



02

POSITIVE THINKING

Change can be positive
if we look for opportunities



03

The case for Annuities

This edition of the Newsletter
takes an in-depth look at
Annuities

PROS

CONS



The value of investments and the income derived from them can fall as well as rise. You may not get back what you invest.

This newsletter does not represent personalised advice and readers should seek qualified advice before taking any action.



FINDING THE POSITIVES IN TIMES OF CHANGE



The whole country was hoping that with young people going back to school and university, pubs and restaurants re-opening and office workers returning back to city centres, life would slowly return to as normal as it can be in these unprecedented times. But as I write the new ‘rule of six’ has come into effect and new local lockdown measures are being announced following a rise in coronavirus cases.

It is an understatement to say that life will probably not be the same again and we will have to change our behaviour if we want to stay safe and well. However, we think there will be some positive changes in the way we

will advise clients in the future. These include:

- ✓ More regular contact with our clients and better use of video conferencing
- ✓ More emphasis on longer term retirement planning e.g. cash flow modelling
- ✓ Greater emphasis on risk management especially with investments
- ✓ A stronger case for securing guaranteed income e.g. annuities or fixed-term income plans

We have been pleasantly surprised how easily clients have taken to

video conferencing and some people are saying that in many ways this is better than face to face meetings. One of the many advantages of using video conferencing is that we can speak to clients more often and without the need to travel or intrude into their offices or homes.

We are also finding that many client’s want to discuss a wider range of topics such as ‘de-risking’ their pensions and investments, wills, LPA’s and IHT planning. Therefore, over the next few months we will take an in-depth look at these subjects.

We start with the case for annuities.

ANNUITIES

Hopefully, you will know what an annuity is? It is a policy which converts a capital lump sum (e.g. your pension pot) into guaranteed regular (monthly) income payments.

If you would like to know more about annuities, please go the annuity pages on our website

<https://toolbox.brgl.co.uk/annuity/>

Annuities have been in existence for a long time. The first recorded annuities were in Roman times and in 1811 Jane Austen wrote:

“An annuity is a very serious business” in Sense and Sensibility.

Today the most popular annuities in the UK are pension annuities and these have the following characteristics:

- They pay an income for the rest of your life, no matter how long that is
- They are the only way of making sure you maximise your lifetime income without taking undue risks
- They are based on the principle of ‘mortality cross subsidy’

- Enhanced rates are available for those in poor health
- When you die income can continue to be paid to your spouse or partner.

But you probably don’t appreciate the advantages and benefits of annuities because of the negative publicity and dare I say it, “fake news”. We have always prided ourselves on presenting both sides of every argument in a balanced and fair way. So, in this article we will present the pros and cons of annuities in a balanced way.

THE CASE FOR ANNUITIES

The case for annuities can be made very simply; they are the only policy that pays a high level of guaranteed income for the rest of your life. In this sense an annuity is a pension, and in the rush to introduce pension freedoms it is easy to lose sight of why you probably saved for a pension in the first place.

Annuity rates may be low at the moment but they are the only way of guaranteeing a regular income for the rest of your life with peace of mind and security no matter how long you live.

The advantages of annuitisation

Economists have been interested in the concept of annuitisation (the process of converting a lump sum into income for life) for a long time and have argued that those who want to find the best way to stretch their income over their lifetime should purchase an annuity.

If you don't arrange an annuity and take income directly from your pension pot (e.g. pension drawdown) you are faced with two dilemmas:

- ✓ how much income to take every month?
- ✓ where to invest your pension pot?

Annuities solve these problems by guaranteeing income for as long as you (or your partner) are still alive and by providing an internal rate of return higher than cash but without any investment risk.

ANNUITIES ARE INSURANCE AGAINST OUTLIVING YOUR INCOME

'In the long run we are all dead' said the economist John Maynard Keynes, but how long is the 'long run'? It is often much longer than people think because many people grossly underestimate their life expectancy.

This may have serious consequences for your retirement planning because it increases the risk of running out of income in later life.

You can find out your average life expectancy with our calculator at:

