

Introduction

Would it surprise you to know that two thirds of people who have taken the trouble to build up a private pension fund **throw away part of the guaranteed income that it can produce** for the rest of their lives when they retire?

In fact, even of those who do make use of the 'open market option', many do not realise that they could qualify for an 'enhanced' annuity because of their health or lifestyle.

What Is An Annuity?

An annuity is **an insurance provider's promise to pay an income for a set purchase price**. In the context of pensions the income is normally paid monthly for the rest of your life.

After your death, payments could continue to a dependant, such as a spouse, (possibly at a lower level). **It can be for a fixed amount, or can increase each year**, for example in accordance with changes in the cost of living. It provides certainty and security, compared with the other options that are available at retirement.

On the basis that you decide to take a pension commencement lump sum (ie a tax-free lump sum) at the outset, **this may be reinvested to generate additional income** in retirement. You may choose to purchase an annuity with this money as well. This is called a 'purchased life annuity'. Part of the income generated by the purchased life annuity can be paid tax-free.

In essence annuities are **simple, secure and guaranteed**.

There are other options to the immediate purchase of an annuity on retirement but these are outside the scope of these notes.

What is the Open Market Option?

When you reach the retirement age specified under your personal pension plan or its predecessor, the retirement annuity contract, the pensions provider will write to you offering various 'annuity' options.

One of the options that will be referred to in the pensions provider's letter is the 'open market option'. This is simply your ability to purchase your annuity **from a different pensions provider** to the one you have used to build up your pension fund.

Using the open market option will **more often than not lead to an increase in your annuity**.

In the past it has been easy to overlook this option as some pensions providers have, understandably, been reticent to promote it too clearly. However, it is now a legal requirement for **pensions providers to draw clients' attention to the availability of the open market option**.

You might wish to refer to the **FSA Guide to Pensions 3: Annuities and Other Retirement Options** which you will find under www.fsa.gov.uk/consumer. This booklet provides useful information about pension annuities and highlights the nature of the options available to you.

Using The Open Market Option

It is not a complicated procedure to make use of the open market option. You simply contact your independent financial adviser (IFA) and **let him or her have sight of the annuity offer from the pensions provider**.




If you do not have an IFA you could visit the websites of **IFA Promotion** (www.ifap.org.uk) or the **Personal Finance Society** (www.thepfs.org) or simply ask us for advice!

Your IFA will request that you complete a Fact Find if you are a new client, or if the previous Fact Find was last updated some while ago.

Your IFA will then discuss **with you whether some form of annuity is the most suitable option for you**, having regard to your personal financial situation, your family situation, your health, your likely income needs in retirement and your attitude to risk.

We will assume for the purposes of these notes than an annuity is considered the most appropriate option.

Your IFA will discuss with you what type of annuity would be most suitable. This will cover such aspects of the annuity as:

-  whether you should purchase a single life annuity, **or an annuity based on the joint lives** of you and your spouse
-  what **proportion of your pension should continue to your spouse** in the event of your death
-  whether **your pension should increase** each year and, if so, by how much

A whether you need a **guaranteed income or could make use of an equity linked or With Profits annuity** which holds out the prospect of higher annuity payments over the longer term

A whether you should **build in a guarantee period of five years** or ten years in case you die early on

Your IFA will then use a computerised comparison system such as *The Exchange* to find the most competitive annuity rates for your circumstances.

If these provide a higher pension income that you have been offered by your existing pensions provider, your IFA will obtain formal quotations from the most competitive pensions providers.

The Exchange
●●● a vertex company

Annuity Rate Comparison Report
Date Produced: 12/07/2006
Annuity Rate Comparison Report produced for A N Other and P N Other

Provider	Annuity Per Annum %	Date Rate Last Changed	Date Rate Last Confirmed	Quoted Term For	Age Step
Just Retirement ENHANCED	1199	18/07/2006	13/07/2006	14 days, extended to 28 if application received on business	0.25 of a year
Partnership Annuities ENHANCED	1127	07/06/2006	05/07/2006	30 days	3 months
Chelsea Life 100	994	04/06/2006	28/06/2006	14 days	1 month
CELEST ENHANCED 200,000 - 300k	979	11/07/2006	11/07/2006	30 days provided application is received within 14 days	Age related, Single - 1 month, Joint - 4 months
Prudential ENHANCED Band 1	979	01/01/2006	01/07/2006	14 days	Individual days
Metavik Union Band 2	949	21/06/2006	01/07/2006	10 days	1 month
Standard Life > 250k	944	12/05/2006	01/07/2006	14 days	3 months
Legal & General 90-100k	929	01/01/2006	01/07/2006	14 days	1 month
Prudential Annuities Band 5	912	01/01/2006	01/07/2006	14 days	Individual days
ACA Sun Life	907	12/07/2006	12/07/2006	14 days	Quarter year extended
Scottish Widows	824	01/02/2006	13/07/2006	14 days	1 month
Franklin Prudential	753	21/11/2004	01/07/2006	17 days (17/18/19 only)	1 month

If you choose one of these pensions providers and complete their application form **they will then liaise with your former pensions provider to transfer your accumulated pension fund** to them so that they can use it to purchase your annuity.

