



RETIREMENT OPTIONS

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INTRODUCTION

The intention of this report is to show you the different choices available to you and to enable due consideration to be given to the advantages and disadvantages of each. A separate report will follow detailing my written recommendation of what I consider to be the best choice for you.

Essentially you have the following main options:-

1. You may leave your existing pension fund with your current provider. Then, if you wish, take a tax free cash sum (known as a Pension Commencement Lump sum) and utilise their annuity rates to purchase a conventional Compulsory Purchase Annuity, which guarantees a lifetime income.
2. You may exercise a transfer of the whole value of your pension fund to another provider which currently offers the best conventional annuity rate (known as the Open Market Option).
3. You may use the whole of your pension fund after any tax free cash has been paid to purchase a 'with-profits' annuity with your existing or another provider.
4. You may use the whole of your pension fund after any tax free cash has been paid to purchase a unit linked annuity with your existing or another provider.
5. You may convert your retirement fund in stages, over a number of years, into income (often referred to as staggered vesting or phased retirement) by transferring into a Personal Pension Plan.
6. You may transfer the whole value of your pension fund into an Unsecured Pension but only prior to age 75. This allows you to vary future income levels to fit in with your overall financial plan.
7. You may transfer the whole of your pension fund to an Alternatively Secured Pension but only from age 75. This allows you to vary future income levels to fit in with your overall financial plan but to a more limited extent than is available under unsecured pension.
8. You may transfer your pension fund to a provider offering a Scheme Pension. This allows for income levels to be actuarially determined based on your personal circumstances.
9. You may transfer your pension fund to a provider offering a "third way" annuity which attempt to combine the certainty of an annuity with the prospect of investment growth seen with Unsecured Pension.

**COMPULSORY PURCHASE ANNUITY**

An annuity pays you an income for your life time with the amount payable depending on such factors as:

- Your age, sex and health
- The amount of your pension fund
- Options selected

Level or Escalating?

A level annuity pays the same amount of income year after year. It pays a higher income compared to the initial starting income available under an escalating annuity, which will take a number of years to catch up and exceed a level annuity.

An escalating annuity, on the other hand, is designed to increase each year. The greater the level of escalation chosen, the lower the initial income. It is possible to select a fixed rate of increase each year normally in the range of 3% to 8.5%. Alternatively, you can choose to link increases to reflect changes in the Retail Prices Index (RPI), however, your income is not guaranteed to increase each year as the RPI may not rise and if it did fall, so would your income. Annuities can also escalate by Limited Price Indexation (LPI). LPI means your income increases each year in line with the RPI but only up to a maximum of 5%

Spouse/Dependants Pension

A joint life last survivor annuity pays out until the second person of a couple dies. It is possible for the annuity to continue at the same level to a survivor but most couples elect for an income between 1/3rd and 2/3rds of the original amount.

It is not necessary for a couple to be husband and wife and any person of either sex may be eligible for a dependants pension, although it is normally necessary in such circumstances to show financial dependency.

With some pension schemes a spouse's pension must be provided.

Frequency of Income

You may select at the outset how often you want to receive income each year. Most people choose monthly, but you can be paid quarterly, half-yearly or annually.

Income paid in advance or in arrears

Payments can be made either in advance or arrears. If you opt for monthly income and purchase your annuity on 1st January and you receive your payment on that day, you are being paid in advance. If your first payment is not made until 1st February, you are being paid in arrears.

With Or Without Proportion

When you die, an annuity with proportion will pay an amount proportionate from the last payment until the date of death. This is most valuable when income payments are made on an annual basis. This option is only available for payments made in arrears.

**Guaranteed Annuity Rates**

Some annuity providers have guaranteed annuity rates written into their contracts which will provide you with a considerably higher income than would normally be available. If such rates are available it is often the case that the benefits must be taken in a certain form i.e. single life, yearly in arrears.

Capital Protection

This option allows for a return on death equal to the difference between the cost of annuity purchase and the gross income payments received, less a flat 35% tax charge.

Guarantee Periods

If you select a guarantee period and you die within the period chosen, payments will continue for the balance of time remaining. Normally the guarantee period will be either 5 or 10 years. It may be possible for the remaining instalments to be paid as a lump sum. Depending on circumstances payments made during the guarantee period following the death of the annuitant could be liable to inheritance tax.

