

MoneyMarketing



Critical list

December Retirement Strategy



Robert Guildford is aged 60 and his wife is also aged 60. They live in a modest house near the centre of a busy town just outside the M25.

Robert was a chartered engineer who was employed by a national firm before being made redundant five years ago. Since then, he has worked as a consultant for a number of organisations, including the industry regulator.

Burrows: We explained the importance of the client reviewing his pre-retirement investment strategy

At retirement, Robert's financial circumstances were fairly straightforward. (See table A). In addition, Robert will have a state pension of over £6,000 from age 65.

Introductory meeting

At the initial meeting held at our office, we explained the importance of reviewing his pre-retirement investment strategy and if necessary switching to cash and or fixed- interest investments to protect the value of his fund during the run-up to retirement.

We then discussed The Retirement Partnership's 12 critical factors, including the issues around life expectancy, income needs and investment risk, before providing an overview of the various annuity and drawdown options.

Overview of annuity and drawdown options

One of the best ways to explain the full range of options is to consider the three main groups, as set out in Table B.

Attitude to risk and objectives

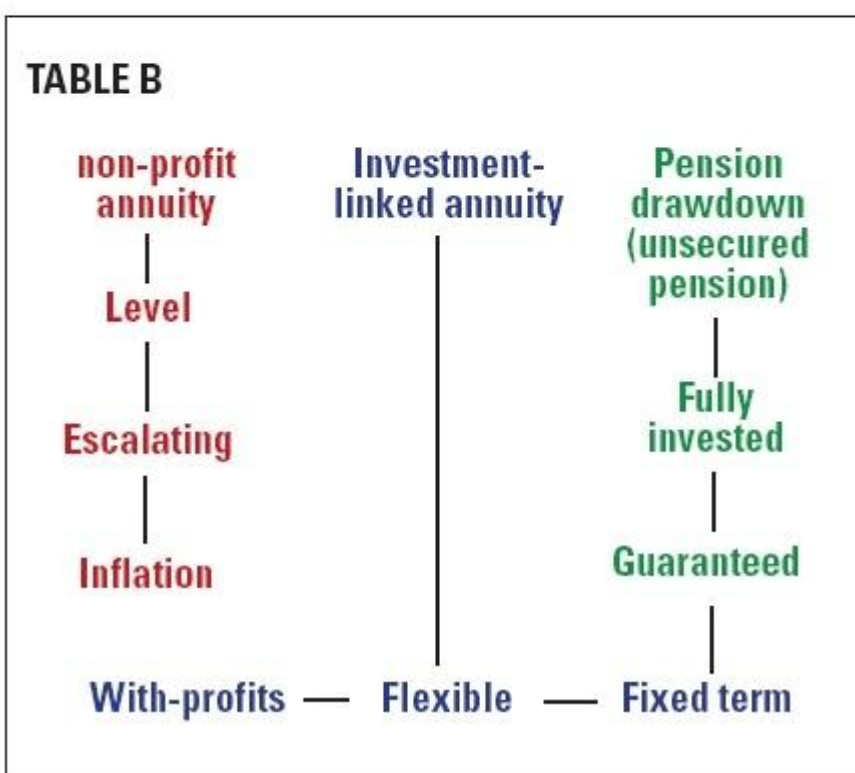
Robert completed our standard financial planning questionnaire and completed our supplementary annuity questionnaire which focuses on the following three questions:

- How much and what type of income he wanted.
- What is his attitude to risk and tolerance to risk?
- How much flexibility over income and death benefits did he want?

Income

He described his objectives in his own words as wanting to take maximum tax-free cash entitlement and maximise his income, ensuring that if he pre-deceased his wife, she would be left in a secure position. He was concerned about future inflation and wanted to have some pension increases each year to offset inflation effects.

TABLE A		
	Capital	Gross income
Consultancy		£12,000 p.a.
Investment income		£3,000 p.a.
Personal pensions	£266,666	
House	£350,000	
Cash	£25,000	
Savings	£150,000	



Risk

Robert described himself as a low-risk investor and went on to say that he wanted an income which was secure and would keep pace with inflation over the longer term. When asked what he thought about the option of an annuity which had potential for income growth but carried some investment risk, he indicated that he was interested in understanding more.

Flexibility

Robert placed a higher priority on maximising his income and ensuring that his wife would be left with an income if he died first and therefore flexibility and the lump-sum death option was not a priority.

