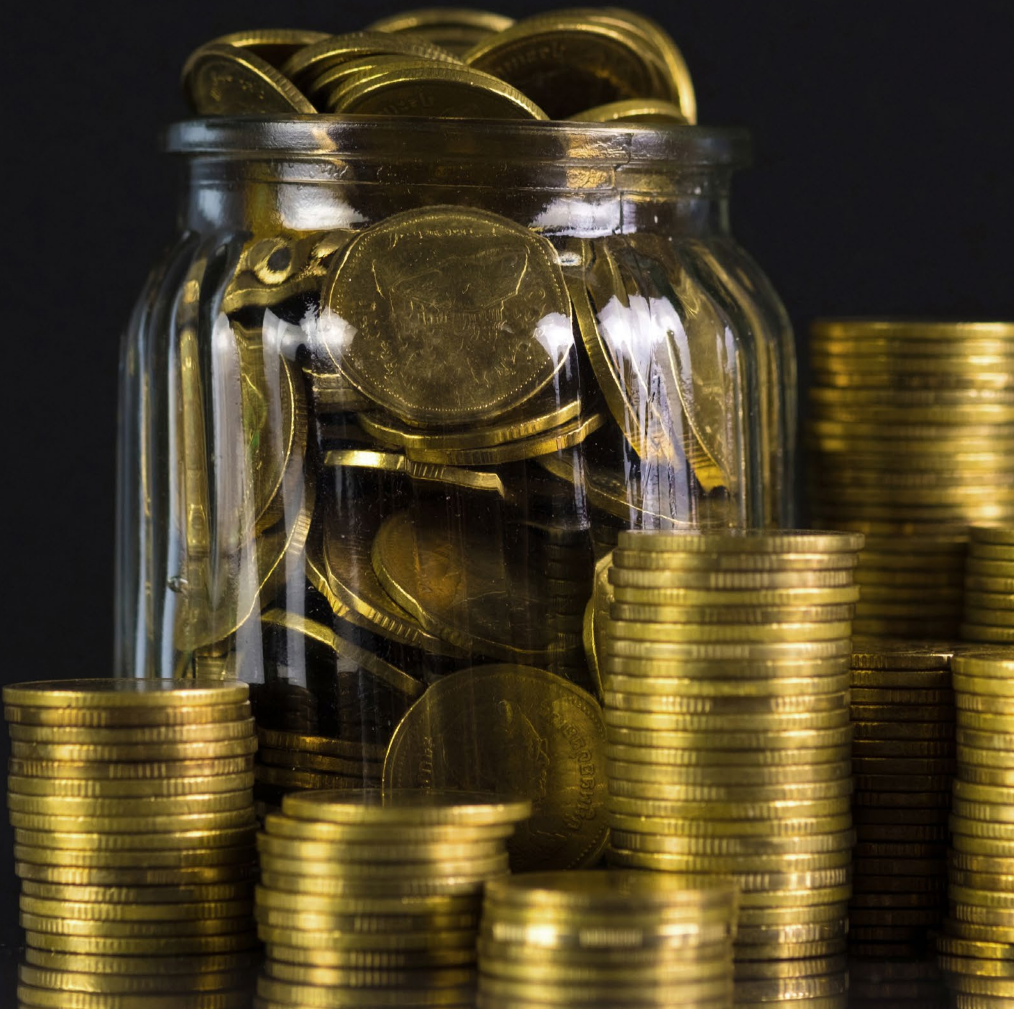
EQUILIBRIUM

A guide to annuities



What is an annuity?

An annuity is a contract between yourself and an insurance provider, that in exchange for some or all of your pension savings, they will provide you with a guaranteed income, based on the current annuity rates offered at the time.

For example, after taking your tax-free cash, if you had a £1,000,000 pension fund and annuity rates were 3%, you would receive an annual income of £30,000. These payments are classed as income and therefore liable to income tax.