<https://toolbox.brgl.co.uk/calculators/life-expectancy/>

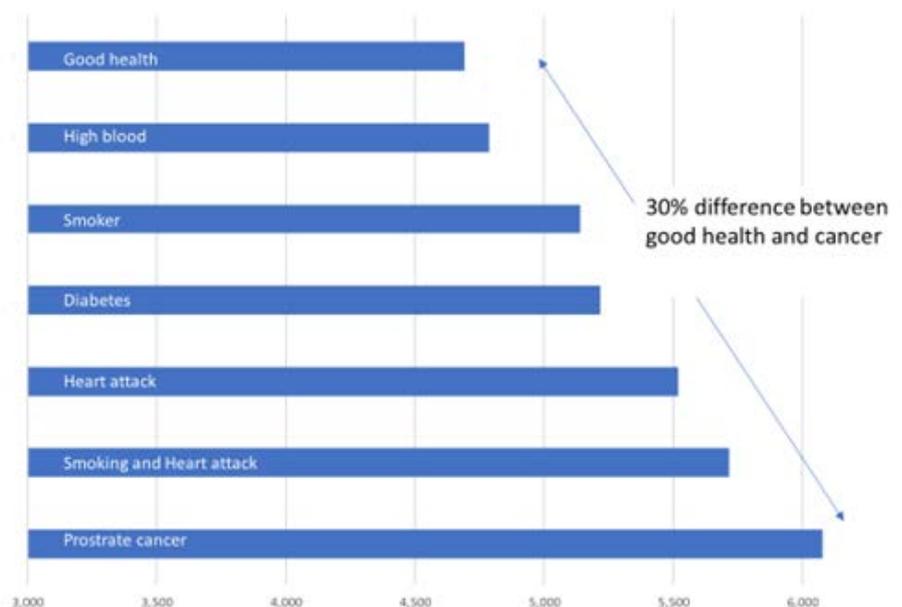
One of the reasons some people do not like annuities is that they worry that if they die soon after taking out an annuity, the capital is gone and there is nothing to pass on to the rest of the family. But the flip side is that if you live well beyond your normal life expectancy, you will not outlive your income if you have an annuity.

some will live longer than expected. Insurance companies make a profit from those dying early and a loss from those living longer, but they use savings from the early deaths to subsidise the income paid to those who live longer than expected.

This is called mortality cross subsidy. It is unique to annuities and clearly favours those in good health who may live longer than expected at the expense of those who die early.

To overcome this problem insurance companies offer enhanced annuities, which pay a higher income for those who have a medical condition that may reduce their normal life expectancy.

Enhanced Annuities – more income for certain medical conditions



£1000,000 single life annuity aged 65 with 5 year guarantee period and level payments. Gross annual income
Source: William Burrows October 2019

Mortality cross subsidy

In order to meet the income for life promise, annuities are based on the concept of mortality cross subsidy.

Annuity rates are calculated assuming you will live until your normal life expectancy. But some people will die before they are expected to and

HIGHER INCOME FOR THOSE IN POOR HEALTH

Those who smoke, take prescription medication or have been in hospital recently may be able to qualify for an enhanced annuity.

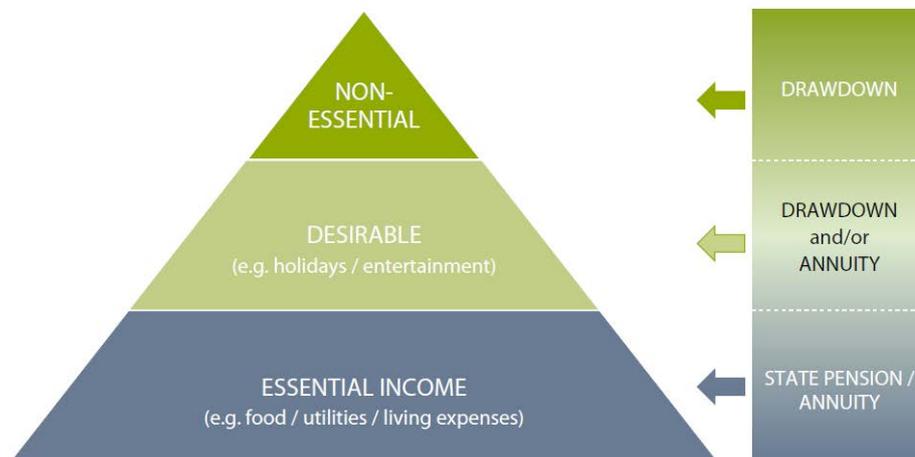
The table compares annuity income for a range of medical conditions.

ESSENTIAL COMPONENT OF RETIREMENT PLANNING

An important part of retirement income planning is making sure you have sufficient income to maintain your chosen lifestyle for the rest of your life.

The best way to do this is to plan ahead but the idea of preparing a budget can be a daunting prospect. But when you have done this you will be in a much better position to work out how much income you will need and where it will come from.

When planning, don't forget to take account of inflation as this reduces your spending power over time and don't forget your income requirements may change over time, for instance you may not spend as much during the middle part of your retirement.



A popular and useful planning technique is to build an income pyramid. Using this approach all essential income should be totally guaranteed, income for desirable expenditure such as holidays should be as safe and secure as possible while non-essential income can be taken from more risky investments.

Annuities are a good way to secure

a solid base of guaranteed income to pay for essential income needs. In many cases it makes sense to strengthen the foundations of the pyramid by purchasing more annuities in subsequent years.

