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The impact of annuities in retirement income planning

William Burrows

This guide is intended for use by financial advisers and paraplanners

Contents

About the author

William Burrows is a well-known expert on annuities. He has over 30 years' experience in the annuity market. During that time he has advised individual clients on their annuity and drawdown options, worked for one the UK's largest annuity providers and contributed to numerous articles about annuities in the national and trade media.

This guide will look at the important role that annuities can play in retirement income planning and help advisers gain insight into how they can contribute to better retirement advice and better outcomes for clients.

This guide will be of particular interest to advisers who have limited experience of advising on annuities as it explains how annuities work, describes the various annuity options and offers some practical tips when advising on annuities.

We're proud to have partnered with William to get insights on the annuities market, and on how these products can fit into retirement income planning.

Annuities provide a guaranteed income, cementing an element of certainty for your clients... and it's clear that due to the Consumer Duty regulations, coupled with the recent recommendations from the FCA's Thematic review, it's now more important than ever to consider annuities as part of your clients' retirement portfolio.

Pete Cowell, Head of Annuities, Standard Life

Learning objectives

After reading the guide, you'll be able to:

- Understand consumer attitudes towards annuities before and after pension freedoms
- Understand and explain the factors that can influence annuity rates and client income
- List the annuity options which allow the product to be tailored to meet specific needs
- Understand the alternatives to lifetime annuities, and the benefits of blending retirement income options
- Summarise the advantages of annuitisation and overcome common objections.

1. Introduction

Advisers with long memories will remember the time when annuity rates were over 15% in the 1990s and annuities were considered a very good idea even though it was compulsory to purchase one at retirement.

Annuities suffered a near mortal blow in 2008 when the credit crunch forced the Bank of England to implement a policy of Quantitative Easing (QE). This pushed interest rates to rock bottom and the income from annuities to fall to the lowest levels in living memory.

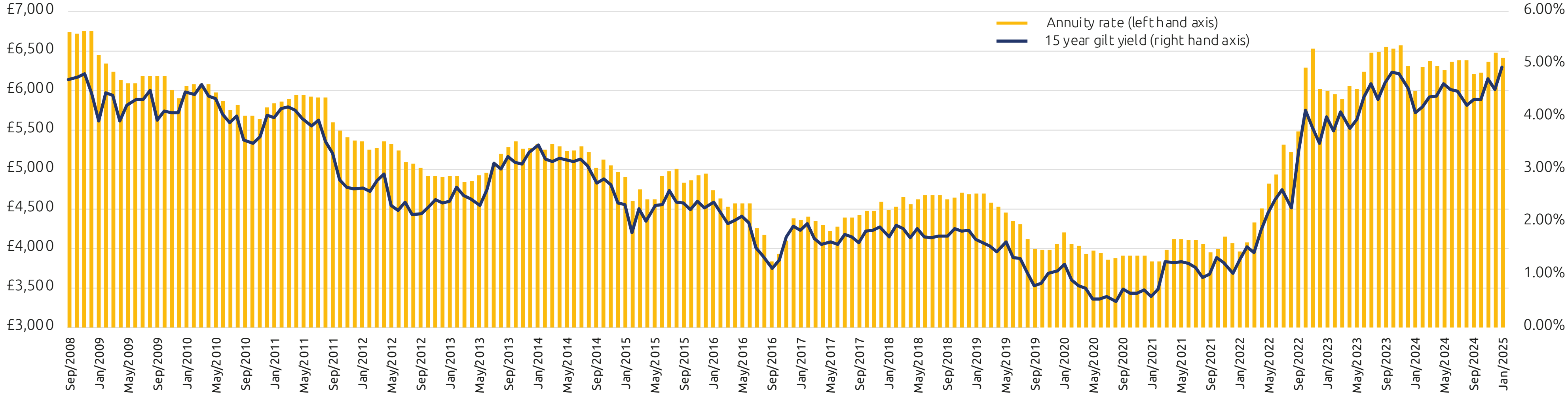
It seemed the final nail in the annuity coffin was the introduction of pension freedoms in 2015 when the link between pension pots and annuities was finally broken and many people turned away from them in favour of the new flexible options. But then in 2022, just as it seemed the annuity market was doomed, interest rates started to rise on the back of inflationary pressure caused by global factors, and annuity rates started to rise. When yields rose to their highest point in September 2022 this resulted in annuity rates soaring to levels not seen for over 10 years.

As the annuity chart shows, between January 2022 and January 2024, the benchmark annuity (£100,000 purchase price, ages 65 and 60, joint life 2/3rds and level payments) rose from about £4,000 per annum gross to just under £6,000. This 50% increase in annuity income has resulted in a surge in demand and means annuities are once again playing an important role in retirement income. They are the only financial policy that guarantees a high level of income for life.

It was not just rising rates that led to the annuity renaissance, peoples' attitudes towards retirement were also changing. After a prolonged period of financial uncertainty following the COVID pandemic many retirees were more receptive to the financial security of annuities rather than the riskier alternatives such as pension drawdown.

Pension freedoms may have increased the use of pension drawdown, but the recent rise in annuity rates has reminded advisers of the important part they play in retirement income planning.

