Living

Will you be retiring to Margate or Monte Carlo? Picking the right annuity could make all the difference between scrimping and saving or enjoying some of life's little luxuries

As your retirement draws near, you probably can't wait to get your hands on all that lovely lucre you've been stashing away.

Sadly, it's not quite that simple. The government won't just let you withdraw the money from your pension once you retire. The law says you must convert funds from most pension schemes into an annuity by the time you're 75. You'll need to buy an annuity with funds from your personal pension, stakeholder pension and most money-purchase employer schemes. If you've got only a final-salary pension, you may not need to worry about annuities (see 'Your annuity questions answered', right).

What is an annuity?

An annuity is a policy that converts a lump sum into an income. It's your main option for turning your pension fund into a retirement income.

How much income you receive depends on the size of your pension fund, the rates your provider offers, your gender (women get less because they're expected to live longer), your age, your health and whether you want your income to stay the same or increase every year. This income is taxable.

You don't have to convert all your pension fund into an annuity. You can take up to a quarter as a tax-free lump sum. But you should use the rest to buy an annuity before you reach the age of 75.

Why shop around?

Make sure you search for the best rate rather than taking the rate your pension provider quotes you. Our analysis of annuity rates shows up to a 16 per cent difference between the best and worst rates. Yet only one in three of us takes this open market option (see 'Jargon buster', right).

With a pension fund of £25,000, the best rates give you £100-£200 a year more than the worst (see table, p18). This may not sound like a lot, but it can add up to thousands of pounds over your lifetime. A 60-year-old woman who retires today can expect to live until she's 84. In our table, if she converts £25,000 into an annuity, she could be as much as £4,500 better off over her lifetime – just by choosing the best rate over the worst. And that's before you consider the special rates that smokers and people in poor health can get.

Start thinking about getting an annuity about four months before you retire. It's important to get the best rate you can because once you've chosen there's no

SHOPPING AROUND FOR MORE INCOME

Helen Bedford *59, teacher*

Helen Bedford is more than £500 a year better off, thanks to taking independent advice on her annuity.

Helen, who retires in August, has five pension pots totalling nearly £155,000. 'Like many people, I wasn't sure I really understood the information on annuities being sent to me, or how to get myself the best possible deal,' she told Which?.

Helen's funds include two stakeholder pensions (with Scottish Life and Scottish Widows), two personal pension plans (with Virgin and Norwich Union), and her teacher's additional voluntary contribution scheme.

A specialist pensions annuities adviser found her a £7,200-a-year deal from Canada Life. Three quarters of Helen's funds will be used to buy this single-life level annuity with a ten-year guarantee. This guarantee ensures that husband Bernie, 60, would continue to receive Helen's income if she were to die in the next ten years. The rest she's withdrawing as a tax-free lump sum. She's happy this option gives her the highest spending power over the next 20 years – while she's still young and fit enough to enjoy it.

Helen estimates she'll recoup the £1,100 she paid to the adviser within about two years. She urges other women to be proactive and shop around to ensure they enjoy a financially secure retirement.

'The cost of taking advice is more than worth the peace of mind from knowing I'm getting a good deal,' she says. 'I'm really glad I finally got everything sorted. Now I can look forward to enjoying my retirement instead of worrying about money.'

the good life

going back. Make sure you see an independent financial adviser who specialises in annuities (see 'Contacts', p18, for details).

When it pays to smoke

Buying an annuity is one of those rare times when it pays to be unhealthy. Make sure you tell providers or your financial adviser if you smoke or have poor health – you could get better rates than your healthier friends. Such annuities are called 'enhanced' or 'impaired' annuities. You get better rates because your provider anticipates paying the annuity for a shorter period. The same goes if you're looking for a joint-life annuity, and your partner smokes or has poor health. And at least one provider offers specialist annuities to construction workers.

We calculate that a 70-year-old male smoker could be more than £500 a year better off than his non-smoking friend if he converts a £25,000 pension fund into a smoker-rate annuity. Annuities for people with impaired health may pay out even higher rates.

Types of annuity

There are two main types of annuity:

'Now I can enjoy my retirement instead of worrying about money'

YOUR ANNUITY QUESTIONS ANSWERED

Which sorts of annuity to buy and when

Q Can I get an income that increases every year?