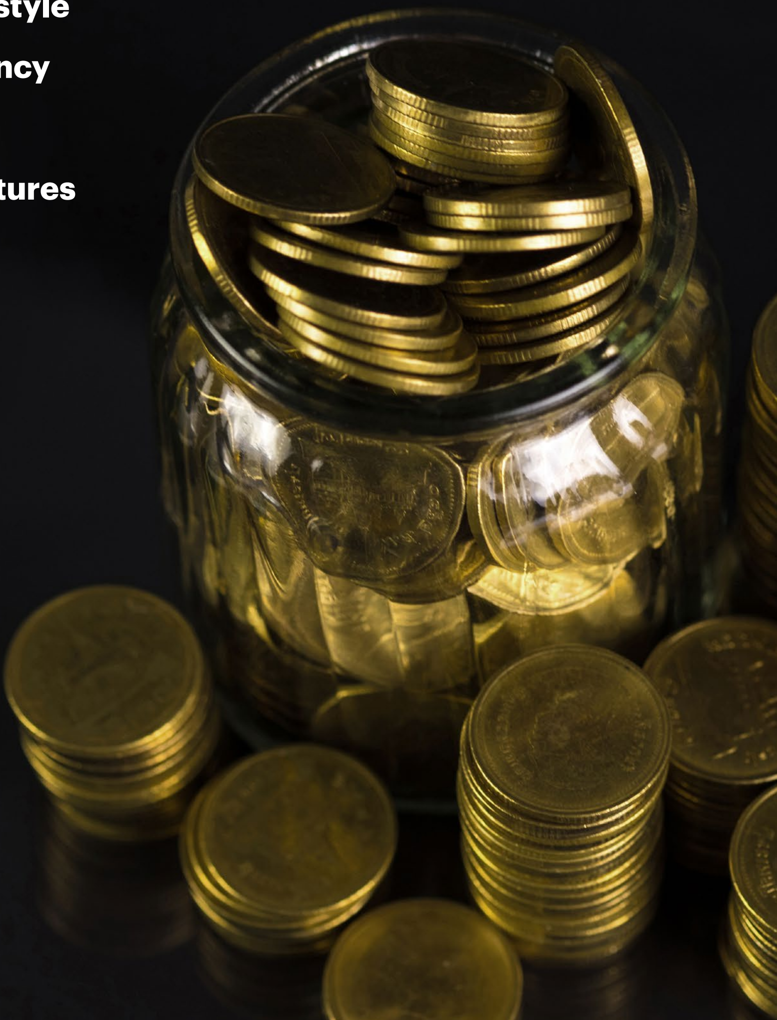
Annuities offer the benefit of certainty. Unlike a flexi-access drawdown pot, an annuity will pay you regardless of what’s happening in the stock market.

You can take out an annuity from 55 years old but this is set to increase to 57 by 2028 (based on current government rules).

What goes into an annuity rate?

There are many factors which affect an annuity quote such as:

- **Age**
- **Health & lifestyle**
- **Life expectancy**
- **Gilt yields**
- **Optional features**



Annuity features

Type

Lifetime annuity

The annuity is guaranteed to pay you for the entirety of your life.

Temporary/Fixed-term annuity

An annuity that pays out a specific amount of money for a set length of time e.g. 5 years or until you pass away, whichever occurs first

Income

Level

You will receive the same payment from the start to the end of the contract. This means that over a long period of time, inflation could erode the real value of the payments.

Escalating/Increasing

The income you receive from your annuity will increase by a specific amount (e.g. 2%, 3%, 4%, 5%) on an annual basis.*

Inflation linked

The income you receive from your annuity will increase by CPI or RPI on an annual basis.*

Guarantee period

A guarantee period provides protection should you pass away early in your annuity contract. For example, If you set up an annuity with a guarantee period of 5 years and you pass away within 2 years, the annuity will continue to make regular payments for the remaining term of the guarantee period (3 years). Alternatively, a lump sum may be offered depending on the provider.

* Purchasing an annuity with increasing or inflation linked income, will likely result in a lower rate offered at outset.

Death benefits

Single Life

Taken out in your name only. Should you pass away, your income will cease and no capital will be returned. Except under any guarantee period if chosen.

Joint life

When you pass away, the income you were receiving from the annuity will be paid proportionally to your spouse, partner or named beneficiary.

Payments

Annuities can be paid on a monthly, quarterly, six-monthly, or annual basis and you can choose your preference at outset. Once selected you cannot change how the income is paid.

In advance or in arrears payments

Monthly basis: if you opt for 'in advance', you will receive your first monthly payment straightaway, whereas 'in arrears', you will receive the first payment a month after you arrange your annuity.