Annuities and gilt yields, 2008–2024



*Joint life annuities. Ages 65 and 60, healthy life, £100,000, joint life 2/3 rds, with level payments.
Source: www.williamburrows.com

2. All about annuities

An annuity is a financial policy which converts a lump sum (normally a pension pot) into a series of regular income payments. Annuities have the following characteristics which have to be chosen at outset:

- Income payments are guaranteed for life
- They can be a single life or a joint life policy
- Income payments can be guaranteed for a minimum period of time
- It's possible to have a 'money back' guarantee called value protection
- Income can remain level or increase by a fixed percentage, or in line with inflation
- Enhanced rates may be available for those who have certain health conditions such as overweight, smoker, other lifestyle factors or medical conditions including serious illness
- Annuities can be purchased using pensions (pension annuities) or from personal savings (purchased life annuities)
- Pension income is taxed as earned income whereas purchased life annuities are partly tax-free

Annuities are unique because they are the only financial policy that guarantees income for life. In order to meet the income for life promise, annuities are invested in cautious investments and are based on the concept of **mortality cross subsidy**.

Mortality cross subsidy

Actuaries calculate annuity rates assuming people will live until their normal life expectancy, but some policyholders will die before they are expected to and some will live longer than expected.

At an individual level, Insurance companies make a profit from those dying early and a loss from those living longer, but they pool savings from the early deaths to subsidise the income paid to those who live longer than expected. This is called mortality cross subsidy.

Mortality cross subsidy 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 rates. Enhanced annuities pay a higher income for those who have a medical condition that may reduce their normal life expectancy (see section on enhanced rates).

Annuity rates used to calculate the amount of annuity income depends on a number of factors including:

Age and health – the older the annuitant the higher the annuity payments and if they have certain health conditions they may qualify for an enhanced rate

The annuity options – e.g. single or joint life, level or increasing, income guarantee period or value protection and choice of payment terms

Interest rates – annuities are priced based on underlying assets which move broadly in line with bond yields (fixed interest investments) so when yields are low annuity rates are low and vice versa (see chart on page 4)

Age and health

The annuity income for a given purchase price is higher for a 75-year old compared to a 55 year old, and it's also higher for someone in poor health compared to a person without health issues.

The reason for this should be self-evident; the longer the annuitant's life expectancy, the lower the starting income because annuity payments will be spread over a longer period of time.

Using life expectancy tables, a man aged 65 has an average life expectancy of 85 years and a woman is likely to live to age 87. Although men and women have different life expectancies, they get the same annuity rate because all annuities are quoted on a gender-neutral basis because of a European Union Gender Directive ruling in 2012.

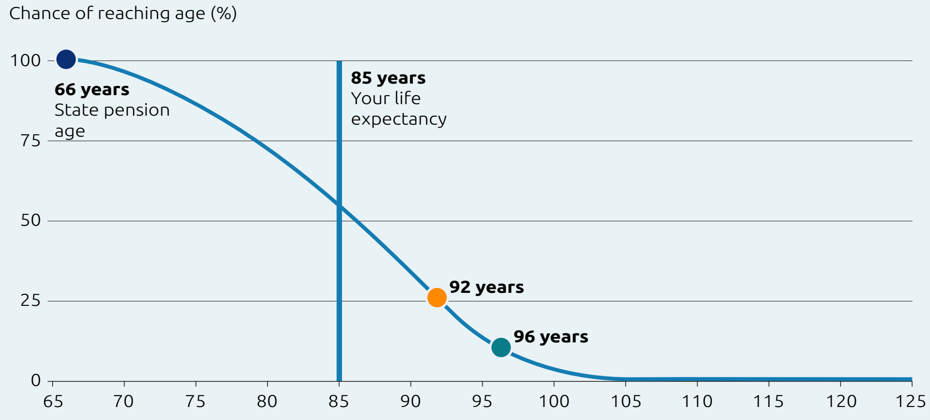
Top tip

You can estimate your client's life expectancy on the website of the Office for National Statistics (ONS) www.ons.gov.uk.

For a man aged 65, their average life expectancy is 85 years

However there's a chance your client might live longer:

92 years (1 in 4 chance) **96 years** (1 in 10 chance) **100 years** (3.1% chance)



If the same person is a regular smoker or has a qualifying medical condition that might reduce their life expectancy they could receive an enhanced annuity rate.

The table below gives examples of the annual income a client could receive depending on their age and certain medical conditions.

	60	65	70	75
Healthy person	£6,692	£7,364	£8,275	£9,489
High blood pressure	£6,809	£7,601	£8,493	£9,893
Regular smoker	£7,068	£7,936	£9,021	£10,476
Heart conditions e.g. angina	£8,108	£8,721	£10,017	£11,856

- Purchase price £100,000, paid monthly in advance, level income no additional options added.
- These figures are based on the the highest annuity figure given on the 10/01/2025 via the AMS portal. These figures are for illustrative purposes only.

Annuity options

The highest annuity income a person could receive is from a single life annuity with no death benefits or escalation. This is because if the annuitant died the day after purchasing the annuity there would be nothing paid to beneficiaries.

Understandably, many people don't like the thought that their annuity will disappear if they die soon after handing their money over, so annuity companies offer several different options to provide continued income or a lump sum in the event of early death.

These options include:

- Joint life options
- Guaranteed payment periods
- Value protection
- Increasing income

It is worth noting that adding additional options will reduce the initial income that will be payable from the annuity.

