



A Guide to Lifetime Annuities



A Guide to Lifetime Annuities (Also known as Secured Pensions)

The most common way of obtaining benefits from a pension fund is to take part of the fund as a 'Pension Commencement Lump Sum' (that is, as tax-free cash) and use the balance to buy a lifetime annuity from an insurance company.

Many different types of lifetime annuity are now available. However, all are designed to provide you with an income for the rest of your life.

It is also possible to include a number of extra features within your lifetime annuity.

These 'add-ons' tend to increase either the amount of future income payments, and/or provide monetary benefits to your surviving spouse or dependants, in the event of your prior death.

However, each 'add-on' comes at a price and so will reduce the initial amount of income you receive (please see the table on page 4 for an indication of the cost of incorporating different 'add-ons').

Examples of 'add-ons' include:

- A guaranteed increase in income each year - to help combat the future effects of inflation;
- Provision for income payments to continue to your spouse or civil partner, if you die before them; and
- Provision for your income payments to continue for a minimum period of time (usually five or ten years), even if you die within the chosen period.

How much income will I get from my Lifetime Annuity?

The amount of income provided by a lifetime annuity will depend on such factors as your sex, your health, your age at outset, the annuity rates applying at outset (which typically move in line with long-dated gilt yields and interest rates) and whether or not you have opted for any 'add-ons'.

Please note that any 'add-ons' must be selected at the outset of the annuity and, once selected, cannot subsequently be altered or removed.

All income received from a lifetime annuity will be taxed as earned income on a 'pay-as-you-earn' (PAYE) basis.

What types of Lifetime Annuities are available?

1) Conventional Annuities

A conventional annuity is a guaranteed stream of income provided by an annuity provider, in exchange for the monetary amount built up in your pension 'pot' (which is called "the purchase price"). This remains the most popular choice of lifetime annuity and provides a guaranteed income throughout the lifetime of the policyholder (who is called the 'annuitant').

2) With-Profit and Unit-Linked Annuities

Unlike conventional annuities, the level of income is not guaranteed, but is linked to the performance of the underlying investment fund(s). As long as a pre-set annual rate of growth is achieved or exceeded, your income may increase in the future. However, your income could go down if the required annual rate of growth is not achieved. The with-profits approach is less volatile than the unit-linked option, but does not have as great a potential for higher income, as the underlying with-profits fund will normally apply a less aggressive investment strategy.

3) 'Retail Prices Index' (RPI)-Linked Annuities

Although a guaranteed pension annuity with fixed increases offers some protection from the effects of inflation, this is the only type of lifetime annuity that offers full protection of the future buying power of your income.

Your income tracks the Retail Prices Index (RPI), so the real buying power of your annuity (before tax) stays the same.

You'll start off on a (significantly) lower income than you would with a conventional annuity that pays a level income, as the amount will be based on the annuity provider's expectation of what inflation might be over the remainder of your lifetime.

Your income is then adjusted each year to reflect changes in the RPI. However, your income is not guaranteed to increase each year. In addition, if inflation ever falls below zero your income would also go down, unless you take out a guarantee against negative inflation at outset.

4) Impaired Life Annuities

An impaired life annuity is offered to policyholders who have medical problems that are likely to adversely affect their life expectancy. As the potential length of life of the annuitant affects income from an annuity, those with a reduced life expectancy can usually receive an increased annuity income.

5) Enhanced Annuities

The income received from enhanced annuities takes into account certain factors surrounding the annuitant's lifestyle and background, which could affect their life expectancy, albeit not as adversely as to secure an impaired life annuity; for example, a non-smoker is expected to live longer than a person who has smoked twenty cigarettes a day for most of their life.

6) 'Deferred Purchase' Annuities

These types of annuity are relatively new and can be quite complex in structure. Although they are still annuity products, they do provide the annuitant with the ability to defer the purchase of a final lifetime annuity until after their 75th birthday.

7) 'Value Protection' Annuities

These are very similar to a conventional annuity, except for the death benefit options. Since 6th April 2006, it is possible for a value protection annuity to provide a return of capital on the death of an annuitant, provided this occurs before age 75.

The maximum return of capital payable is calculated as the initial annuity purchase price, less the total income actually paid out up to the date of the annuitant's death and less a one-off 35% tax charge.

If a surviving spouse's pension is also selected at outset, the lump sum will only become payable in the event of the second death before age 75, and will take into account the aggregate income paid to both the annuitant and the surviving dependant.

Due to the enhanced death benefits, a value protection annuity is likely to be more expensive than a conventional annuity.

Advantages of Lifetime Annuities

- **Guaranteed income:** a conventional annuity provides a guaranteed income for life. This means that you know how much income you will receive for the rest of your life, no matter how long you live.
- **Flexibility:** with most pension plans you can purchase an annuity on the 'open market'. This means that you can 'shop around' in order to get the most competitive annuity rate available on the market. This is an option that we would strongly encourage you to explore.
- **Death benefits:** annuitants benefit from a 'cross-subsidy' arising out of mortality. This means that those who die early subsidise those who live longer, so allowing a higher income to be paid. However, this subsidy reduces in value, the longer that annuity purchase is deferred.

Disadvantages of Lifetime Annuities

- **Timing:** when you buy your annuity, you are locking into the annuity rates available at the time. If annuity rates are relatively low, your income for the rest of your life may be adversely affected.
- **Lack of flexibility:** once you have made your decision and purchased an annuity, it is not possible to change any aspect of that decision, or the nature, or scope, of any 'add-ons', which may have been included at outset.
- **Death benefits:** annuities are usually only payable for the rest of your life. With the possible exception of a value protection annuity, if you (or your spouse / civil partner, if you included provision for a survivor's pension after your death) die soon after purchase, it is unlikely you will receive back the full value of the fund used to purchase the annuity.
- **Lack of investment control:** by purchasing a conventional annuity, you lose all control over the future investment of your pension fund, in return for a guaranteed income for life.
- **Effects of inflation:** the buying power of your annuity income may not keep pace with inflation, even if you select an increasing income.

The Cost of Incorporating Different Annuity Features

The table overleaf shows how choosing different 'add-ons' can reduce the actual income you receive, compared with a single life lifetime annuity that includes a five year guaranteed payment period, but no yearly increase in your income.

Please note that the table is for indication purposes only and the actual cost of incorporating different options can vary quite significantly between annuity providers.

OPTIONAL BENEFITS	Age 60	Age 65	Age 70	Age 75
50% spouse's pension	-18%	-20%	-23%	-26%
66% spouse's pension	-22%	-25%	-29%	-32%
100% spouse's pension	-29%	-33%	-37%	-41%
3% a year increase	-30%	-27%	-23%	-20%
5% a year increase	-47%	-42%	-37%	-32%

Suitability

Conventional lifetime annuities are most likely to suit individuals who want absolute guarantees with their future income payments and possibly also for their spouse or civil partner.

Conventional lifetime annuities, therefore, typically suit individuals with a low attitude to risk, those who have relatively small pension funds, or those who are heavily reliant on their pension income in retirement.

For further information or to book an initial consultation, please call us on 0208 722 0734.

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