Impaired Life/ Enhanced Annuities

Some annuity providers offer annuities which pay you a higher than normal income if you have a medical condition(s) which can affect your normal life expectancy. These are called impaired life annuities. You might even obtain a better annuity if you smoke regularly or are over weight and some providers offer improved terms to people who have followed certain occupations or live in certain parts of the country.

Advantages

- You receive a guaranteed level of gross income for life
- Your spouse can enjoy a guaranteed level of gross income, in the event of your death (if applicable)
- Your pension can be payable for a guaranteed period of time (e.g. 5 or 10 years)
- You will be able to access your tax free cash lump sum immediately, (although you will receive a lower pension), to spend or invest as you wish.

Disadvantages

- The level of income is fixed at outset and cannot respond to changing personal financial circumstances
- The level of income is fixed at outset and will depend upon the level of annuity rates available at that time
- There is no possibility of benefiting from future investment growth on your pension fund, although an implicit rate of investment growth has been assumed when setting the annuity rate to provide your income
- In the event of death, depending upon the type of annuity you have purchased, benefits to your dependants could be lower than those enjoyed under some of the other options available to you and briefly explained in this report.



INVESTMENT LINKED ANNUITIES

With Profits Annuities

A With Profits Annuity provides an income that is linked to the investment returns of an insurance company's with profits fund. As for all Investment Linked Annuities, the income payable can go down as well as up in the future. With Profit Annuities do however provide smoothed investment returns. Smoothed investment means, in poor years, your income will not necessarily go down as much as the underlying investments have gone down. It also means that in very good years, not all of the investment return is necessarily paid out (some is retained to cover the bad years). So, With Profit fund returns should be less volatile than other investment funds.

Typically, income is made up of two parts:

A minimum starting income

This is set at a low level but, unless investment conditions are very bad, you'll usually get at least this much income. Some with-profits annuities guarantee it.

Bonuses

The insurance company usually announces bonus rates once a year. Bonuses can be both 'reversionary' (usually announced once a year guaranteed to pay out for the duration of your annuity) and 'special' – these only pay out for a year or so until the next bonus announcement. The amount of bonuses depends on many factors, the most important of which is stock market performance. When you start a with profits annuity, you normally select an anticipated bonus rate (ABR). The minimum and maximum rates of ABR you can choose vary by provider, but typically, the range is from 0% to 5% and normally once selected cannot be changed.

The insurance company announces new bonus rates every year. If the rate equals your chosen ABR, your income does not change. If the declared bonus is higher than the ABR, your income increases. But if the bonus is lower than the ABR, your income falls. If you choose a low ABR, your starting income is low. But you increase the likelihood that future bonuses will exceed the ABR and that your income will rise. You also reduce the risk that your income will fall. If you choose a higher ABR, your starting income will be higher. If you choose the lowest ABR of 0% in other words, assuming no bonuses at all, your starting income will be just the minimum. As long as the company declares any bonus at all, your income will increase. In general, your income can't fall, because the bonus rate can never be lower than 0%. However, if long-term stock market performance were very poor, even this minimum starting income could be cut, except in the case of with-profits annuities that guarantee the minimum.

Some of the products offer more flexibility than others. For example, some providers allow you to change the anticipated bonus rate after the start of your annuity. This gives some control over the income levels and the risk of income falls in the future.

Some providers allow you to convert to a standard annuity (which must be purchased with the same provider) at given points in the future. This means that you can change your annuity to one which provides set income levels and no investment risk. This can be useful if your circumstances change or standard annuity rates change.

Advantages

- You receive a minimum guaranteed level of gross income for life
- Your spouse can enjoy a semi or minimum guaranteed level of gross income, in the event of your death (if applicable)
- Your pension can be payable for a guaranteed period of time (e.g. 5 or 10 years)
- You will be able to access your tax free cash lump sum immediately, (although you will receive a lower pension), to spend or invest as you wish.
- Your income may rise above the guaranteed levels if the with profits fund performs well

**Disadvantages**

- The level of income is fixed at outset and cannot normally respond to changing personal financial circumstances
- Although an implicit rate of investment growth has been assumed when setting the annuity rate to provide your income there is no guarantee that investment returns will exceed or even match that assumed. Your income, therefore, could fall
- In the event of death, depending on the type of annuity you have purchased, benefits to your dependants could be lower than those enjoyed under some of the other options available to you.