Joint life options

Those who are married, in a civil partnership, or have financial dependants should consider a joint life option because if they die before their partner the annuity income will continue at the percentage selected at outset.

Joint life options can include 50%, 2/3rds or 100%, however other percentages are available.

£100,000 purchase price	Single life	Joint 50%	Joint 2/3rds	Joint 100%
Annual income	£7,364	£6,716	£6,487	£6,178

- Purchase price £100,00, paid monthly in advance, level income.
- These figures are based on the the highest annuity figure for a 65 year and their 60 year old spouse/partner on the 10/01/2025 via the AMS portal. These figures are for illustrative purposes only.

Guarantee period

This can be thought of as insurance against dying soon after the start of the annuity. For example, with a five-year guarantee if the annuitant dies after three years, the remaining two years of the guarantee period will be paid to beneficiaries.

Annuity guarantee periods can be up to 30 years.

£100,000 purchase price	No Guarantee	5 Years	10 Years	20 Years
Annual income	£7,403	£7,364	£7,247	£6,728

- Purchase price £100,00, paid monthly in advance, level income.
- These figures are based on the the highest annuity figure for a 65 year old on the 10/01/2025 via the AMS portal. These figures are for illustrative purposes only.

Value protection

Value protection gives the annuitant and their beneficiaries the option of protecting all or part of the amount they used to buy their annuity. On death, the difference between the 'amount protected' and the amount of annuity income made, is paid to beneficiaries.

For example, if the annuity purchase price was £100,000 and payments were £6,000 per annum but the annuitant died after 10 years, the total payments would be £60,000 (£6,000 x 10). If the 100% value protection had been chosen, the remaining £40,000 would be paid to beneficiaries as a lump sum.

£100,000 purchase price	No protection	50%	100%
Annual income	£7,403	£7,325	£7,014

- Other percentages are available.
- Purchase price £100,00, paid monthly in advance, level income.
- These figures are based on the the highest annuity figure for a 65 year old on the 10/01/2025 via the AMS portal. These figures are for illustrative purposes only.

Increasing income

An annuity that provides income at the same level throughout the life of the policy, is known as a level annuity, and these pay the highest income.

It's natural to want the highest income initially, but it is important to consider an increasing income to protect against the effects of inflation.

Increasing income can be a fixed amount, e.g. 3 or 5%, or in line with inflation. Some company pension schemes may have a limited price increase, e.g. RPI up to a maximum of 3%.

£100,000 purchase price	Level	3% p.a.	5% p.a.	RPI or LPI
Annual income	£7,364	£5,503	£4,417	£4,814

- Purchase price £100,00, paid monthly in advance.
- These figures are based on the the highest annuity figure for a 65 year old on the 10/01/2025 via the AMS portal. These figures are for illustrative purposes only.

Income frequency

Annuities are often paid monthly but it is possible to have other payment modes, e.g. yearly. Payments can be at the beginning of the period, in advance, or at the end of the period, in arrears.

A summary of the main annuity options:

Type	Options	Description
Single life		Pays the highest level of income but income stops when the annuitant dies unless a guaranteed period or value protection has been selected.
Joint life	• 50% • 2/3rds • 100%	On the death of the policyholder, annuity income can continue to a surviving spouse, civil partner or financial dependant at the selected level.
Guarantee period	• Nil • 5 Years • 10 Years • Or up to 30 years	With a guarantee period, income will be paid for a minimum period of time. For example, if a 5-year guarantee is selected and the policyholder died after 2 years, the beneficiaries would continue receiving income for the next 3 years. If it was a 10-year guarantee, the payments would continue for another 8 years.
Value protection	• 50% • 100%	Sometimes called the money back option, on death this option pays out the difference between the selected proportion of the amount invested and the income already received.
Increasing income	• 3% • 5% • up to a maximum of 10%, or in line with inflation	A level annuity means that income remains at the same level throughout. Increasing at 3% means the income increases each year by 3% and the RPI option means the annuity increase each year in line with the retail prices index.
Income frequency	• Monthly • Quarterly • 1/2 yearly • Yearly	Annuity income is often paid monthly but other options can be chosen. Payments can be at the beginning of the period, in advance, or at the end of the period, in arrears.

Tax is payable on income payments at the annuitant's marginal rate and tax will be normally deducted by the plan provider.

Interest rates

Annuity providers invest the money from annuity purchases into assets such as long dated gilts, corporate bonds, sovereign debt and commercial property.

The yields on these assets are used to calculate the underlying annuity interest rate. Annuity providers do not publish these rates as it is sensitive commercial information, but it can be approximated by looking at the yield on long dated gilts.

I use the yield on 15-year gilts as published in the Financial Times as the benchmark and at the time of writing (January 2025) this is 4.9%. It is important to note that the underlying annuity interest rate is different to the actual annuity rate because the latter includes an element of the return of capital. The current rate for the benchmark rate is 6.4%.

Annuity providers must comply with strict financial rules, e.g. Solvency II, which ensure that annuity assets match the expected annuity liabilities. In the rare case that an annuity provider was unable to make annuity payments to customers, policyholders will be 100% protected by the Financial Services Compensation Scheme (FSCS).

