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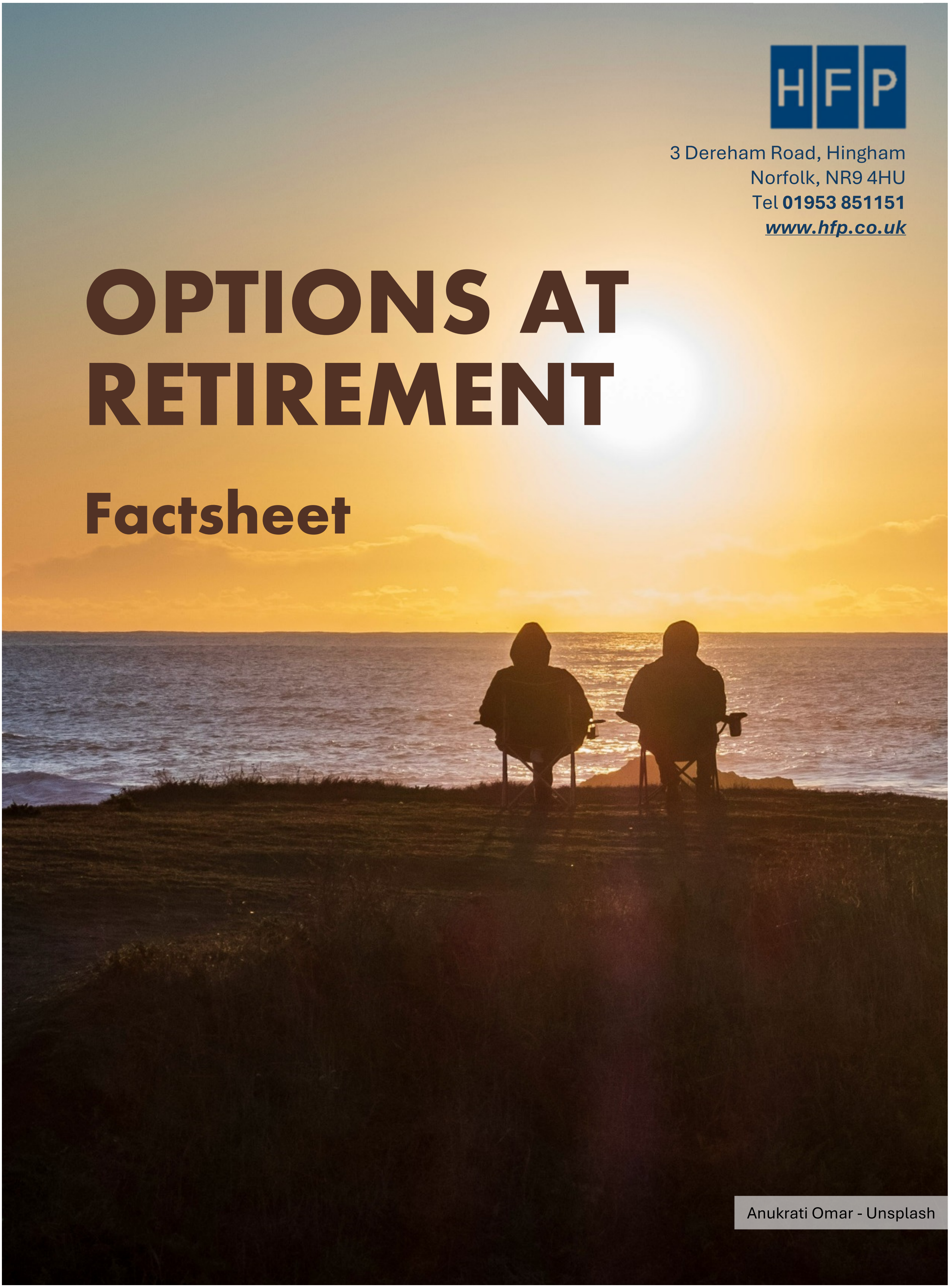
OPTIONS AT RETIREMENT