Unit Linked Annuities

Your income in retirement will be linked directly to the value of an underlying fund of investments. Generally, there is a wide range of funds to choose from catering for most risk profiles including, fixed interest/deposits, property, equity and tracker funds.

The more risky the underlying fund you choose, the more your retirement income may vary – both up and down. Some unit-linked annuities work in a similar way to with-profits annuities.

Your starting income is based on an assumed growth rate and if the fund grows at that assumed rate, your income stays the same. If growth exceeds the assumed rate, your income increases. If growth is less than the assumed rate, your income falls. A few unit-linked annuities let you invest in a 'protected fund' which limits the fall in your income. Most unit-linked annuities do not guarantee any minimum income. Even if your income is based on an assumed growth rate of 0%, your income could still fall if the value of the underlying investment fund falls.

If the underlying assets are equities, the income payments made are likely to be more volatile compared to a with profits annuity. Although in the long term equities have produced the greatest returns, there is no guarantee that this can continue in the short term.

Advantages

- Your income fully reflects the movements in the value of underlying assets
- Your spouse can enjoy an income, in the event of your death (if applicable)
- Your pension can be payable for a guaranteed period of time (e.g. 5 or 10 years)
- You will be able to access your tax free cash lump sum immediately, (although you will receive a lower pension), to spend or invest as you wish.
- Your income may rise above your chosen assumed growth rate

Disadvantages

- Your income may fall even if a 0% assumed growth rate has been selected
- In the event of death, depending upon the type of annuity you have purchased, benefits to your dependants could be lower than those enjoyed under some of the other options available to you.



PHASED RETIREMENT

Most personal pensions can be arranged not as a single plan, but as a cluster of many separate plans, sometimes called 'segments'. The segments can then be used to buy annuities at different times. All the segments must be used to buy annuities by the time you reach the age of 75, unless you decide to move into an alternatively secured pension. This process is called 'phased retirement'.

Each time you convert a segment to an annuity, you can first take part of the segment's fund as tax-free cash (normally 25% of the segment). Converting segments regularly e.g. Once a year means you can effectively use the tax-free cash, as well as the annuity, to provide your income. The drawback is that if you stagger the conversion of segments into annuities, you will not be able to take all your tax-free cash from your total pension fund at once as a single lump sum.

You must convert enough segments each time to buy an annuity.

Phased retirement can be a very useful financial planning tool, for example, if you want to ease back gradually on work and start to replace your earnings with pension income. It also provides more flexible help for your survivors if you die. It is possible to vary the type of annuity on each occasion and it need not be on the same basis as the first or subsequent years. Segments that have not yet been converted to annuities can provide a pension for your surviving dependants or a lump sum, depending on the terms of the pension plan. Phased retirement is generally suitable only if you have a fairly large pension fund, or have other assets or income to live on. This is because the bulk of your pension savings remain invested, usually in the stock market, which may be more risky than buying an annuity straight away.

Advantages

- You can use tax free cash as 'income' and thus, for a given level of income, reduce your overall liability to Income Tax.
- The balance of your pension fund (i.e. the segments not cashed in or 'vested' to provide you with a given level of income required) continues to be invested, thus providing you with the possibility of higher future income. This depends largely on how much income you take out of the pension fund (especially in the early years) and future investment returns achieved on the residual pension fund.
- As you get older there is the prospect of annuity rates rising and providing you with higher income. This is because life expectancy is shorter for someone older and it therefore costs less to provide them with the same given level of income than for a younger person, assuming all other things being equal. The annuity is purchased by cashing in those contracts not previously cashed in or 'vested' to provide benefits (i.e. income required).
- If your market expectations are that medium to long-term interest rates and gilt yields may rise, annuity rates might also rise. If this happens, you will be able to achieve a higher amount of income, through the purchase of an annuity, for the same amount of pension fund 'cashed in'.
- You will be able to change the shape of your retirement income to reflect your personal circumstances in the future (although once you have purchased an annuity, this income payment will continue for the rest of your life).

