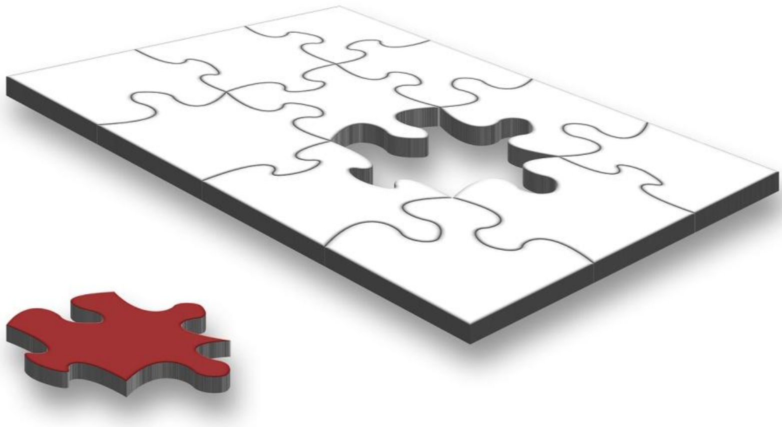
Making the pieces fit



A guide to retirement income

from Annuity Direct Ltd

annuitydirect ltd.

The Retirement Income Specialists

FINANCIAL PLANNERS CII CHARTERED

Contents

Look out for the special focus tips throughout this booklet.

About this booklet

We at Annuity Direct Ltd have written this booklet. We are one of the best known names in retirement income. We are Chartered Financial Planners – one of the highest honours an advisory firm can receive. We have been advising clients since 1992 and have received many positive comments from highly satisfied clients. The media often ask us for our views and we regularly contribute to articles in consumer and professional publications.

The first and possibly most important point to make is that our advice is totally independent of any product provider and we operate across the whole market. This is becoming a highly relevant feature for two reasons.

The market is becoming more complicated and you need an independent view of all products offered by all product providers if you are to get to the right solution for your retirement needs.

A number of firms, including product providers, will only use a limited number of annuity providers. If you use one of these firms, there is a very real possibility that you will not get the highest income and so will lose income each year for the rest of your life.

Ask any adviser you speak to if they operate on a 'whole of market' basis for all sizes of fund. Some will restrict choice for smaller funds in exchange for larger commission.

We operate in the whole of the market for all funds above £10,000, which is the minimum fund size we will advise on (after paying tax-free cash).

Your pension scheme

In a booklet which is all about taking income from a pension scheme, it may seem strange that our first section is about the policy (or policies) that you may have started many years ago to build up a retirement fund. It is our basic belief that this has to be the starting point. This is because, very often, old pension schemes have clauses that can either benefit or disadvantage you. As a result we need to fully investigate your existing scheme and this is all part of our service. Simply give us authority to talk to your pension provider about your arrangement and once we have all of the information we need, we will report our findings to you. We will point out any issues that you need to be aware of.

Ask any firm you are speaking to if they investigate your existing arrangements and if so, what is the list of items they look at. If they do not carry out investigations, consider if you want to continue without this investigation, or how confident you feel about carrying out your own investigation.

The issues we investigate include:

The availability of guaranteed annuity rates
These are often unbeatable in today's market and if you have this type of benefit, we will often recommend that you use it, depending on your circumstances.

Whether there are any financial penalties
You may have to pay a charge by taking the income or making changes to your policy. We will also find out what date in the future these penalties are removed.

Whether any final bonus is due on a future date
This may mean that it is in your interest to wait until that date. Funds can sometimes increase significantly on certain dates.

Attached life cover
Some policies have life assurance or premium waiver benefit attached to them. This will almost certainly be cancelled if you buy an annuity. We can sometimes arrange for the life cover to be continued if it is important – for example, if it covers a mortgage.

Tax-free cash
The HM Revenue & Customs rules around pensions are complicated. Some old policies may have a tax-free cash entitlement that is greater than 25%. If available, many clients find this attractive.

Contracted-out status
Some older policies can include benefits you have built up from a period of contracting out using an employer's occupational pension scheme. The value of the fund is not always enough to support paying these valuable benefits if they are transferred elsewhere.

Tax-free cash

You are normally entitled to take up to 25% of the value of your fund as a tax-free cash sum to invest or spend as you want. Even if you don't need the cash, we would discuss the effects on the tax you pay of taking a higher pension – there are arrangements such as purchased life annuities that may improve your net income – and we will compare these for you. You might also consider investing in an ISA which allows you to take income without having to pay tax.

Risk and your retirement income

The first and most important question for you to answer is how much risk do you want to take with your pension? If the answer is none, you want an absolute guarantee that your income will not fall, the only option is to buy an annuity.

However, if you are prepared to accept some risk that your income may fall, or rise, depending on the performance of an investment fund, there are options. These range from annuities that link to the stock market or with-profit funds through to unsecured pension arrangements.

