

When to annuitise – In search of the golden scenario

Factsheet

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The risks of trying to time the purchase of an annuity

In a perfect world everyone would be able to get their timing right when it comes to annuitising, a “golden scenario” to aim for. It would mean picking the best possible time to exit investment markets (when they’re riding at relative highs - the end of 2010 comes to mind as an example) to enable you to maximise your client’s annuity purchase price, when annuity rates are at a relative high.

Many clients may not have the option to delay the purchase of an annuity (for example, if they need the income immediately), but for those whose circumstances do allow them to consider delaying, how does such an approach fit with the attitude to risk of the typical annuity

purchasing client? Isn’t one of the main reasons why the client is deciding to purchase an annuity because they are cautious and not wanting to expose themselves to ongoing investment risk?

So how well does deciding to remain in the markets, hoping for a recovery or market rally in a relatively short period of time, combined with hoping that fixed interest prices fall (and yields rise as a positive effect on annuity rates) sit with the average annuity investor?

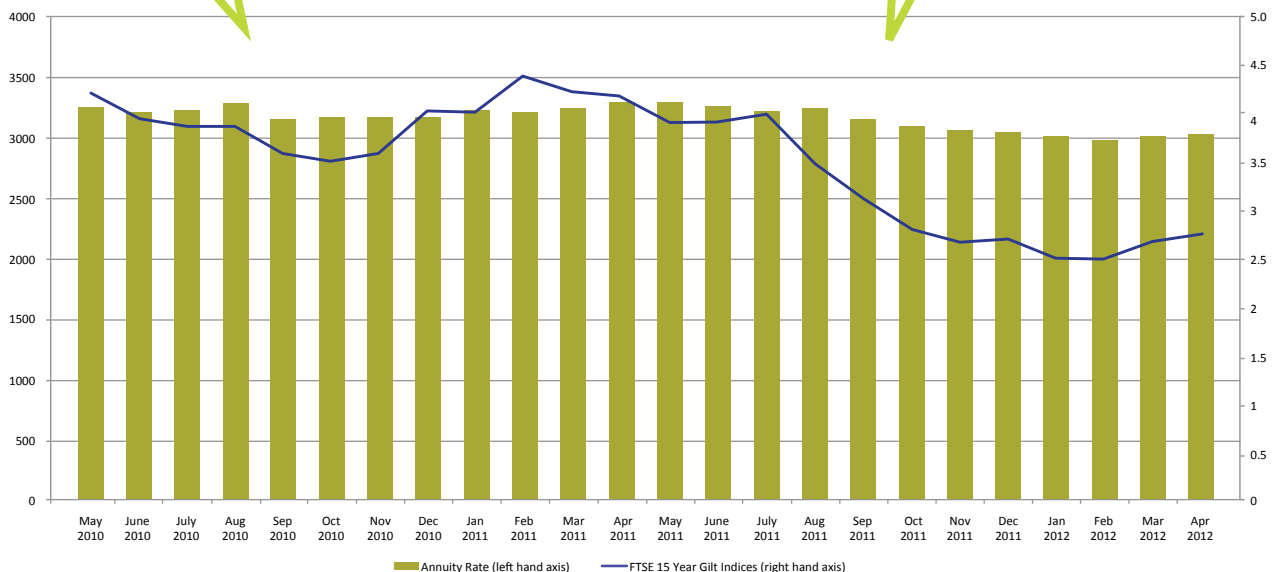
At best this makes them feel uncomfortable. At worst it may be completely at odds with their instincts and desire to avoid investment risk.

Let’s look at the risk of trying to time the annuity purchase

Income from Standard Rate Annuities

If things go well, and markets rally **and** yields improve, then it will have been a very good decision to defer the purchase of annuity.

But what if they don’t improve? And what if markets rise, but annuity rates don’t, or vice versa?



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Risks and benefits

Let's look at the pros and cons of searching for the golden scenario

Benefits	Risks
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.
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.
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.

No matter what the pros and cons are, the reality for the client may mean that there really is only one possible solution if they have no option but to draw their annuity because they need their retirement income – even if they are planning to continue working for a few more years to come (as may well be the case for a number of clients in these current highly volatile economic circumstances).

Avoiding future annuity purchase perils

So what can be done to help clients who are coming up to retirement in the next few months and years?

Lifestyling – love it or loath it?

Much has been written about the risks and benefits of lifestyling, by reducing the client's exposure to equity markets and increasing their exposure to cash and fixed income investments as they approach retirement. Clearly such a strategy would have produced a number of benefits recently with investment markets having been extremely volatile and fixed interest being so popular with investors.

This may well have acted as a great hedge against both falling investment markets and falling annuity rates as the capital value of fixed interest holdings have held up well. This does demonstrate the benefit of such an approach to the client planning to annuitise. But how often is such a programmed change in investment strategy in place for the typical annuity purchasing client, or the client who is undecided between annuitising, or moving in to Drawdown?

A manual move to fixed income?

Where a lifestyling programme isn't in place is this something that is worth considering on a manual basis in the client reviews in the last few years when the client is approaching their intended retirement date?

No perfect solution – but some clear options to address market volatility risk

Hence, whilst there is no perfect solution, there are a number of very clear options that mean the client doesn't have to be exposed to as much market volatility risk at the point of purchasing their retirement income.

Help address market volatility risk at retirement: call IFA Support on 0845 302 2287 or visit justadviser.com to find out more

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