Not only does this increase the amount of guaranteed income, it takes advantage of the increased benefit from mortality cross subsidy as you get older.

IN DEFENCE OF ANNUITIES

Although we recognise the advantages of annuities (after all we have been advising on them for over 25 years) many people don't like annuities, often describing them in colourful language such as 'legalised theft' or "a rip off".

Annuities are not right for everyone and they do have some limitations and disadvantages but before

dismissing them outright it is important to correct any misconceptions or misunderstandings.

Nobody has described the possible flaws in annuities as eloquently as Lord Grantley, who speaking in a House of Lords debate on pensions in October 1997 said: "In my view, there are two overwhelming reasons why people should not invest in

annuities under any circumstances. The first is that investing in annuities is contrary to the interests of a family ... in that they are worth nothing when the investor dies. The second reason is simply that annuities are a lousy form of investment."

Lord Grantley is wrong on the first point because people purchasing annuities can have a guaranteed period or capital protection and if they are married they will have a joint life annuity which will continue as long as their spouse or partner is still alive. In this sense they can be good for the family.

There is nothing wrong with the concept of annuities – it is just that interest rates have been at historically low levels since the credit crunch in 2008

I do have sympathy for the assertion that annuities are a lousy form of investment, however, as annuities are not an investment but a type of insurance policy.

There has been a lot of academic research into the value for money of annuities and these have all concluded that annuities are fairly priced and annuitants are getting a good deal with an annuity.

This may be difficult for many people to appreciate when the payouts from annuities are so low, but there is nothing wrong with the concept of annuities, it is just that interest rates have been at historically low levels since the credit crunch in 2008.

Low interest rates are good news if you have a mortgage but bad news if you are relying on the interest from your savings.



However, despite low interest rates there is still a strong case for annuities because through the hidden power of mortality cross subsidy they are still the only policy that can guarantee an income for life.

FLEXIBILITY

There is one limitation to annuities and that is lack of flexibility. Once an annuity is set up the terms cannot be changed no matter what happens to your personal circumstances or interest rates.

This is especially relevant since the advent of Pension Freedoms in 2015 because now everyone has the freedom and flexibility to spend their pension pot as they wish and when they die, any money left over can be left to the family.

In my experience, many older people end up with complicated solutions they probably don't understand and are taking more risk than is good for them

However, freedom is not license and it can be very risky. Just because you have flexibility it does not mean you should spend your pension pot unwisely and take undue risks.

The most powerful argument in favour of annuities compared to other options was in a paper entitled *'Annuitisation; it shouldn't be a secret'* published by the National Association of Variable Annuities (NAVA) in the US over 20 years ago.

It contained some important observations about the concerns and needs of retirees including:

- ✓ A concern for lifetime income and risk of outliving their financial asset
- ✓ A strong desire to preserve their standard of living in the long-term
- ✓ The need of many older individuals for simplicity and structure in their financial affairs
- ✓ They are getting to grips with their own mortality and expressing concern about the desire or ability of a surviving spouse to manage money in the event of their death

I particularly agree with the point about simplicity and structure especially because, in my experience, many older people end up with complicated solutions they probably don't understand and are taking more risk than is good for them.

The paper went on to give reasons why people don't take annuities more seriously:

- ✓ Benefits of annuitisation are not sufficiently emphasised

- ✓ The desire for flexibility, control and death benefits
- ✓ The mistaken belief that the same goals can be achieved by a systematic withdrawal from a mutual fund (drawdown fund)

This last point; the mistaken belief that drawdown is always better than an annuity, is often overlooked.

I will look at this in the next newsletter which will focus on drawdown in more detail.

CONCLUSION

There is a strong case for annuities in the right circumstances.

Key points:

- ✓ Annuities are the only policy that guarantees income for the rest of your (and your partner's) life
- ✓ There is nothing wrong with the concept of annuities – it is just that interest rates are low at present
- ✓ Annuities provide simplicity and structure and give you peace of mind and security
- ✓ Other options may offer more flexibility but are more risky and there is a mistaken belief that they produce better outcomes
- ✓ It normally makes sense to secure your essential income with an annuity.

BETTER ANNUITIES – a professional and personal annuity advice service

If you are considering arranging an annuity contact us for the best advice and the highest annuity rates.

Not only can we secure the best possible annuity rates, especially if you qualify for an enhanced annuity, we will make sure you make the right decisions and choose the most suitable options.

Unlike non-advised annuity brokers we don't get paid by commission and are able to offer:

- ✓ Totally independent and whole of market
- ✓ Specialists in arranging enhanced annuities
- ✓ We can give you financial advice and consider all options
- ✓ No commissions or hidden fees

Better Retirement is one the oldest and most respected annuity advisers in the UK, advising clients for over 25 years and regularly feature in the national press.

Contact Steve Hunt or Billy Burrows for a professional and personal service:

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