Annuities are 100% guaranteed by the FSCS

In the UK annuity policies are issued by life assurance companies which are regulated by the Financial Conduct Authority (FCA) and the Prudential Regulation Authority (PRA). This means that annuities are highly regulated and insurance companies must ensure they invest their annuity funds in cautious funds so they can always meet their future annuity payments. Therefore, annuities are one of the few financial products that provide an income guarantee.

If an insurance company were to be declared insolvent and was unable to pay annuity payments, policyholders are protected by The Financial Services Compensation Scheme (FSCS). The amount of compensation is 100% of the value of the income that is protected. Policyholder protection is triggered if an authorised insurer is unable, or likely to be unable, to meet claims against it, for example if it has been placed in liquidation.

3. Annuities and tax

Income from pension annuities are normally subject to tax at the annuitant's marginal rate. Annuity providers will deduct tax at source and any under or over payments can be settled with HMRC.

If the annuitant dies before age 75, there is currently no tax payable on income paid from a joint life annuity, a guarantee period or value protection, but these payments will be taxed at the beneficiary's marginal rate if death occurs after age 75.

Purchased life annuities (annuities bought from personal savings) are not liable for tax on the part of the payment which is considered to be repayment of the original capital but tax is payable on the interest element.

Annuities and inheritance tax

Payments from a joint life annuity, a guarantee period or value protection (annuity death benefits) will not attract inheritance tax if paid to a surviving spouse or civil partner. Payments made to the estate or nominated beneficiaries under the terms of a discretionary trust will normally not fall into inheritance tax calculations (until 2027), but non-discretionary payments might.

In the November 2024 budget, it was announced that from 2027, most unspent pension funds will be included in an individual's estate upon their death, potentially subjecting these funds to inheritance tax. This may affect the inheritance tax on some annuity death benefits and HMRC will issue guidance on this is due course.

There are few details at the moment but the new inheritance tax rules may result in people looking to use more of their pension savings from age 75 either by withdrawing more income or purchasing an annuity.

4. Alternatives to guaranteed lifetime annuities

Annuities are not the only way to convert a pension pot into income. The alternative to annuitisation is drawdown.

Pension drawdown is where an income is taken from the pension pot either as regular income payments or a series of ad hoc payments. The pension savings remain invested and on death the remaining savings can be paid to beneficiaries. There are a number of different types of drawdown but the two main options are:

- Fixed term income plans
- Pension drawdown

Fixed term income plans

Also known as 'fixed term annuities', fixed term income plans are a type of drawdown plan which can pay a guaranteed income for a fixed term. There are three important things to understand:

- The amount of income
- The guaranteed maturity amount (if chosen)
- What happens on death

The amount of income

This can be anything from zero to the maximum allowed. The more income taken the less payable as a guaranteed maturity value. You can select a level income but it's also possible to choose for payments to increase each year.

The guaranteed maturity amount

This is the amount payable at the end of the term and is shown on the initial quotation. If this option is chosen then the guaranteed maturity amount can be paid as follows:

- As a lump sum to the plan holder– this will be taxed at their marginal rate
- To purchase a lifetime annuity
- Purchase another fixed term or invest in a drawdown plan

What happens on death?

Just as with lifetime annuities, there are a number of options which payout money if the plan holder dies before the end of the term. However, these options will reduce the amount of income payable at outset. There is a Joint life option where income can continue to a spouse or partner. For example these can be 50%, 2/3rds or 100% if the spouse/partner survive to the end of the plan the guaranteed maturity is paid if chosen. However, if they die before the end of the term there is no maturity value (unless they choose a guaranteed period the same as the full term).

Payments can be guaranteed for a set period e.g. 5 or 10 years. If the guaranteed period is the same as the full term of the plan, this may guarantee that the maturity value is paid even if the customer dies within this time.

There is also a value protection option which like the same option for a lifetime annuity pays a proportion of the original purchase price.

How flexible are fixed term income plans?

As the income is only guaranteed for a fixed term, customers can use the maturity value and any other pension plans they hold to select a different retirement income product at the end of the term. However, the options available and the income rates that will be payable are not guaranteed.

Once the plan is set up the options cannot be changed. However, some providers allow the remaining pot within the plan to be surrendered under certain conditions if their circumstances change.

Pension drawdown

Although this is a guide about annuities, it is important to mention pension drawdown because one of the important decisions facing advisers and their clients is, 'is it better to invest in pension drawdown or purchase an annuity?'

Pension drawdown was introduced in 1995 in response to criticisms of the compulsion to purchase annuities at a time when annuity rates were falling. Successive governments introduced different versions of drawdown, e.g. capped and flexible drawdown until 2015 when the new pension freedoms created flexi-access drawdown.

A pension drawdown plan allows investors to take normally up to 25% of their pension pot as a tax-free lump sum and then take a regular income or ad hoc income payments directly from their pension pots.

There are three important components to flexi-access drawdown:

1. Income flexibility

Regular or ad hoc income can be paid directly from your client's pension savings. It is important to remember that, unlike an annuity, income is not guaranteed and if too much income is taken in the early years or if their pension savings does not increase in value as planned, income will reduce or even run out entirely.

2. Investment control

The pension pot can be invested in a number of ways ranging from cash, bonds, equities and even property (you cannot invest directly in residential property).