There should be **no charge applied by your existing pensions provider** provided that you are taking your benefits at the age originally specified in your pension contract. The new pensions provider will have allowed for their charges in the rates quoted to you.

Your IFA will either take commission from the new pensions provider out of their standard charges (so there is no direct cost to you), or you can agree to pay him or her a fee for their work, for which they will normally sacrifice part, or all, of their commission entitlement, which will result in a slight increase in your pension.

Using The Open Market Option With Occupational Pension Scheme Benefits

The use of an open market option is **not restricted to personal pensions**. At your retirement, the trustees of an occupational pension scheme, of which you are a member, can also transfer funds to a pensions provider of their choice.

If your occupational pension scheme is of the 'money purchase' variety this might have the effect of **providing a higher pension for you**. If your occupational pension scheme is of the 'final salary' variety, however, the cost of providing the pension to you might simply be reduced to the benefit of the remaining pension fund rather than to you.

Even under a 'final salary' occupational pension scheme, **it is possible that the trustees may decide to use the open market option to purchase a higher pension** for you than that which has been promised under the scheme.

Using The Open Market Option With A Freestanding AVC Plan

The use of an open market option is **permitted under a freestanding AVC plan**. Under the new 'pension simplification' legislation, post 5 April 2006, such plans also provide an entitlement to a pension commencement lump sum (ie tax free cash) of up to 25%.

Where You Have Several Personal Pension Plans

Where you have several personal pension plans with different providers, it is possible to transfer as necessary to **bring them all together with whichever of the providers offers the best annuity rates**.

What Are Enhanced and Impaired Life Annuities?

If you have suffered a heart attack, have insulin dependent diabetes, or even just smoke manufactured cigarettes, you are likely to qualify for an 'enhanced' annuity. It is estimated that **40% of retiring people will qualify for enhanced annuity rates because of their lifestyle** (the most important of which is their smoking habits), their medical history, current state of health, where they live, or the type of work they do.

Whilst enhanced annuities offer the prospect of a higher pension for a good number of people who are retiring, **a much smaller number may qualify for an 'impaired life' annuity**.





In very broad terms an impaired life annuity might be offered to someone whose medical condition meant that there was **a very high risk of death within the next five years**, whereas an enhanced annuity might be offered to someone whose health or lifestyle meant that their life expectancy was reduced.

Applying for an impaired life annuity can be time consuming because pensions providers normally require detailed medical evidence, sometimes requiring a medical examination and underwrite each application individually.





On the other hand **applying for an enhanced annuity is fairly straightforward** with simplified application procedures.

Conventional Annuity

Advantages

-  You receive a guaranteed level of income for life
-  A guaranteed level of income Benefits can continue to be paid to your spouse or dependent in the event of your death
-  Your payments can be made for a guaranteed period of time (usually for 5 or 10 years). This means that, should you die within this period, payments will continue to be made
-  You will be able to take a pension commencement lump sum (ie tax-free cash) immediately (although you will receive a lower annuity payment), to spend or invest as you wish

Disadvantages

-  The level of income is fixed at the outset (unless you opt for inflation-linking) and cannot respond to changing personal financial circumstances
-  The level of income will therefore depend on the level of annuity rates available at the time you purchase your annuity. If they are at a low level and you purchase, there is nothing that you can do about it in the future if rates rise once more
-  There is no possibility of benefiting from future investment growth on your pension fund, although an implicit rate of investment growth has been assumed when setting the annuity rate to provide your income
-  In the event of death, depending on the type of annuity you have purchased, benefits to your dependants could be lower than those enjoyed under some of the other options available to you such as unsecured pension (ie income withdrawal). There may in fact be no payment at all

Risk Factors

- Your circumstances might change after your annuity starts.
- You may not have made adequate provision for your dependant.
- The contract (and therefore payments) will cease upon your death unless you have selected the guarantee option and death occurs within this period.
- Inflation may exceed any rate of escalation provided by your retirement income and consequently its purchasing power would diminish.
- The total return from the annuity will depend on how long you and (if applicable) your dependant live.

For Further Info

If you would like to discuss whether the use of an open market option might be appropriate for you please ask your usual Arch adviser or contact us via one of the following:

Tel: **01483 204600**
Email: **enquiries@arch-fp.co.uk**
Online: **www.arch-fp.co.uk**

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