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MONEY

Annuity deferral not for everyone

PENSIONS

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Pension annuity rates have fallen almost continuously over the past 20 years.

Some commentators have suggested recently that it might make sense to defer buying an annuity, given rates have been predicted to rise in the future. However, this is not as straightforward as it may appear.

A pension annuity is guaranteed income for life which you receive in exchange for your pension fund at retirement.

There are two main reasons why annuity rates are so low:

- The yield (returns) on fixed-interest investments such as gilts and corporate bonds which are used to price annuities have fallen to record lows.
- People are working for a shorter time and living longer, so their pension funds need to provide income for a longer period and this costs more.

The average pension fund value at retirement in the UK is about £30,000 and annuity purchase will remain the default choice at this level, since the priority for most will be a guaranteed and secure income.

It is vital that people in this category exercise their "open-market option"; basically shopping around for a higher return. As you will be locked in for life, it is essential you find the best deal. Lifestyle and medical conditions are increasingly being taken into account and can add significantly to the income received if your life expectancy is adversely affected.

Waiting for annuity rates to improve can be a dangerous exercise as, although it is likely rates will improve, by how much and when is open to debate.

Consider this example: if a client could secure an annual annuity of £6,000 today but decided to wait a year and rates rose by 10% they would receive an annuity of £6,600. They have, however, forgone £6,000 of income and would need to live for at least 10 years before they were better off.

For those with larger pension funds, more options are available and deferring may be viable; particularly for younger retirees.

Deferring purchasing an annuity is not risk free and ultimately the pension fund will need to be invested, which introduces the risk that the fund can fall in value as well as rise, potentially negating the benefit of any potential future rise in annuity rates.

A more pragmatic approach often adopted is to purchase annuities in stages and provide a base level of guaranteed income to meet essential expenditure and adopt a more adventurous approach with the balance. This can work well for those with other assets and sources of income such as final-salary schemes or rental income who have the risk appetite associated with deferring annuity purchase.

The retirement income options market can be extremely complex and it is vital advice is taken from a specialist in this area.

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