justretirement

Deferring an annuity.

When is it worth the gamble?

For intermediary use only

Everyone wants to be able to secure the best possible value from their pension plans by choosing to purchase an annuity at a favourable time. However, being able to assess when is a good time to buy an annuity is very difficult since it is dependant on so many factors – for example the economic situation and the effect this has on pension funds and annuity rates; or your clients' health and personal circumstances.

What proves to be the right decision for one person could be completely the wrong decision for another.

No one can predict what the future will look like. So it's important to look at the benefits and risks surrounding the timing of the purchase of an annuity in order to help the decision as to whether it makes sense to proceed with annuitisation or to defer this decision.

Some potential benefits and risks of deferring the purchase of an annuity:

Benefits	Risks
Annuity rates may increase during the deferral period and the fund may buy a higher pension than it would do currently.	Annuity rates may decrease during the deferral period and the fund may not buy as a high a pension as it could currently.
Fund growth could increase the size of the fund – giving a higher pension and a higher Pension Commencement Lump Sum (PCLS) when the client does retire.	Fund value could drop, reducing the size of the fund with which to purchase an annuity and affecting the income that can be taken as a result.
Retiring at an older age would increase the annuity rate received as a proportion of the pension fund, all other things being equal.	If other savings are exhausted during the deferral period, they may not be available for future emergencies.
Flexibility of options – by not locking into a set of specific options with an annuity, the client can retain a greater flexibility by deferring. For example, if their married status were to change after purchasing an annuity, they would not be able to change any spouse benefits already selected.	The ability to continue drawing income from other sources may be restricted by investment considerations, interest rate movements or other issues, and these may be difficult to control or to predict.
Dependants may receive a higher pension if the client dies and may have more flexibility in how they draw benefits if death occurs before annuity purchase.	It may take a number of years before the income foregone through deferring is recouped.

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Health – the additional factor

Whatever you think your client's level of health is, the only way to check to see if they qualify for an enhanced annuity is to use the Common Quotation Form.

Just as movements in pension fund value and annuity rates can impact the level of annuity, changes in health will have an impact. In some cases changes over time can lead to a higher annuity, and in other cases a lower annuity.

Consider John. An accountant for many years, and now aged 65, he is looking forward to his retirement. He had a heart attack a year ago. John is a few stone overweight and smokes, and as a result of his heart attack is taking medication.

He has a £50,000 pension fund (after PCLS) and based on his medical conditions an annuity of £3,576.84 p.a. is offered.

Now consider two hypothetical situations. For simplicity, let's assume that there is no change in pension fund value.

John defers and his health improves…

John defers his annuity purchase for 6 months. When you next see him, he has managed to give up smoking and has lost his extra weight as a result of the exercise he has undertaken in his free time. He has had no further problems with his heart, although he is still on medication. Given his current condition, for the same pension fund and despite being older, he is offered an enhanced rate of £3,536.88 p.a. – around 1% lower.

John still qualifies for an enhanced annuity, but at a lower rate.

John' defers and his health deteriorates…

Now consider the second scenario. John gave up smoking, and worked hard at losing weight. Unfortunately, while exercising John had a second heart attack, which led to surgery and an increase in his medication. Now, although having given up smoking and lost the excess weight, as a result of his increased age and poorer medical condition John is able to secure an annuity of £3,771.36 p.a. – over 5% higher.

The table below summarises the outcomes, compared to securing his annuity at age 65:

	John doesn't defer, and annuitises at age 65	John defers, and his condition Improves	John defers, and his condition deteriorates
Annuity level	£3,576.84	£3,536.88	£3,771.36
Change	-	-1.1%	+5.4%
Total income paid by age 73 (month 96)	£28,614.72	£26,821.34	£28,599.48
Year in which lost income is recouped	-	Never	8

This illustration is based on a male aged 65, with a £50k fund, 5 years guaranteed, no escalation, no value protection, based on RH2 7RU postcode, compared to the lowest standard annuity rate offered via Just Retirement and Avelo Exchange on 16.06.11.

Just as there are unknowns in terms of, for example, future fund performance and changes in interest rates, likewise changes in health are also unknown.

The impact can be significant, and it is important that this additional factor is also taken into account when considering the options available.

Other options that may be considered

Where a client is unable to secure an enhanced annuity rate, the decision may prove to be even more challenging since the purchase of a lifetime annuity will be based on the standard rates available only. It is therefore very important to consider all of the options available, some of which we have identified below:

- Accepting the rate of income on offer and proceeding with an annuity purchase because the income is needed
- Delaying retirement – not purchasing an annuity and continuing to work (if this is possible)
- Phasing in to retirement by purchasing an annuity with some of the pension fund over a period of months or years
- Changing investment strategy by adopting a different asset mix
- Moving into cash to protect against market falls but avoiding locking in to current annuity rates
- Utilising a SIPP or Insured Drawdown plan to release the tax free Pension Commencement Lump Sum (PCLS) whilst deferring any income purchase decision
- Purchasing a guaranteed Drawdown plan that provides a guaranteed income payment for life
- Purchasing an asset backed annuity to retain ongoing exposure to the investment markets whilst securing a regular ongoing income
- Utilising a Fixed Term Annuity to release the PCLS and either defer taking income or provide an ongoing income for a fixed number of years. Clearly this is a route where people may well want to include the ability to convert to an enhanced annuity during the term of the plan to provide added flexibility.

How can Just Retirement help?

Whatever decision proves to be right for your client, it's important to factor in as many of the benefits and risks as possible.

Completing the Common Quotation Form (CQF)

Undertaking a thorough assessment of health by completing the CQF is a very important part of this process as the outcome may well influence the decision that is taken. We can support you with this process and you can find a wealth of material at **justadviser.com/Underwriting**

Advice process for the Fixed Term Annuity

We can also help you identify how you may be able to build in the Fixed Term Annuity in to your advice process to avoid your clients becoming "Stranded on Standard" – i.e. having to lock into a standard rate annuity for life if they are one of the 40% that we estimate that don't yet qualify for an enhanced annuity. You'll find a number of items to support you at **justadviser.com/StrandedonStandardResources**

For more information or to request an illustration, call IFA Sales support on 0845 302 2287 or email IFASupport@justretirement.com