ANNUITIES ARE BACK
- WHAT'S THE DEAL?

Careful planning for retirement is essential to ensure your pension savings last as long as you need them to.

Buying an annuity is an option when the time comes to retire. It's an income-generating contract bought with money in a pension and pays a set income for life in exchange.

Since pension freedoms came into force, people have been seeking alternative, more flexible methods to generate income, such as drawdown.

But in the last year, annuities have made a comeback for those keen to lock in a fixed income in retirement, as you can now get better value for money.

That's because annuity rates – which largely determine your income level – have improved, which means you can now secure a much higher income.

Today's average annual annuity income is up around 27% compared to last year's. In March 2022, a 65-year-old with a £50,000 pension pot could have bought an annual income of £2,430 compared to £3,086 in March 2023[1].

Even better, annuities come with the option of adding a guarantee that means instead of your annuity payments stopping when you die, the insurance company will refund any remaining funds to your beneficiaries in a lump sum. This add-on is now more attractive as the cost of this option is coming down.

Recent calculations[2] show the margin between no guarantee and a 20-year guarantee is just a 4% reduction in annual income, with a £100,000 annuity securing an income of £6,532 vs £6,270, a reduction of £262 a year. The 20-year guarantee will return income of at least £125,400, irrespective of what happens to the customer.

Why buy an annuity?

Annuities have been out of favour, with rates low for an extended period. Rates are strongly influenced by interest rates which hit historic lows in recent years.

Annuity providers typically buy government bonds to generate returns. High interest rates improve returns, which means that a rise in interest rates should push annuity rates up too.

With better annuity rates on offer, for some, using part of your pension pot to purchase an annuity is a good idea. The rest can be put into income drawdown.

The beauty of an annuity is that it guarantees you will never run out of money because the payments are made for life.

While drawdown offers much more flexibility, an annuity still may be the right choice for at least part of a pension pot to fix in stone a guaranteed amount which may be needed to cover a mortgage payment, for example.

Knowing a large portion of your bills will be covered can give you some comfort whilst retaining an invested element to help meet further expenses.

What level can I get?

Your income depends on how much you have saved and the annuity rates offered.

You can buy a standard annuity which does what it says on the tin, but there are other types to consider. Some annuities link to inflation, whilst purchasing a joint annuity that will continue paying an income to your partner or another dependant after you die is also possible.

There are options to buy a fixed-term annuity that pays out an income for a period rather than your lifetime.

You can also add a guarantee – sometimes known as a money-back annuity – which means that if the annuitant dies before receiving all payments, the insurance company will refund the remaining payments to their beneficiaries.

The amount is also dependent on your health. Better annuity rates are available to those in poor health or with a shortened life expectancy. Among the most common conditions people declare are high blood pressure, obesity, diabetes and high cholesterol. An "enhanced annuity" could improve your income by over 40%.

Keen to learn more?

It's prudent to take advice when considering your retirement options as you are making a decision that will determine your income for perhaps the next 20 or 30 years. Different providers offer different rates, so it's important to find the best rate available to you, not just the best rate from your own pension provider. Plus, with an annuity, it's important to choose the right one, as once purchased, there's no going back.

Remember, you don't need to choose either annuity or drawdown, a combination of the two may be the most suitable option.

[1]Moneyfacts, April 2023, based on a standard single life level annuity without guarantee

[2] https://www.canadalife.co.uk/news/money-back-annuities-cost-peanuts/