

ANNUITY RATES

One of the consequences of the credit crunch has been that lenders have become more cautious, and borrowing has become more expensive for both individuals and companies.

Depositors have benefited from the higher rates, and so also have annuity buyers, because annuity rates reflect the interest rates which companies have to pay on the borrowings which they make in the form of corporate bonds.

However, the Government has been seeking to ease the plight of borrowers by relaxing interest rates, and commentators are suggesting that this may lead to a reduction in corporate bond yields, and that the improved annuity rates currently available may not last.

There is therefore an argument for retired people who may have deferred annuity purchase taking this opportunity to commit at least some of their cash to the annuity market now, rather than waiting.

The types of annuity which have benefited are those that provide an income which remains level or escalates at a fixed rate, and such annuities may in either case carry a guarantee that income will be paid for a fixed period. The types of annuity whose rates have not improved are those whose payments are linked to the Retail Price Index and therefore provide protection against inflation.

The reason that index-linked annuity rates have not improved is that they are backed by index-linked Government fixed interest securities, for which demand has surged because of concerns about inflation of energy and food prices.

Whether retirees opt for level, escalating or index-linked annuities, and whether they decide to add in further options (the cost of which will inevitably reduce the annuity income), will depend on their personal circumstances and the amount of risk they are willing to take. However, in most cases it will be appropriate to opt for a judicious mix of annuity types.

In formulating this mix consideration should also be given to With Profit and possibly Unit Linked annuities, particularly where larger amounts are to be committed and the investor's attitude to investment risk is compatible.

There is also a new type of product, namely the "variable" or "third way" annuity, which providers suggest offers a middle road between conventional annuities and the riskier option of pension income drawdown, now known as Unsecured Pension.

These new products come in a number of forms, but most invest in equities to produce a potentially higher income in the future and provide a guarantee that the capital invested will not be eroded.

Third way products were first developed in the US and most of the providers are American, but some leading UK providers are poised to enter the market.

The questions which need to be asked are whether the price of the guarantees can be justified; and what options are open to the investor at the age of 75, when tax considerations may provide a strong encouragement to purchase a conventional annuity.

OVERSEAS PENSIONS

An increasing number of people are choosing to live or retire abroad, and this often gives rise to the wish to export pension benefits which have accrued in the UK.

It has always been possible to transfer UK pension benefits overseas, but in the past the procedure has been complicated and has required individual consideration of each scheme.

However, since 2006, there is a single simplified procedure, which is to transfer benefits into a QROPS (a Qualifying Recognised Overseas Pension Scheme).

A QROPS is a pension scheme which conforms to a number of regulatory and tax conditions. It must be either a personal pension or an occupational scheme which is regulated in the country in which it is established, and which in the case of EU countries requires that at least 70% of the pension fund is used to provide an income for life, payable no earlier than the normal minimum pension age.

The scheme manager must notify the UK tax authorities and provide evidence that the qualifying rules have been observed. HMRC must also be advised of certain payments made from the scheme.



However, the reporting requirement ends when the scheme member has been out of the UK for at least five years. As from this point the scheme will be subject to local pension legislation.

This is a complex subject, on which specialist advice is required.

ABSOLUTE RETURNS

Some fund managers have been suggesting that now might be a good time to invest in fixed interest securities, i.e. gilts, (Government securities), investment grade corporate bonds, high yield corporate bonds or global bonds.

But different factors drive these markets. For example, gilt prices are driven by expectations for interest rates and inflation, whereas corporate bond prices are influenced mainly by the ability of the borrower to repay the debt.

Potentially one of the better ways for the private investor to gain exposure to these markets is to invest through a 'strategic' bond fund, which can access all sectors of the bond market and switch between sectors in a way which would not be feasible for the private investor.

Investors seeking income and relative stability of capital values might also consider a variant of the strategic bond fund known as the absolute return bond fund. This has as its objective simply to make a positive return (rather than trying to beat a benchmark) and to this end may buy a wider range of market instruments. Such funds have only been available for a few years, and their performance to date has been lacklustre, but their time may have come!

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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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