

Deferring an annuity

Weighing up the potential costs and considerations

Factsheet

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When there are current uncertain economic conditions and market volatility, clients approaching retirement may see their pension fund values fall and so may question whether to start receiving annuity income or wait to see if their fund value improves.

Predicting market trends is not easy so knowing precisely when to invest and secure the best possible value from their pension plans is extremely difficult. So, whilst we cannot predict what will happen in the future, we can look at some of the potential effects, considerations, risks and benefits to help establish whether deferral is an appropriate decision for your client's individual situation.

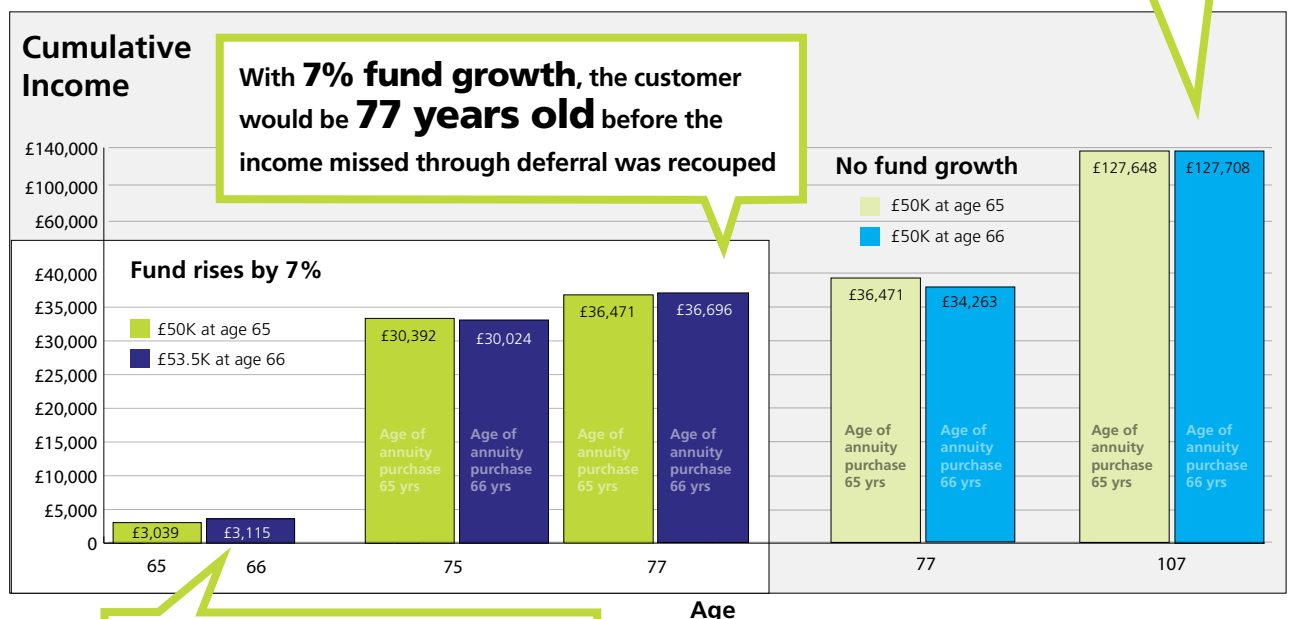
Take two scenarios: first that a year later his fund value has risen by 7% and second that his fund value remains the same a year later, and compare the cumulative income received with buying the annuity today.

In the first scenario he now has £53,500 to buy an annuity but in the second, he still only has £50,000. In both scenarios he is a year older so achieves a better annuity rate. For the purpose of illustration we assume that annuity rates in general have remained constant.

What could the cost of deferring be?

Take for example, a client aged 65 who has the option of annuitising today or deferring the purchase of their annuity. He has a fund of £50,000. This could generate him a guaranteed annual income of £3,039 p.a. by purchasing an annuity. An alternative could be to defer annuity purchase, hoping that his accumulated fund increases in value.

With no fund growth, the customer would be 107 years old before the income missed through deferral was recouped.



With 7% fund growth, the customer would be 77 years old before the income missed through deferral was recouped

In both scenarios, the client is a year older so achieves a better annuity rate.

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What happens if his fund rises by 7%?

The combination of a higher fund value and being a year older means the annual income has increased to £3115 p.a., however the client has not had the benefit of income in the first year.

Simple analysis shows that it takes 11 years for the cumulative income from the deferred purchase to catch up with the cumulative income received from the immediate purchase option.

How long could it take with no fund growth?

Where the customer only has the benefit of a higher annuity rate due to being a year older, and with no fund growth, the time taken for the cumulative income to catch up is extended to 42 years i.e. the customer would be age 107.

It is impossible to be certain which way investment markets will go over the coming months and years, and the same goes for annuity rates. What is certain for many retirees is that they need income in retirement and whilst deferral may be an option, it is not certain to prove to be beneficial.

Some questions to consider?

- What income is necessary to meet your client's needs in retirement?
- Can they continue to work full-time or part-time? If they have a choice, do they want to?
- Do they want to spend their Pension Commencement Lump Sum (PCLS) on living expenses instead of for other planned uses such as purchasing a new car or holiday, etc?
- Do they have assets and savings which can be used instead, bearing in mind that these might need to be depended on later in life?
- Has their health been considered along with the potential additional income of an enhanced annuity?
- If they don't qualify, could a Fixed Term Annuity secure income without committing your client long-term?
- Is equity release an option for generating additional cash?
- Do they want certainty in an uncertain world?

| Benefits | Risks |
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| 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, the amount of Pension Commencement Lump Sum (PCLS) as a percentage of the fund that could be taken and affecting the income that can be taken as a result. |
| 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 high a pension as it could currently. |
| Retiring at an older age would increase the annuity rate received as a proportion of the annuity fund, all other things being equal. | Savings may be depleted or exhausted during the deferral period, and will then not be available for future use. |
| Flexibility of options – by not locking into a set of specific options with an annuity, the client can retain a greater flexibility by deferring. | 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 predict. |
| Dependents may receive a higher pension if the client dies and may have more flexibility in how they draw benefits if death occurs before purchase. | It may take a number of years before the income foregone through deferring is recouped. |

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

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 best standard annuity rate offered via Avelo Exchange on 21/03/2012.

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