Factsheet



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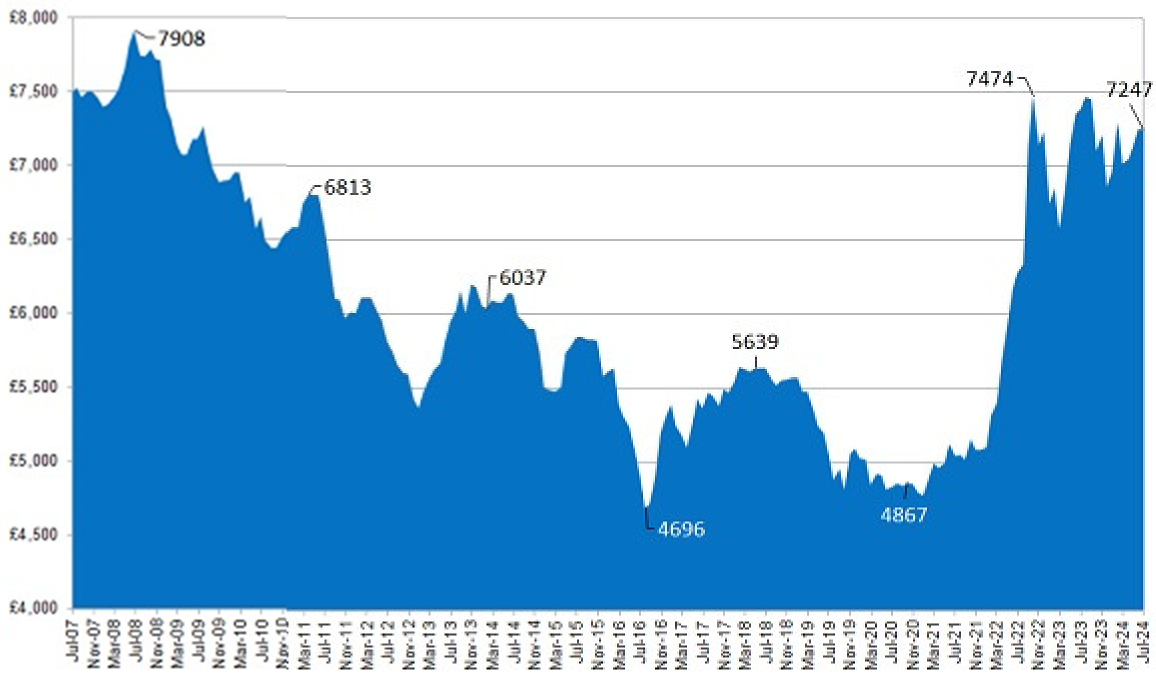
ANNUITY PURCHASE

An annuity is an income purchased by a lump sum such as an accumulated pension fund. It is normally paid monthly for the rest of your life and can continue to a dependant, such as a wife or husband, after your death (possibly at a lower level). It can be for a fixed amount or can increase each year, for example in accordance with changes in the cost of living. It provides certainty and security of future benefits.

Under this type of arrangement, you can take up to 25% of your fund as tax-free cash (called a Pension Commencement Lump Sum) immediately. You then receive a guaranteed level of income for life. The level of income is fixed at outset and can be guaranteed for a certain period of time (e.g. 5 or 10 years) which means that in the event of your death during the guarantee period, the pension would continue to be paid. We have detailed below how annuity rates have changed over the last 17 years:



Annuity rates chart for £100,000 fund, aged 65, level and single life

Source: Sharing Pensions, July 2024

The annuity can be purchased either with your existing company or you can exercise your Open Market Option and transfer your fund to a different company offering a better annuity rate.

As an alternative to purchasing an annuity throughout life you could select a Fixed Term Annuity. Generally, the term is selected at outset and this could be between 3 and 10 years. At the end of the period you will have a Guaranteed Maturity Value to purchase another annuity. The advantage of this approach is that you are not buying a rate fixed throughout life at a poor time to do so. This may because annuity rates are low and you believe that they will rise in the future.

A fairly recent innovation is the introduction of 'Impaired Health' annuities. Several companies will offer better annuity rates for individuals who suffer from a serious health condition or who are long term smokers. This is because they expect to pay the annuity for less time than for a person of standard health or who is a non-smoker. On average these rates can be up to 20% higher than standard rates and they may be dependent on a short report from your own GP, which will be paid for by the annuity provider.

UNITISED ANNUITIES

The fundamental difference with a Unitised Annuity is that it allows you to continue to share in the performance of investment funds after you retire.