3. Death benefits

Most drawdown plans offer three options following the death of the plan holder:

- Pay the balance of the drawdown pot as a lump sum
- Arrange flexi-access drawdown for beneficiaries (no income needs to be taken)
- Purchase an annuity for selected beneficiaries, normally a spouse / partner

If the plan holder dies before age 75, all payments will normally be free from income tax, but if death occurs after age 75, any payments will normally be taxed as income at the beneficiary's marginal rate.

The advantages and disadvantages of income drawdown

Advantages	Disadvantages
Income flexibility – income can be changed at any time	There is no guaranteed income, if too much income is taken it may have to reduce in the future or even run out
Control of investments – pension pot can remain invested in any permitted investments	If invested unwisely, or there are poor returns, the value of the pension savings will fall in value
Choice of death benefits – on death, the remaining pension savings can be paid to chosen beneficiaries	Drawdown does not benefit from mortality-cross subsidy which is a feature of an annuity

A pension plan is a long-term investment. Its value can go down as well as up and could be worth less than was paid in.

People do not have to make a black and white choice between an annuity or pension drawdown because in some cases it will make sense to consider a combination of both.

5. The advantages of annuitisation

The process of converting a pension pot (or savings) into a regular income is called 'annuitisation'.

It helps to separate the concept of 'annuitisation' from the actual annuity policy because it is important to think about the key role annuities play in retirement income planning rather than just focusing on the annuity itself and getting the highest annuity rate. In economic theory, annuities are considered to produce the optimum distribution of income throughout the lifetime of the annuitant and ensures they do not outlive their annuity investment.

Economists point out that a risk-averse retiree who faces uncertainty about life expectancy should place a high value on an annuity that pays a guaranteed income for life. But in reality relatively few people choose to annuitise when they convert their pension pot (or savings) into income. Therefore, they talk about 'The Annuity Puzzle'. Put simply, if annuities are so good why do so many people avoid them?

Reasons include:

- Many people are reluctant to make irrevocable decisions
- Many people do not understand the value of annuities
- There is a reluctance to choose an option that may not leave an inheritance for their family

This puzzle may not be easy to solve but better education and more information will help advisers and their clients understand the benefits and importance of annuitisation.

Three advantages of annuitisation:

Annuitisation is the only way of arranging a guaranteed income for life no matter how long they live

- Ensures people do not outlive their financial resources

There is a mistaken belief that the same income goals can be achieved through other options

- It may not be possible to get the same income from other options

Annuities provides peace of mind and financial security

- Guaranteed income with no investment risk

Annuities are the only way of arranging a guaranteed income for life

When looking at the advantages of annuitisation, a good place to start is to consider what would happen if annuities had not been invented?

If there were no annuities, advisers and their clients would be faced with two dilemmas when it came to taking an income from their pension savings;

- How much income to take?
- Where to invest their money?

How much income to take?

If too much income was taken from their pension savings they would run the risk of running out of money.

Problem: But if they took too little income they could die without having enjoyed all the income they could have had.

Solution: Annuities solve this problem by guaranteeing a known amount of income as long as the policy holder (or their partner) is still alive.

Without annuities people will either overspend or underspend.

Where to invest the money?

Without annuities, there would also be the problem of where to invest their pension savings.

Problem: Investing in the stock market puts their pension savings at risk because it would fall in value if there was a stock market crash.

However, investing in money market instruments (including cash) or low yielding assets produces low investment return and increases the risk of running out of money or not keeping up with inflation.

Solution: Annuities solve this problem by providing a guaranteed rate without any investment risk to the policyholder.

There is a mistaken belief that the same income goals can be achieved through other options

The most popular alternative to annuity is pension drawdown but despite the many benefits of this flexible option, drawdown may not payout as much income to your client over their lifetime as an annuity. There are two reasons for this:

- Investment returns may not be as high as predicted or adversely affected by the sequence of returns risk
- Pension drawdown does not benefit from mortality cross subsidy.

Whereas annuities are invested in assets with fixed returns, drawdown products can be invested in a wide range of funds. If these funds under perform compared to fixed interest investments then they will not be able to sustain the same income as an annuity. This is especially true if drawdown is affected by unfavourable sequence of returns. This is the risk that investment returns are lower than expected (or even negative) in the early stages of drawdown resulting in capital being eroded quicker than anticipated. If this happens the drawdown pot may not be able to sustain future income payments at the same level and there is an increased risk that income may be reduced or the worst case scenario, your client's could run out of money, unless investment returns are higher than expected in the future.

The other reason why drawdown may not pay as much sustainable income as an annuity is because drawdown does not benefit from mortality cross subsidy. This occurs because annuities tend focus on paying an income for life rather than a death benefit, and hence they can pool together all the death benefits that would otherwise be payable to beneficiaries to increase the income payable to annuitants whilst they are alive. The benefit of this mortality cross subsidy varies depending on the age and health of the annuitant and what death benefit they want to include with their annuity.

For drawdown customers looking to match the income payable from an annuity, the impact of the lack of mortality cross subsidy is called 'mortality drag', because compared to annuities, drawdown investment returns would need to increase each year at an ever-increasing rate in order to compensate for the lack of mortality cross subsidy. This is despite the fact that as investors get older they generally look to take less risk not more. For this reason, the case for annuities gets stronger as people get older.

Annuities provides peace of mind and financial security

As well as having many financial advantages, annuities also provide many non-financial advantages. Peace of mind is achieved by knowing that each month, a regular income will be paid to help pay for essential bills and to maintain a certain standard of living.