We can offer advice on all types of arrangements and our aim is to help you to understand the advantages and disadvantages of each. There is no perfect answer – only the one with which you are most comfortable. This sums up our approach to clients. We want to help you to understand what you are doing so you can make an informed buying decision. We will never try to sell you a product you are not completely comfortable with.

Not all firms are prepared to discuss the full product range and some are only interested in selling. You should aim to understand the issues and only agree to buy when you are totally comfortable. Remember – this may be your first and only trip into the retirement market so it is important to get it right.

Guaranteed income

The first decision is whether you want to buy your income for life or for shorter periods. The following information may help with this decision.

Income for life (also known as guaranteed or lifetime annuity)

Once you buy an annuity, it is for life and you cannot change it, cash it in or transfer it to another provider. You need to get the best possible rate and that is why you should use a whole-of-market adviser.

Short term annuity

You buy an income for a period of years, normally at least five years. At the end of the chosen period you get back a guaranteed amount that you can use to either buy a lifetime annuity or another short-term annuity. There is a risk that your income could fall (or rise) at the end of your chosen period, depending on changes in annuity rates generally, your increased age, changes in the law or if you have developed a health issue.

What sort of income you want

We can arrange your income to fit your exact needs. The following is a list of options.

How often do you want to be paid?

You can choose to be paid every year, every six months, every three months or every month. As a general rule, the longer you leave between payments, the more you get. However, you need to balance this with your own budgeting needs. You can be paid at the start (known as 'in advance') or end ('in arrears') of the chosen period. Most people choose monthly payments in arrears as this is how they received their salary. Again, you tend to get a slightly higher income if you choose to be paid in arrears instead of in advance because the annuity company passes on some of the extra interest or growth they earn on funds over that period.

Do you want a guaranteed period?

You can include a guaranteed period of up to 10 years (up to five years for protected rights). This means if you (and your partner) were to die within the guaranteed period, either a continuing income or lump sum could be paid to your estate which would represent the amount due to the end of the guaranteed period. The lump sum is only available if you have a five-year guarantee. Another option is to have the balance of your fund less income received so far (known as value protection) paid to your estate as a lump sum. Any payments made to the estate are taxed at different rates.

How much income will be left to your partner if you die first?

This can be any percentage up to 100% of your income, but the most common options are 50% or 67%. You will need to talk this over with your partner, taking into account any pensions or other income available to you both. As a general rule, the more income you leave to your partner, the lower your annuity. However, this will depend on their age and health.

Do you want your income to rise each year?

You can increase your income by a fixed amount (for example, 3% or 5% a year) or in line with inflation (retail prices index or RPI). Your starting income will be at a much lower amount than if you choose a level annuity. The general rule is that you will benefit most from an increasing annuity if you live for a very long time. We can help you investigate increasing your income.

The following table is an example only but shows you the effect on your income of the options shown above. The highest possible income would be paid each year in arrears on a single-life basis with no increases each year. If a 65-year-old man received an income on this basis of £10,000 a year, then changing the benefit structure would reduce the income by the following amounts.

Table 1 – Example income options

Option	**Income**
Payments monthly in arrears	£9,688
Including a 100% spouse's pension for a 62-year old spouse	£8,029
Including a 10 year guaranteed period	£9,692
Including 3% annual escalation	£7,359
Including annual increases linked to RPI	£6,330

This table is an example only and actual rates will vary. These figures are stand-alone; only one variable is being altered each time.

Discuss your income needs with your partner. You need to work out how much income you both need depending upon who dies first. Take into account all income you are both receiving and any benefits either of you may be entitled to. Our advisers can go through all these options and discuss them with you. Remember you can find out about your State Pension entitlement by visiting www.direct.gov.uk or by calling 0845 3000 168 and asking for a State Pension forecast.

Your health – could mean more pension

When a provider works out an annuity, they are making an assumption about how long they think you will live – your fund has to last until that point. An increasing number of providers (known as specialist or enhanced annuity providers) will now take health and lifestyle conditions (for example, smoking) into account and this can lead to a larger income (as they assume you will die sooner than someone who doesn't smoke). The process is quite simple. You only need to fill in one medical questionnaire that we send to all enhanced annuity providers by secure email. These specialists offer you a rate based upon your answers and we will always recommend the highest rate.

You will never be asked to have a medical examination although the provider may ask your doctor to fill in a questionnaire if your condition is particularly complicated.

If you or someone you want to share your pension with smokes or is taking prescription medication please ask them to fill in the medical questionnaire. We always use secure encrypted email to send this to the enhanced providers so your confidential details are safe with us. Make sure your adviser gets quotes from all providers who underwrite enhanced annuities. You do not want them to only get quotes from a restricted panel of providers.

Investment linked annuities

It is possible to split these products into two.

- Those that offer a guarantee that your income will not fall below a fixed level.

- Those that do not offer a guarantee.