Disadvantages

- There is no guarantee that your income will be as high as that offered under the compulsory purchase annuity or transfer routes referred to earlier.
- You must still purchase an annuity to provide income whenever you draw part of your tax free cash sum. Annuity rates at that time may not be favourable.
- Deferring the purchase of the annuity does not guarantee a higher level of future income and the value of your remaining pension fund, when aggregated with any annuity you have purchased, may not achieve the required level of growth to maintain income levels at the same level as those achieved through the purchase of a conventional compulsory purchase annuity purchased at outset. This is because withdrawals of tax free cash and annuities purchased may erode the value of your pension fund if investment returns are not sufficient to make up the balance (including charges for the ongoing administration of the plan).
- You may feel that the prospect of future higher income does not compensate you for not being able to enjoy a guaranteed and secure level of income today and for the rest of your life.
- You will not receive all of your tax free cash as a lump sum at outset, because you are using the cash to supplement your income.
- Annuity providers make a profit from the fact that some individuals die sooner than is expected. They utilise some of this 'mortality profit' to enhance current annuity rates. By delaying the purchase of your annuity, the benefit of this potential profit, which can be significant, may be lost.

**UNSECURED PENSION (USP)**

You do not have to buy an annuity straight away when you want to start taking an income from your pension fund. Instead, you can put off buying the annuity as late as age 75, unless you decide to move into an alternatively secured pension, and in the meantime, you can take an income direct from your pension fund. This is often referred to as 'income withdrawal' or 'income drawdown'.

If you want to take part of your pension fund as a tax-free lump sum you do this before starting to take income from the fund. The income you take out of your remaining pension fund is taxable. USP is an option with some personal pensions and some types of employer's scheme. But sometimes, if you are in an employer's scheme and want to use USP, you must first transfer your pension rights from the employer's scheme to a personal pension. There will probably be charges for making this transfer.

The amount of income you are allowed to take each year must be no greater than the maximum set by the Government Actuary's Department (GAD). The maximum limit (120%) is taken from a table produced by the GAD. Like annuity rates, this maximum often changes. Although there is a maximum level of withdrawal there is no minimum and you will be able to vary your income between these limits to suit your individual circumstances. The company that you invest with must review your income withdrawal arrangement every five years. This is to make sure that your income does not exceed the Inland Revenue's maximum limit. This means that you may have to adjust your income, especially if you had been drawing the maximum. You should think about reviewing your income every year as well as the decision on when to make the final annuity purchase.

If you die whilst drawing an income from the plan your dependants will have the option of continuing to take withdrawals (USP or ASP), buying an annuity or taking the remaining fund as a lump sum, with liability to tax at 35%.

It is also possible to combine Phased Retirement with USP which would mean that you would start to draw an income from just part of your pension fund on one date, leaving the rest of the fund intact. To increase your income at a later date, you could either increase the rate of withdrawal (provided you did not exceed the maximum limit) or start to draw an income from a further slice of your pension fund.

Advantages

- Subject to limits imposed by legislation, you will be able to plan in advance the level of income that you wish to take each year, so that you can take into account any other sources of income which may become available to you.
- You can structure your income to mitigate liability to personal income tax. By reducing your income in some years you may be able to avoid higher rate tax liability.
- You can take a tax free cash lump sum immediately to spend or invest as you wish.
- The pension fund value (less any income withdrawn and associated charges) will continue to be invested for you until you decide to purchase your annuity. Depending upon investment returns, which can fall as well as rise and are not guaranteed, this may provide the opportunity to achieve sufficient growth to improve your ultimate benefits when you decide the time is right to purchase an annuity.
- You can delay purchasing your annuity if you think rates will improve.
- As you get older there is the prospect of annuity rates rising and providing you with higher income. This is because life expectancy is shorter for someone older and it therefore costs less to provide them with the same given level of income than for a younger person, assuming all other things being equal.
- The remaining pension fund (i.e. policies not being used to provide income) can be returned to your beneficiaries, normally free of Inheritance Tax and the 35% tax charge.