Financial security is achieved through knowing that whatever happens to financial markets or to personal circumstances, annuity payments are guaranteed and will continue for the rest of the annuitant's life.

The alternatives, such as drawdown may provide flexibility and control but they may be adversely affected during times of volatile financial markets and there are no income guarantees.

> **"Financial security is achieved through knowing that whatever happens to financial markets or to personal circumstances, annuity payments are guaranteed and will continue for the rest of the annuitant's life."**

6. Annuities and retirement planning – questions and answers

Having explained how annuities work and the advantages of annuitisation, it is time to look at how annuities can fit into the retirement advice process. I have been advising and consulting on all aspects of annuities for over 25 years and here are some of the most frequently asked questions about annuities from adviser and clients.

1. Are annuities good value?

Yes, there has been lots of research carried out that show annuities provide good value for money.

In 2014, the FCA published a report "The value for money of annuities and other retirement income strategies in the UK"* which demonstrated that annuities were fairly priced and provided good value for money. Under the FCA's Consumer Duty, annuity providers are required to monitor their rates to ensure they provide Fair Value for customers.

A common mistake made by people who say annuities are poor value is to confuse the concept of annuitisation with low yields on fixed income investments.

There is nothing wrong with the concept of annuitisation and as explained above it has many positive benefits and advantages. However, at times when yields are very low (e.g. after the 2008 credit crunch and after Brexit) the income from annuities is low. This is not the fault of annuities but of financial markets.

*www.fca.org.uk/publication/occasional-papers/occasional-paper-5.pdf

2. When is the best age and time to purchase an annuity?

There are two aspects to this question; when is the right age and when is the best time in relation to rising or falling annuity rates.

When working out when is the best age to purchase an annuity there are three main factors to take into consideration; age, income needs and financial security.

Although annuities can be purchased from pension pots at any time after age 55 (this is set to change to 57 on 6 April 2028), most annuities are arranged between the ages of 60 and 75. Below the age of 60 there is little benefit from mortality cross subsidy, and it may be too early to lock into an annuity. After the age of 75 care must be taken to avoid missing out from the benefits of increased mortality cross subsidy. Consideration of an annuity should not be delayed for too long as customer may be missing out on the key benefits of an annuity.

Many people will consider annuities when they reach retirement age and need to convert their pension pots into income in order to replace their income from work. Those with more complex financial affairs will need to take other factors into consideration such as tax and the need for flexibility. For instance, if someone does not need additional income they may end up taking money out of a tax privileged pension plan and paying tax on income they don't need at the moment.

Annuity rates do not move in a vacuum; the amount of annuity income is a product of both annuity rates and the value of the pension savings that are used to purchase them. This means that those looking to maximise their annuity income must have one eye on changes to annuity rates and the other eye on the pension investments.

Obviously, it is better to purchase when annuities and plan values are high but getting the timing right is difficult. Similarly, it would be good to buy an annuity when the investment yields that underpin annuities are high, but getting the balance right can also be difficult.

Finally, another issue to take into account with timing is the 'Opportunity cost' it may be costly to delay an annuity purchase. It is tempting, especially if annuity rates are predicted to increase, to delay an annuity purchase. However, for every month an annuity is delayed, it is a month without that annuity income. This lost income may not be compensated by higher income in the future.

In general terms, take as long as needed to make the right decisions, but once a decision has been made it may be better to arrange the annuity as soon as possible.

3. What emotional and behavioural factors affect annuity decisions?

It is important not to underestimate how emotional and behavioural factors impact annuity decisions. Industry professionals often make the mistake of thinking that people are rational and make decisions based on information and facts.

But many people make decisions based on gut instinct and intuition. Unfortunately, this can result in bad decisions which may lead to poor outcomes.

Some of the most common behavioural biases are:

- **Survival Pessimism** – The tendency to underestimate life expectancy
- **Present Bias** – Focus on immediate gratification at the expense of long-term benefits
- **Loss aversion** – Fear about short-term losses may result in being over cautious
- **Overconfidence** – Many people overestimate their ability to make the right decisions
- **Information bias** – People are easily influenced by misinformation

Advisers need to learn the skills to overcome these emotional and behavioural factors. One good technique is to explain the options and present information in a clear and unbiased way, making sure to present the advantages and disadvantages of each option in a fair and objective way. After all, advisers can be influenced by their own emotional and behavioural biases.

The table below shows some positive behavioural impacts and the corresponding negative impact when purchasing an annuity.

Positive Impacts	Negative Impacts
• Takes away worry of living too long	• Worry of dying before allotted time
• Income security for partner	• Fear of not leaving money for family
• Regular and secure income	• Concern about need for flexibility
• Takes away most of retirement risk	• Worries about playing too safe
• Peace of mind and security	• Anxiety about losing control of capital

Source: William Burrows

Good retirement advice involves analysing the technical aspects of pension and annuity options as well as taking into account the important emotional and behavioural factors. Advisers may be experts on the technical aspects, but they also need to have the expertise and empathy for the emotional and behavioural factors that influence retirement decisions. I talk a lot about annuities providing peace of mind and financial security and this is not just an abstract concept, it is something that resonates with a deep-rooted desire for financial security in retirement.