The important point about these arrangements is that income can fall as well as rise as it is linked to the performance of funds invested in the stock market. If you cannot afford to take that risk, you should probably avoid an investment-linked annuity.

As a general rule, a fund needs to achieve at least 7% a year in growth after charges for the income to be enough to beat a guaranteed annuity. Charges can add up to 2% a year to the performance the annuity needs to achieve.

These arrangements are most suitable for people who have enough guaranteed income already and want to take some risk with a smaller pension pot (for example, the proceeds of a free-standing additional voluntary contribution scheme). This is because they can afford the risk of their income falling.

Drawdown

This is where you do not buy an annuity. Instead you can withdraw 25% of the value of the fund as a tax-free lump sum and leave the rest invested. You take an income each year direct from your fund within levels laid down by Her Majesty's Revenue & Customs (HMRC). If the investments in your pension fund do well, you can take an increasing income (within HMRC limits). However, if they do not perform well enough, your fund may reduce, forcing you to reduce your income.

If you die, either your husband, wife or partner can continue to draw an income direct from the fund, buy a guaranteed annuity or the fund can be returned to them less tax at 55%. The options available will depend upon your age and your partner's age when you die.

There are two big decisions about drawdown:

To help you decide, we work out what return (yield) you need to achieve each year on the fund to be able to continue to draw an income that is equal to the guaranteed annuity you could take from the beginning. We work this out by finding the best annuity rate that would be available to you – taking account of your medical history if appropriate and then working out the yield needed to match it. The higher the annuity, the higher the yield you will need.

Does the type of investment needed to meet this yield fit with your own attitude towards investment risk?

If you decide this is the right option for you and that you can achieve the yield you need, we can recommend you to a firm that specialises in managing investment funds for darwdown. You can decide who you use to manage your fund but we believe this is a highly specialised area and our expertise is in the technical aspects of unsecured pensions – not managing investments.

Do not rely on standard insurance company quotes for drawdown. These will not take account of your medical history or income needs. Be wary of those who claim to be experts in everything – make sure they have specialist pension and investment departments.

What next?

We hope that this booklet has helped you to understand the issues you need to make decisions on. If you want to go ahead, please do the following.

Send the letter or letters of authority back to us. This will allow us to ask your pension provider the important questions to see if your arrangements mean your retirement plans may be affected.

If you or your partner smoke or are taking prescription medication, fill in the medical questionnaire and send it back to us. There should be a prepaid envelope in your pack.

Think about which product is most suitable – to guarantee your income or not.

Work out how you want your income to be paid, or the options you want to discuss with us. We are happy to provide quotes on more than one basis. Remember, we want to put you into a position where you can make a decision you are comfortable with.

What we do

On the day we receive your letters of authority, we send our questionnaire to your pension providers asking them about your arrangements. Each provider has a different service standard and it can take up to 15 working days for us to get the information we need. However, while we are waiting for the information, we send any medical questionnaire to all specialist providers and ask them to quote for your annuity. Once we have the information from your provider and the best annuity rate for you, we write to you letting you know the results of our investigations and recommending a course of action. If you have not decided on your annuity options at this point, we will write an options letter to you instead. This will give you a selection of figures to choose from.

We will let you have all the documents you need to put our recommendation into force. If you are happy to sign and send these back to us (together with proof of age, marriage (if this applies) and identification), we will arrange to set up your annuity. This includes chasing your pension providers to transfer your money to the new arrangement as soon as possible. We are not authorised to hold client money in any way.

Our service ends when we send you your policy documents. At this point, we ask you for your comments on our service. We pride ourselves on the quality of our customer feedback, and use real customer comments (anonymously) on our website.

Our charges

When insurance companies work out your annuity, they include an allowance to pay for financial advice. This is usually 1.5% of the value of your pension fund after you have taken the tax-free cash. If the case needs underwriting (because you have provided some medical or lifestyle information) it can be up to 3% of the fund (after tax-free cash) to reflect the extra work we do for these cases. This amount is included in the annuity rate you are offered and is not a direct charge from your fund.

Because we are independent advisers, you can choose to pay us by cheque for our services. If you do this, we will take nothing from the insurer which will result in you receiving a slightly higher income. Our fees will be:

- the commission we could have received; or
- our time and cost charge for advising on and arranging your annuity for you;

whichever is lower.

Most clients prefer us to be paid by the insurer as the reduction in their taxable pension income is only small, and the fee is effectively being paid from a pension fund that has received tax-relief. (If you pay the fee by cheque, you would normally pay this from taxable income).

If you have funds over £200,000, special terms will apply that reflect the work involved. In most cases we can take less from the annuity provider and improve the annuity as a result.

We always discuss charges in an open way and we include the amount we receive in your letter of recommendation.

Avoid any firm who is not prepared to be totally clear about their charges.

Your notes …

Use this page to make notes of any points you want to talk about when you contact us.

Remember you can call and speak to us free on 0500 50 65 75.

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