A Yes, you can choose an annuity that matches inflation or goes up by a set percentage, such as 3 or 5 per cent a year. The downside of an increasing annuity is that you'll start off with a lower income than if you'd chosen a level rate – expect about £500 a year less on a £25,000 pension fund (see table, p18). And if your income rises at 3 per cent a year, it will take you about 14 years to catch up with rates from a level annuity.

The downside with a level annuity is that inflation will erode your spending power. Within 25 years of retirement, your income would have halved in real terms, assuming inflation of 3 per cent. One strategy is to take the level annuity but save up during the early years to put towards higher prices later on.

Q What if I die soon after I buy my annuity?

A Sadly, your income dies with you, unless you buy a guarantee. This passes your full pension income on to your heirs for up to ten years. During your lifetime, you'll be on slightly less than you would otherwise. Expect to forfeit anything from £12 to £130 a year with an annuity bought for £25,000 (see table, p18).

Some companies also offer a capital-protected annuity, which guarantees to give you back as much as you originally paid for it. If you die before age 75 and you haven't already received all the money you paid in, your heirs get the rest, after tax.

Q I've just retired at 65 – do I have to buy an annuity now?

A No. You can wait until you're 75 if you don't need the extra income just yet, or if you've opted for income drawdown (see 'Jargon buster', right). You need at least £200,000 for income drawdown, though.

Q I'm in a final-salary scheme – do I need to buy an annuity when I retire?

A No – your pension is paid directly from the scheme so you don't need to worry about an annuity. But if you've been making additional voluntary contributions (AVCs), you will probably need to buy an annuity with these extra funds you've built up.

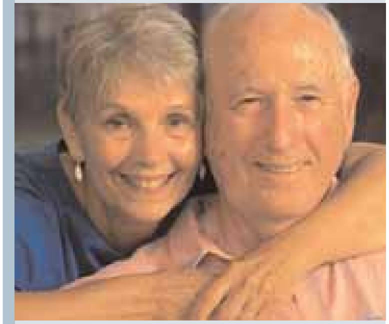
Q I don't have a pension, but can I buy an annuity to give me income?

A You can convert any cash sum – such as your savings, or even the tax-free lump sum from your pension – into a purchased life annuity (PLA). Unlike a pension annuity, only some of your PLA income gets taxed.

Jargon buster

Annuities lingo made simple

ALTERNATIVELY SECURED PENSION Instead of buying an annuity at 75, your pension fund remains invested. But this high-risk option is generally advisable only for people with a pension pot of more than £100,000 or other sources of retirement income. Financial advice is a must.



ENHANCED OR IMPAIRED ANNUITY You should qualify for higher rates if you smoke, or if you are in poor health. Rates for impaired health vary from person to person.

INCOME DRAWDOWN Instead of buying an annuity, you take an income direct from your pension fund while it continues to be invested. With this high-risk option, you need a decent-sized pension fund – £200,000 or more. At 75, you must buy a lifetime annuity or an alternatively secured pension.

INCREASING ANNUITY You can choose for your income to match inflation for the rest of your life, or to rise by a specific percentage each year, such as 3 per cent.

LEVEL ANNUITY Your income will stay the same each year, irrespective of inflation.

OPEN MARKET OPTION Your right to shop around for the best rates when you retire. You don't have to buy an annuity from the same company you've had your pension with.

PURCHASED LIFE ANNUITY Converts any lump sum, such as savings, into an income.

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conventional and investment-linked.

Conventional lifetime annuities
Under this basic annuity, you hand over your pension fund in return for an income for life. Answering these three questions can help you choose the right type.

1 Do you want your income to go up every year or stay the same? You'll get more at first with a level annuity, but your spending power will shrink with inflation (see 'Your annuity questions answered', p17).

2 Would you want to pass on your annuity to your family if you were to die soon after retiring? If so, consider paying for a guarantee or capital protection.

3 Do you want your partner to receive an income for the rest of their life after you die? Under a joint-life annuity your partner continues to receive some or all your income if they outlive you. But there's a trade off. The more you choose them to get after your death, the less you will get when you retire.

In our table (see right), the 65-year-old man receives £200-£300 a year less under a joint-life annuity versus a single annuity. That's if the joint-life annuity pays out two thirds of his income to his wife.

Investment-linked annuities
These are riskier than conventional annuities because you're investing your pension fund in the stock market. Your income could go down as well as up rather than being agreed when you embark on your retirement. Because of the risk, an investment-linked annuity would suit you only if you have a large pension pot. And again, because investment-linked annuities are riskier than conventional ones, it's vital you get specialist advice first.

