

Annuities Revisited

The announcement that the new Government intends to remove the requirement for pension plans to be annuitised by age 75 is more than welcome. However, most people will still end up buying one or more annuities with their pension pots.

Buying an annuity involves exchanging a lump sum of money, which has been accumulated in a pension policy, for a lifetime income; and the only alternative way of achieving such an income is by means of a form of income drawdown known as Alternatively Secured Pension ('ASP'). This enables people to maintain the investments in their pension plan and to draw an income from them.

However, there are disadvantages to ASP. Unless the pension plan is converted to a form known as Scheme Pension, the income which may be drawn is significantly restricted, and the residual fund is subject to penal levels of tax in the event of the death of the policyholder or, subsequently the policyholders spouse or civil partner, should they elect to continue ASP.

In addition, ASP can be expensive to administer, and the investments are subject to the vicissitudes of the stock market. Consequently, ASP is only suitable for investors with substantial pension pots who can afford the costs and are willing to accept the risks. Which brings us back to annuities.

The Government's main concern in relation to annuities has been that, despite their insisting that all pension providers must draw to their policyholders' attention their right to shop around for the best rates (the so-called Open Market Option), most investors are still failing to do so and are consequently receiving poor value for their money.

The range of annuity options is considerable. They can provide an income which is fixed or which escalates at pre-determined rates or in line with the rate of inflation or whose value depends on the growth of underlying stock market investments.

They can be arranged to be payable for the lifetime of an individual or for the joint lives of an individual and his or her spouse/civil partner. They can also be guaranteed to be payable for a minimum period of years.

There are also Annuities available which have a deferred commencement date so that, for example, someone retiring at age 65 could arrange for the annuity payments to commence at age 80.

The greater the number of benefits included in the contract and the earlier the commencement date, the lower the income will be. So, delaying annuity purchase, either by simply not vesting benefits or by using Unsecured Pension to provide income in the near term, not only reduces the period over which annuity payments will be made, and therefore increases the amount of each payment, but may also eliminate the need for optional benefits such as guarantees and spouses' benefits.

When considering whether to delay annuity purchase it is wise to consider whether future annuity rates will be as they are now. Increasing longevity and major annuity product developments in recent years, particularly regarding the increased personalisation of annuities, might suggest that they may not be.

Enhanced rates are available to people whose lifespan seems likely to be shortened by illness, and some annuity providers take account of the health profiles of people living within particular postcode areas. The more personalised annuities become, the less will be the benefit of the mortality cross-subsidy traditionally available to people who outlive average expectations of longevity as a result of others dying earlier.

Premature Reports Of Death

How short memories are! The announcement in the 2010 emergency Budget that the rate of capital gains tax applicable to trust investments was to be increased from the anomalously low rate of 18% to 28% prompted cries in the national press that this would be "the final nail in the coffin for trusts".

What the aggrieved commentators appear to have forgotten is that only a few short years ago the CGT rate applicable to trusts was 40%.

What they have also forgotten – or overlooked – is that in the case of bare trusts the CGT liability falls on the beneficiaries at the flat rate of 18%, subject to their own annual exemption.



Where discretionary trusts are concerned there are tax-efficient ways of investing which take the sting out of the tax rise.

If the investments for a discretionary trust are held within an Investment Bond, they are taxed at the same rates as the other investments managed by the insurance company which provides the bond; and these are much lower than the rates applicable to trustees.

Furthermore, trustees are able to draw down up to 5% of the original value of the bond each year without any immediate liability to tax, and to distribute these funds to beneficiaries similarly tax-efficiently.

Trusts have a vital role to play in financial planning for families, and they are far from dead!

Cashflow Forecasts

Cashflow forecasting is becoming an increasingly important part of financial planners' armoury.

An obvious application is in the field of personal injury awards, where the Court needs to be satisfied that the funds are invested in such a way as to ensure that they will last the lifetime of the recipient. However, there are many other situations where it is necessary to assess the variables which will impact on the likely future value of investments – for example, planning for long term care, for divorce and for redundancy.

Thought for the day

"I view (stock) markets as noisy children. You have to pay attention to them but you shouldn't take them too seriously. Markets have predicted eight of the last three recessions".

Willem Buiter
Chief Economist of Citigroup

July 2010



No responsibility can be accepted for the accuracy of the information in this newsletter and no action should be taken in reliance on it without advice.
Please remember that past performance is not necessarily a guide to future returns.
The value of units and the income from them may fall, as well as rise. Investors may not get back the amount originally invested

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Authorised and Regulated by the Financial Services Authority. Reference Number 207474