Suitable options

Taking Robert's objectives into consideration, we suggested considering a number of different annuity options and in order to compare these options, we provided a detailed analysis of the following options:

- 1: Level v annuity escalating at 3 per cent a year
- 2: Level annuity v income choice with 4.17 per cent required smoothed return
- 3: RPI annuity v income choice with 1 per cent RSR

We recommended joint life annuities with two-thirds spouse pension and we provided illustrations based on £100,000 as this would make it easier to consider purchasing two different types of annuities. We provided examples of the income choice annuity to match the starting income of the corresponding non-profit annuities.

The gross income for these options is set out in Table C.

Non-profit	Gross income	Income choice	Gross income
Level	£5,599	4.17% RSR	£5,600
3%	£3,705	1.26 % RSR	£3,705
RPI	£3,065	1% RSR	£3,547

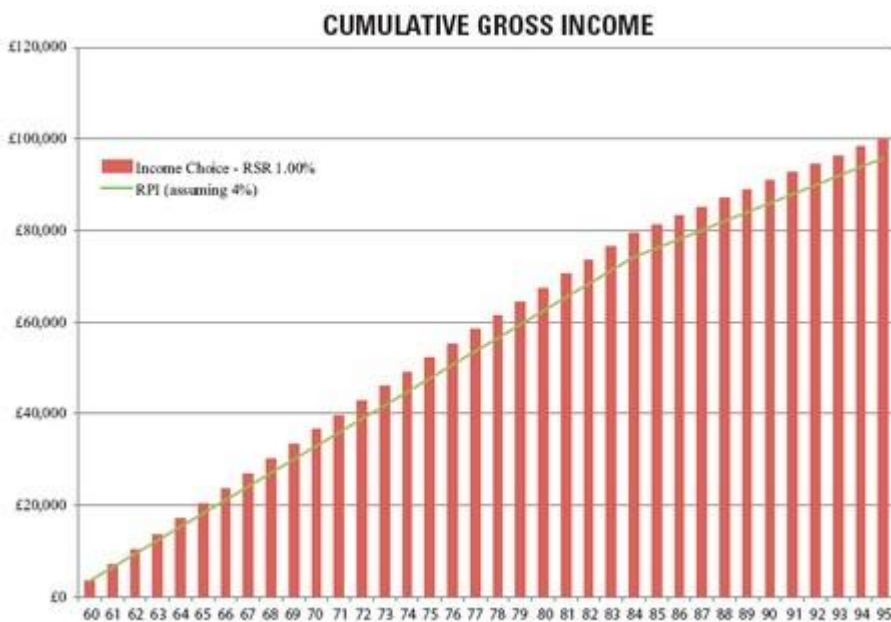
Pension funds	£266,667	
Tax-free cash	£66,667	
Annuity purchase	£200,000	
Annuity Type	Fund	Gross income
Level annuity	£100,000	£5,599
Income choice	£100,000	£3,547
Total	£200,000	

The chart above shows the cumulative gross income for each option expressed in real terms, that is, after allowing for inflation which we have assumed is 4 per cent a year. The projected returns for the income choice annuity assume future bonuses are 7 per cent before charges, that is, FSA's lower and middle projections.

The client wanted an income that was secure and would keep pace with inflation in the longer term

The decision

Robert confessed to be a little confused by the different options at first but after we explained the rationale for considering a with-profits annuity, he was less confused. Annuities are a long-term investment and so should be invested



in long-term assets such as global equities and property, which aim to provide an effective hedge against inflation and potential for income growth.

Robert's initial reaction was as follows:

- Although the level annuity maximised his income initially, he was at risk from inflation.
- The 3 per cent escalating option seemed to offer poor value for money because of the time it took for the escalating annuity to catch up with the level annuity.
- The income choice had the attraction in that the potential for income growth would result in increasing income payments in the future but he was still concerned about the risk, especially as the bonus return required to match the level annuity was 4.17 per cent RSR.
- Having considered the returns, he was attracted by the income choice annuity with 1 per cent RSR as this compared favourably with an RPI annuity.

The recommendation

We recommended that Robert arranged two different types of annuity, as set out in Table D.

The suitability letter referred to Robert's opening comments when he said "he didn't want to take any risk with this pension" and that he "wanted an income that was secure and would keep pace with inflation over the longer term" and showed that during the course of the advice process Robert came to the conclusion that:

- Level annuities were not without risk because of the effects of inflation.
- Inflation-linked annuities did not seem to offer value for money.
- Income choice and the with-profits annuity concept had the potential to deliver income growth and was an alternative to an inflation-linked annuity, albeit with additional risk

The detail of the suitability letter explained the mechanics and risk of the income choice annuity.

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