obtaining the most suitable retirement package, otherwise by going directly to the insurance company you may receive a lower retirement pension and the insurance company will consequently pocket the commission which could have been used to give you independent advice.

Please note that our "advice service" can be accessed by selecting the "Getting started" menu option.

Costs of using Pension Annuity Advisory Service

Charging structure
We offer either commission option or fee-based advice to suit the customer. Please note that the charging structures cannot be altered once they have been agreed.

Commission based Advice
Commission rates for most conventional annuities range from 1% to 1.35% of the fund used to buy an annuity depending on which company is used. Please note that this does not come out of your fund. We provide full commission disclosure so you can view the amount of commission payable. Enhanced or impaired life annuities may pay up to 2% commission. We are able to provide advice and service on a commission only basis. The advantage with commission-based option is that you can be sure of obtaining full advice about your pension but with nothing to pay.

Please note that if you decide to deal directly with the annuity provider, then they will not give you any commission rebate or any improved annuity rates and you will not benefit from full independent advice that PAAS provides concerning your individual retirement options.

Large case discounts
If you have a large case, we recognise that is discount is fair and we offer the following discounts.

REBATE AVAILABLE FUND AFTER TFC
10% of commission payable £100,001 to £200,000
15% of commission payable £200,001 to £500,000
20% of commission payable OVER £500,000

In the case of non-annuity products, a commission of 3% initial and trail commission of 0.5% is payable. We are happy to discuss commissions before any work is undertaken.

Fee-based Advice
Some clients prefer to pay on a fee basis. Fee based advice is charged a fee of 1½% on any annuity business with any surplus commission being rebated back to you and any shortfall billed to you. All commissions are fully disclosed through personalised quotations so you know exactly how much commission has been paid and how much can be rebated or billed.

For more complicated retirement options, such as draw-down where the advice may be more complex and require ongoing advice, either an initial fee (and ongoing fees in all cases where the contract requires regular reviews) can be negotiated at outset on an hourly rate. This will be offset against commission payments with any surplus commission rebated and any additional fee owing billed to you. Fees are agreed between PAAS and yourself using a formal fee agreement form setting out the fee level payable and payment terms.

About PAAS

We've been advising clients on their retirement options since 1992 and one of the benefits of being independent and specialising in the retirement and investment sector, means that we can give you a fully comprehensive advice service encompassing the fields of investment and taxation.
We are totally independent

Our company has no outside shareholders and tie-ups.

There are other advice providers operating that are independent financial advice firms, but they may have substantial share holdings owned by insurance companies. This particularly applies to the large annuity advice operations.

The PAAS website

We created this website in order to make the process of understanding your pension options easier and clearer.

The PAAS website is not an annuity comparison website, in fact, beware of execution only websites, where they simply want to sell you an annuity as quickly as possible, without being responsible for giving advice.

Our service is based on being fully aware of the clients' situation and producing a comprehensive written report that explains the reasons for the recommendations given, and then implementing the purchase of the product.

We also take care of all the administration involved in transferring your pension funds to the new provider, checking policy documents, making sure all your questions are answered. This involves a considerable amount of time and this role should not be underestimated. You'll know how frustrating it is dealing with big companies at customer services phone lines, you never speak to the same person twice, and no one is accountable.

At the end of the day, you have to be aware of the complexities of the choices available to you. We hope that this website allows you to do just that!

This website was created to provide a comprehensive and informative annuity resource as possible to those looking ahead at their approaching retirement options. We hope it meets these objectives, and that you find this website both straightforward and logical. If there are any parts of this website that you have problems with, we are more than happy to hear from you.

Range of PAAS service

The Pension Annuity Advisory Service operates nationally by phone, email and fax.

Using PAAS – Getting started

You need to go to the website, and go to the "Getting started" menu option. Then you need to enter your details and to agree to our terms of business, then click the next button at the bottom right hand corner of the page. This takes you through to our Fact Find form, which you need to print off, complete, and then post to us at PAAS. If you have problems with any of the form, please phone on 0845 351 9928 so that we can answer your queries. The address and contact details are on the PAAS fact find form.

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