4. How do I apply for an annuity and get the highest income?

Advisers can obtain annuity quotes from providers offering rates in the open market. They can do this through one of the following online annuity portals:

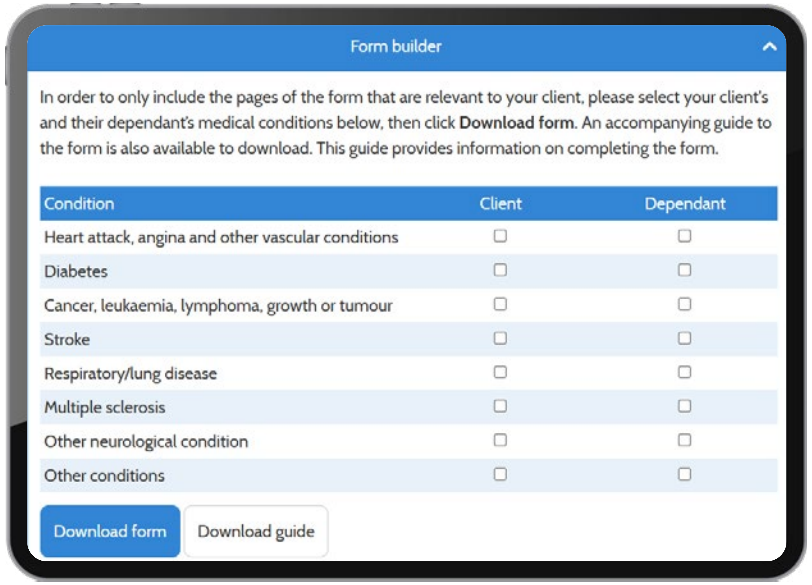
- AMS
- iPipeline
- IRESS
- Synaptic Webline

These portals produce real time annuity quotes, key information documents and pre-filled applications from annuity providers.

As well as producing standard annuity quotation, health and lifestyle information can be included to get an enhanced annuity rate if appropriate. The companies offering enhanced rates all worked together to produce a common form containing all the relevant questions required in order to produce these enhanced rates. The form is available from the annuity providers and there is an online version at www.retirementhealthform.co.uk/Adviser.

Standard Life accepts no responsibility for the site not being available at all times.

This website has a useful 'form builder' tool that allows advisers to tailor the form to their client's medical and health conditions. The medical condition sections are shown in the graphic opposite.


Form builder

In order to only include the pages of the form that are relevant to your client, please select your client's and their dependant's medical conditions below, then click **Download form**. An accompanying guide to the form is also available to download. This guide provides information on completing the form.

Condition	Client	Dependant
Heart attack, angina and other vascular conditions	☐	☐
Diabetes	☐	☐
Cancer, leukaemia, lymphoma, growth or tumour	☐	☐
Stroke	☐	☐
Respiratory/lung disease	☐	☐
Multiple sclerosis	☐	☐
Other neurological condition	☐	☐
Other conditions	☐	☐

Download form | Download guide

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Although providers usually direct advisers to apply online, some companies allow for manual underwriting. This is where advisers send in the completed medical details form and the annuity provider's underwriting team will produce a quotation with enhanced rates if appropriate.

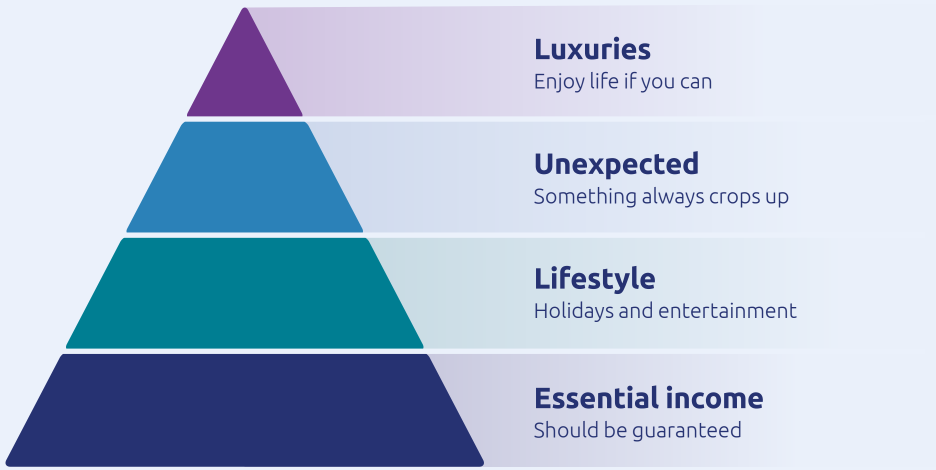
Some third-party firms offer a service where clients are contacted by a medically qualified person such as a trained nurse who will record the medical details and prepare a report that can be sent to the annuity provider. This service is helpful where there is sensitive medical information that the client does not want to share with the adviser or where the client has complex medical issues.

5. Is a combination of annuities a good idea?

When clients want both income guarantees and flexibility there is a strong case for a combination of annuities and drawdown. This may include the following circumstances:

- Where there is need for a base level of guaranteed income (see income pyramid)
- Where people want the best of best worlds; a guaranteed income and the flexibility of drawdown
- When it is prudent to reduce income and investment risk

One of the classic ways of looking at retirement income is to consider the 'income pyramid'. At the base is essential income and at the top is discretionary income for luxuries, and in between is income for things that increase the quality of life.