Annual basis: 'in advance' payment will be received straightaway, and 'in arrears' will be received at the end of the year. This choice can affect the rate you are quoted from an annuity provider as an 'in advance' payment may be subject to a slightly lower rate.

Proportion of payments

When receiving payments 'in arrears', an annuity can be set up with or without proportion of payments. For example, if an annuity commences on 1 January on an annual (in arrears) basis and you pass away on 1 September, the following will apply:

With proportion: the estate would receive 8/12 of the annual payment.

Without proportion: the estate would receive nothing.

Other types of annuity

Enhanced/Impaired Life:

If you are in poorer health, the annuity provider will offer you a better rate than a standard annuity.

Immediate care needs/long-term care:

You can use this type of annuity to cover some or all the costs of care home fees when a loved one goes into care. If it is paid directly to the care home, this is classed as a tax-free payment.

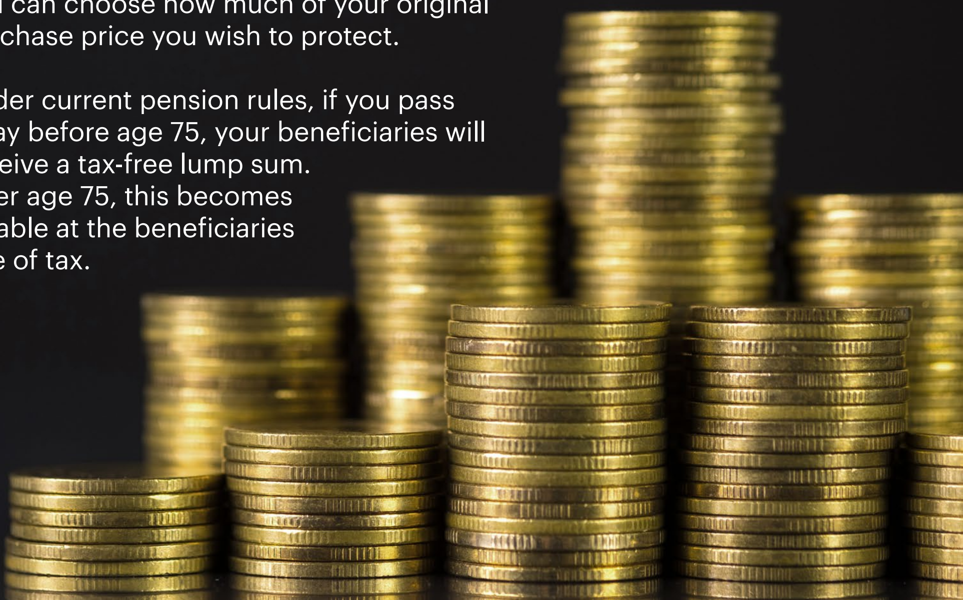
Value Protection:

You can protect a proportion of the initial capital you paid to purchase your annuity. This is most suited for those who want their loved ones to receive some return of the capital invested in an annuity following the passing of the annuitant.

For example, if you protect £100,000 and only receive £30,000 in income by the time you died, your beneficiaries would receive £70,000.

You can choose how much of your original purchase price you wish to protect.

Under current pension rules, if you pass away before age 75, your beneficiaries will receive a tax-free lump sum.
After age 75, this becomes taxable at the beneficiaries rate of tax.



The pros and cons

Pros

Certainty

Guaranteed income for life or a set period of time, which could be inflation linked. After you pass away, your spouse or partner could receive a proportion of the income.

Insurance against volatility

Whatever happens in the financial markets, you are guaranteed to get income each month without seeing the value of your pot fluctuate.

Longevity

There is no need to worry about outliving your pension pot, a lifetime annuity will continue to provide income until the day you die.

Cons

Lack of flexibility

As the income level is fixed throughout the annuity contract, the monthly payment cannot be altered to allow for any ad hoc spending such as a holiday, your children's wedding or other gifts.

Control

At Equilibrium, we consider all assets and income sources and holistically generate your retirement income. As we have seen, governments can alter tax rates at short notice. Due to the fixed level of income from an annuity, this could prevent income being paid from more efficient sources.

Intergenerational planning

When you purchase an annuity, you are giving up capital value for regular income. As such, the capital cannot be passed to your spouse or future generations.

If you have any further questions, please don't hesitate to get in touch with our experts on **0161 486 2250** or email **info@equilibrium.co.uk**.

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