Disadvantages

- Annuity rates may be at a lower level when annuity purchase takes place and there is no guarantee that your income will be as high as that offered under the other options referred to earlier.
- There is no guarantee that annuity rates will improve in the future. They could be lower when you decide to purchase your annuity than they are currently. Your pension may be lower than if you bought a compulsory purchase annuity now.
- You have to purchase your annuity by age 75, unless you decide to move into an alternatively secured pension and will be subject to the annuity rates available at the time of purchase.
- The value of your pension fund may go down as well as up and investment returns may be less than those shown in the illustrations.
- Taking withdrawals may erode the capital value of the fund, especially if investment returns are poor and a high level of income is being taken. This could result in a lower income when the annuity is eventually purchased.
- High income withdrawals may not be sustainable during the deferral period
- Death benefits which are not paid to your spouse or dependants might be liable to Inheritance Tax.
- Death benefits payable as a lump sum under contracts being used to provide income are subject to tax at a special rate of 35%.
- You may feel the prospect of future higher income does not compensate for the guaranteed level of income available today, and for the rest of your life, that a conventional annuity provides.
- Annuity providers make a profit from the fact that some individuals die sooner than is expected. They utilise some of this 'mortality profit' to enhance current annuity rates. By delaying the purchase of your annuity, the benefit of this potential profit, which can be significant, may be lost.
- If investment returns do not at least match the critical yield (in simple terms, the value of growth required to provide an equivalent income at age 75) your eventual income is likely to be less than what could have been available at outset.

Unsecured Pension (short-term annuity)

Your fund is initially divided into two separate elements. The first element will be used to secure a temporary annuity not exceeding five years. As a temporary annuity costs less to provide than a similar lifetime annuity, the bulk of your fund will be available for investment.

After the chosen period the temporary annuity will cease and you then have two options with the remaining invested part. You can decide to secure another temporary annuity or buy a lifetime annuity. You may repeat this process over and over again but cannot go past your 75th birthday.

As with standard annuities, there is no return on death unless you select a guarantee period and or a spouse's/partner's pension. However, this product does allow you to change the spouse's/partner's pension provisions at each review to reflect changes in your circumstances.

Advantages

- You receive a guaranteed level of gross income both at outset and at your chosen yearly intervals
- Your spouse can enjoy a guaranteed level of gross income, in the event of your death (if applicable)
- Your pension can be payable for a guaranteed period of time (e.g. 5 or 10 years)
- You will be able to take a tax free cash lump sum immediately, (although you will receive a lower pension), to spend or invest as you wish.

Disadvantages

- The level of income is fixed initially and for any subsequent chosen yearly intervals and cannot respond to changing personal financial circumstances
- The level of income is fixed initially and on 5 yearly reviews will depend upon the level of annuity rates available at that time and may be smaller than the income that you received at outset
- The rate of growth needed within the investment element to provide an annuity at the end of the chosen period which is at least equal to the annuity level at outset may not be achieved
- In the event of death, benefits for your dependants could be lower than those enjoyed under some of the other options available to you and briefly explained in this report.
- You have to purchase your annuity by age 75, and will be subject to the annuity rates available at the time of purchase.



ALTERNATIVELY SECURED PENSION (ASP)

ASP is only available from the age of 75 and is a limited form of income withdrawal. It was specifically introduced because certain religious groups object to annuities on moral grounds.

Any tax free cash available must be taken prior to moving into ASP as this option will be lost once in ASP. Income is taken directly from your fund and must be no greater than the maximum set by the Government Actuary's Department (GAD). The maximum limit (90%) is taken from a table produced by the GAD, based on an age of 75.

When ASP was first introduced there was no minimum withdrawal figure but, following the 2007 Budget, a minimum of 55% of the GAD figure must be taken. If this minimum is not taken, then a tax charge of 40% of the difference between the required minimum and the actual amount withdrawn will be levied.

Reviews to set the income limits must be undertaken annually, but the rate used must continue to be based on an age of 75, rather than your actual age. If the fund remains at the end of the alternatively secured pension period, the death benefits are contingent upon whether the deceased has any surviving dependants.