For a full guide to buying an annuity, and for a comparison of providers' rates, see our website at **www.which.co.uk/annuities**.

Contacts

Finding an IFA
IFA Promotion 0800 085 3250
www.unbiased.co.uk
Personal Finance Society
020 8530 0852; www.thepfs.org

IFAs specialising in annuities
Annuity Direct 0500 506575
www.annuitydirect.co.uk
The Annuity Bureau 0845 602 6263
www.annuity-bureau.co.uk
The Insurance Surgery 0800 083 2829
www.the-insurance-surgery.co.uk

Annuities for construction workers
B&CE Benefit Schemes 0845 741 4142
www.bandce.co.uk

WHAT £25,000 BUYS – THE BEST AND WORST RATES

We've shown the best and worst annuity rates for people of various ages. We've assumed they have an average-sized pension pot of £25,000. In this table, if the 70-year-old man buys a level annuity, he can get 9 per cent extra income by shopping around. He would be £168 better off a year on the best rate than on the worst.

ANNUITIES	WHO THE POLICY IS FOR									
	MAN, 65		MAN, 70		WOMAN, 60		WOMAN, 65		JOINT: MAN, 65, AND WOMAN, 62	
	NO GUARANTEE	TEN-YEAR GUARANTEE	NO GUARANTEE	TEN-YEAR GUARANTEE	NO GUARANTEE	TEN-YEAR GUARANTEE	NO GUARANTEE	TEN-YEAR GUARANTEE	NO GUARANTEE	TEN-YEAR GUARANTEE
LEVEL										
Best a year (£)	1,824	1,776	2,136	2,004	1,548	1,536	1,704	1,680	1,596	1,584
Worst a year (£)	1,716	1,656	1,968	1,836	1,392	1,368	1,572	1,536	1,416	1,380
Yearly gain (£)	**108**	**120**	**168**	**168**	**156**	**168**	**132**	**144**	**180**	**204**
Lifetime gain (£)	**1,836**	**2,040**	**2,184**	**2,184**	**3,744**	**4,032**	**2,640**	**2,880**	**3,660**	**4,148**
INCREASING										
Best a year (£)	1,332	1,308	1,656	1,560	1,056	1,056	1,224	1,212	1,104	1,104
Worst a year (£)	1,236	1,200	1,488	1,404	924	924	1,104	1,080	960	948
Yearly gain (£)	**96**	**108**	**168**	**156**	**132**	**132**	**120**	**132**	**144**	**156**
Lifetime gain (£)	**2,089**	**2,350**	**2,624**	**2,436**	**4,544**	**4,544**	**3,225**	**3,547**	**3,695**	**4,003**

Source: Financial Services Authority (www.fsa.gov.uk/tables)

USING THE TABLE
The figures show yearly income for converting a £25,000 pension fund into an annuity. Rates correct at 23 January 2008.

No guarantee Your income dies with you (unless you've bought a joint-life annuity). **Ten-year guarantee** This ensures that if you die soon after retiring, your estate will continue to get your full income for ten years after you retire. **Joint** In this example, the husband buys a joint-life annuity so that if he dies first, his wife will receive two thirds of his full income for the rest of her life. This is on top of any guarantee. **Annuities** Rates shown are for conventional lifetime annuities, excluding special rates for smokers, those in poor health or construction workers. **Level** This annuity pays the same every year. **Increasing** An annuity that rises every year – in this case by 3 per cent . **Yearly gain** How much better off each person will be a year with the best rates versus the worst. **Lifetime gain** How much better off they will be over their lifetime with the best rate versus the worst. Our sums are based on official forecasts, which show that a woman retiring now will live for 24 years if she's 60, 22 years if she's 62 and 20 years if she's 65. Men retiring now at 65 are expected to live another 17 years, or for 13 years if they're 70.

Checklist
How to get the best rate for you

Shop around Don't just take what your pension provider offers – shop around for better rates.

Get advice Find an IFA who specialises in annuities – your choice of annuity will affect the rest of your life (see 'Contacts', left).

Your other half? Decide who you want the annuity to benefit after you die – a joint-life annuity looks after your partner if they outlive you.

Inflation costs An increasing annuity pays less when you retire but your income stands more chance of keeping up with inflation.

Be honest Tell your IFA about you and your partner's health problems. You may be in for an enhanced annuity. Smoking, being obese, having high blood pressure or a heart bypass could all help you retire on more money.