Although the level of income paid can vary, the basis on which the pension amount is determined is fixed at the start. In return for investing your pension fund in a unitised annuity, you get a pension where payments depend on the value of a number of Base Units in the underlying Investment Fund.

Your initial pension depends on many factors such as your age, sex and the level of spouse's pension provided. After that, your pension will depend on the value, shortly before each payment, of the Base Units. In unit-linked funds, the value of each unit will move directly in relation to the value of the underlying investments. In a unitised With Profits fund, the movement of the unit value will be based on the bonuses declared.

ANNUITY COMPARISONS

The following table demonstrates the effects of using various options and how this will reduce your initial annuity. The figures are based on an annual pension (payable monthly in advance) for a male aged 65 with a spouse 3 years younger.

As an example, we have assumed that a basic single life annuity without guarantees or escalation, produces an income of £1,000 per annum but if you then add a 5 year guarantee the impact on the monthly annuity payment is minimal. However, adding escalation (increasing payments) at 5% per year has a much bigger impact on the starting amount, although clearly this will increase in future.

Annuity option	Male aged 65 – percentage of annuity paid	Female aged 65 – percentage of annuity paid
Standard, level, single basis annuity with no options	100%	100%
Escalation linked to RPI (Retail Prices Index)	62.78%	60.77%
Escalation at 3% per year	72.90%	70.30%
Escalation at 5% per year	57.18%	53.72%
Add 5 year guarantee	99.26%	99.56%
Add 10 year guarantee	97.23%	94.50%
Two thirds of the original pension to your spouse on your death	89.90%	91.07%
Half of the original pension to your spouse on your death	92.88%	92.75%

Source: Investment Sense, July 2024

FLEXI ACCESS DRAWDOWN

Your accumulated pension fund remains in the funds of your choice. From this you can take up to a maximum of 25% tax-free cash and then annual withdrawals (taxable as income) from the balance of the fund. Annual withdrawals are available from zero up to 100% of your fund.

You are free to make investment decisions and retain a great deal of flexibility over the way in which you draw your income and you are free to vary this level.

In the event of your death prior to purchasing an annuity, the full value of your fund is available to your spouse who can:

- Draw the remaining fund as a lump sum in full
- Apply the full value of the fund to purchase an annuity
- Continue to draw an income through a new Member Nominated Flexi Access Drawdown Plan

UNCRYSTALLISED FUNDS PENSION LUMP SUM (UFPLS)

This is where a lump sum can be drawn directly from uncrystallised money purchase pensions. 25% of the lump sum is still paid tax-free and the balance of the lump sum is taxed at the member's marginal rate of income tax. Any remaining pension fund is invested until such time as the fund is exhausted. Unlike Flexi Access Drawdown it is not possible to access the available tax free amount in one go then take flexible income.

MONEY PURCHASE ANNUAL ALLOWANCE

To prevent widespread abuse of the flexibility, a new anti-avoidance measure has been introduced, which is the Money Purchase Annual Allowance (MPAA).

This means that once income is taken from a UFPLS or a Flexi Access Drawdown policy, the annual allowance for making tax relieved contributions will be £10,000.

The Money Purchase Annual Allowance applies:

- When income is taken from Flexi Access Drawdown (FAD)
- When income above GAD limits (150%) is taken post 5 April 2015 from a Capped Drawdown fund
- When an Uncrystallised Funds Pension Lump Sum (UFPLS) is received
- When a payment from a reducible lifetime annuity is taken
- For those already in Flexible Drawdown, who currently have no annual allowance.

Ivan Tsaregorodtsev on Unsplash

However, it does NOT apply:

- Where an individual commences FAD, but does not receive any income i.e. just takes tax-free cash
- Where an individual is in Capped Drawdown (i.e. pre 6 April 2015) and doesn't receive income above 150% GAD after 5 April 2015
- When small pots are accessed.

TAXATION

As referred to above you may draw up to 25% of your fund as a lump sum (or as a series of lump sums) tax free. Any amounts drawn above this limit will be taxed at your highest marginal rate of tax under PAYE. Care needs to be taken when drawing all of your fund as a lump sum as additional tax may be deducted, which may need reclaiming.

On death any income or lump sums paid to a beneficiary will be tax free if death occurs before age 75 or they will be taxed at the recipient's highest marginal rate of tax if death occurs after age 75.