If there are dependants, then the remaining fund must be used to provide dependants pension benefits. No lump sum is payable. The dependants' benefits can take the usual form of an annuity, unsecured pension (if aged under 75) or alternatively secured pension (if aged 75 or over). If a dependant's alternatively secured pension is chosen then, on the dependant's death, the test is again whether there are any dependants of the member. If there are, then again pension benefits must be provided. Where funds are used to provide dependants' benefits, then no inheritance tax or unauthorised payment tax will be levied.

If there are no dependants there are two options available; the transfer lump sum death benefit and/or the charity lump sum death benefit.

The transfer lump sum death benefit allows the transfer of remaining funds to another member's arrangement within the deceased member's registered pension scheme. In this way it is therefore possible to pass funds on to the next generation. Such transfers will be liable to inheritance tax as if they were part of your estate. In addition, following the 2007 Budget such funds will be treated as an 'unauthorised payment' and taxed at up to 70%.

The charity lump sum death benefit enables you to nominate a charity (ies) to receive all or part of your remaining alternatively secured pension fund. As charitable gifts are generally exempt from Inheritance Tax, payment of the lump sum death benefit will not give rise to an inheritance tax or unauthorised payment tax liability. It will also be possible for a scheme administrator to nominate a charity if there is no member nomination.

Advantages

- Subject to limits imposed by legislation, you will be able to plan in advance the level of income that you wish to take each year, so that you can take into account any other sources of income which may become available to you.
- You can structure your income to mitigate liability to personal income tax. By reducing your income in some years you may be able to avoid higher rate tax liability.
- The pension fund value (less any income withdrawn and associated charges) will continue to be invested.
- You do not have to purchase an annuity.
- If you do not leave any dependants your fund could be passed on to other members of your registered pension scheme (though subject to tax) or nominated charity.

Disadvantages

- The value of your pension fund may go down as well as up and investment returns may be less than those shown in the illustrations.
- Taking withdrawals may erode the capital value of the fund, especially if investment returns are poor and a high level of income is being taken.
- If you leave a dependant benefits can only take the form of an annuity, unsecured pension or alternatively secured pension.
- If your pension fund is passed on to other members of your registered pension scheme there will be a liability to inheritance tax and unauthorised payment tax.
- You cannot take a tax free cash sum from your alternatively secured pension.



SCHEME PENSION

A defined benefit scheme has to provide a Scheme Pension whereas other types of pension arrangement are not compelled to do so. This has led to a number of providers deciding to offer this option alongside others such as USP and ASP.

A Scheme Pension can only be taken after the offer and refusal of an annuity, at any time, after age 50 (55 from 2010). It is an alternative way to take an income but is based on your individual circumstances. Unlike USP and ASP which have income limits imposed by GAD, a Scheme Pension will be determined by an actuary with the maximum income that can be withdrawn based on your age, sex, state of health, mortality, any escalation or guaranteed period and fund value. In many situations this will potentially allow a larger income to be taken.

There are regular reviews and these again are based on your circumstances prevailing at the time of the actuarial review. This can be particularly useful where your state of health has worsened and the actuary is able to reset the income at a level whereby the reduced longevity can be reflected by an increase in the amount of Scheme Pension payable.

It is also possible to provide a dependants Scheme Pension although it cannot be higher than the Scheme Pension the deceased received.

There are rules set by HMRC with regards to increasing and decreasing the amount of Scheme Pension you can take and if these are breached, substantial tax charges may apply to your fund.

Up until very recently the UK retirement market has been dominated by providers of traditional annuities and income drawdown plans but new plans are starting to emerge which attempt to combine the certainty of an annuity with the prospect of investment growth seen with income drawdown i.e. the best of both worlds. Generally speaking these third way annuities fall into three main categories;

THIRD WAY ANNUITIES

- Annuities with flexibility- these are similar to traditional annuities ie payable through out lifetime but with a degree of income and/or investment flexibility
- Fixed term annuities – these provide a guaranteed income for a set period of time with a guaranteed or reviewable maturity value. These plans mature at age 75 when either a conventional annuity must be purchased or alternatively secured pension is selected.
- Income drawdown with income guarantees – these are similar to income drawdown plans but with some level of underpinning income guarantee which will continue no matter how the underlying investment performs. Some plans provide an income for life whilst others either have to purchase a conventional annuity at age 75 or elect for alternatively secured pension.



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