The income pyramid: Guaranteed income at the base with more flexibility at the top

Essential income may come from the state pension or company final salary pensions and in many cases may be supplemented by annuity income. The top layer of luxury could come from pension drawdown or savings. This leaves an important middle layer of income that is neither essential or a luxury but income that most people want to be regular and secure without taking undue risks.

Income that needs to be secure and reliable can be delivered from annuities and the rest of income can be taken from pension drawdown.

It is important to consider the various risks affecting your clients in retirement and these include:

- Income risk
- Investment risk
- Inflation risk
- Longevity risk

These risks affect different stages of retirement in different ways. For example, in the early part of retirement, investment risk and longevity risk may be less important than other risks because time is on the retiree's side. However, it will be important to manage income and inflation risks throughout all stages of retirement.

A good way to manage these risks is through a combination of annuities that changes over time. For instance, in the early stages of retirement it might be appropriate to have some pension drawdown in order to benefit from potential investment growth and to have flexibility but as people get older they may benefit from moving money from more risky drawdown to secure annuities.

7. Conclusion

Annuities are important because not only are they the only financial policy which pays a guaranteed income for life, no matter how long the policyholder lives, they also play an important role in retirement planning.

When giving retirement income planning advice, it is important to separate the strategy from the tactics. The strategy is all about planning and the tactics are about arranging the product solutions on the best terms.

Planning does not have to be overly complicated and nowadays most advisers will use cash flow modelling to identify future money and income needs. During the planning stage it is important to consider how annuities can be used to maximise lifetime income and reduce the various retirement risks. A common mistake made by advisers is to think that pension drawdown will meet their client's income needs without taking undue risk throughout the entire retirement journey.

One of the main themes of this guide is that annuities provide peace of mind and financial security in an increasing uncertain world and the alternatives to annuities, e.g. pension drawdown can be a risky business. Advisers ignore this at the risk of ignoring their consumer duty obligations. People face many different risks during their retirement and the one risk that's often ignored is longevity risk; the risk of living longer than expected and running out of money. Annuities are the only product solution that fully mitigates this risk and good advice should involve considering annuities as a way of mitigating longevity risk.

It does not have to be a black or white decision; an annuity or drawdown, and an increasing number of advisers are recommending a combination of annuities and drawdown as a retirement solution that combines the advantages of annuities with the flexibility of drawdown. When it comes to the tactics of arranging an annuity, it is important not only to shop around for the highest annuity income taking health and medical conditions into account, but also to make sure the most suitable options are selected.

"When giving retirement income planning advice, it is important to separate the strategy from the tactics. The strategy is all about planning and the tactics are about arranging the product solutions on the best terms."

When pension freedoms were introduced in 2015 many people thought this sounded the death knell for annuities but how wrong they were. Now, with annuity rates back to the level they were before the 2008 credit crunch more and more advisers are recommending annuities to their clients.

In conclusion, let me remind you about some of the things that make annuities unique and therefore an important tool in every advisers' toolbox when they are giving retirement income advice:

- **Annuities are the only financial policy that pays income for life no matter how long**
- **Annuities provide good value for money and rates are close to pre credit crunch levels**
- **Those with certain health or medical conditions are likely to get a higher income with an enhanced annuity rate**
- **Annuities provide the comfort of having a regular paycheck, guaranteed to be paid into your account each month. This should not be underestimated as people spend most of their life receiving a regular paycheck**
- **Annuities provide peace of mind and financial security in an increasing uncertain world**

Learning outcomes

After reading this guide, you should now be able to:

- Understand consumer attitudes towards annuities before and after pension freedoms
- Understand and explain the factors that can influence annuity rates and client income
- List the annuity options which allow the product to be tailored to meet specific needs
- Understand the alternatives to lifetime annuities, and the benefits of blending retirement income options
- Summarise the advantages of annuitisation and overcome common objections.

About Standard Life

The Standard Life name has been with us for nearly 200 years and is wholly owned by Phoenix Group, the UK's largest long-term savings and retirement business.

The Phoenix Group can trace its history back to Phoenix Assurance in 1782. The Phoenix Group is listed on the London Stock Exchange under PHNX and is a FTSE 100 constituent.

Key facts

- **c. 12m customers**
- **Over £289bn Assets Under Management (AUM)**
- **168% shareholder capital coverage ratio**
- **£3.5bn Solvency II surplus (estimated)**

Source: Phoenix/Standard Life, as at 30 June 2024

Impartial ratings

Ratings are useful assessments that instantly address how a manufacturer and its products are considered, as well as its position in any given marketplace. Phoenix Life Limited (wholly owned by Phoenix Group) trades as Standard Life and its financial strength ratings are shown in the table.

Phoenix Life's financial strength ratings	AKG financial strength rating	Fitch financial strength rating
Phoenix Life Limited trading as Standard Life	**B+** 03/12/2024	**AA- Stable** 11/10/2024

Source: standardlife.co.uk/adviser/business-support/news/akg-rating-standard-life and thephoenixgroup.com/investor-relations/debt-holdings-credit-ratings

There are no guarantees in life*
*Exclusions apply
In a world of ups and downs, we can help your clients look forward to a little more certainty.
Discover our range of pension annuities.
Find out more at:
standardlife.co.uk/retirement-income
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