



# Living for the Future

retirement income service

TRUSTED • CLEAR • INFORMED



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SKIPTON FINANCIAL SERVICES

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## Living for the Future retirement income service

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# Living for the Future

## retirement income service

### Could you be missing out?

You work and save all of your life to ensure that you can enjoy your retirement in the lifestyle that you are accustomed to and to fulfil those ambitions you have planned for those restful years. When retirement comes you need to ensure your pension gives you the income you need to enjoy your retirement. It is therefore crucial that you find the best retirement income deal that your pension fund will buy, especially if, like many people have found in recent times, your pension fund turns out to be less than you hoped.

When it's time for you to start taking your retirement income, the chances are that the money from your pension scheme will be used to buy a **CONVENTIONAL ANNUITY**.

A conventional annuity is simply an insurance policy that promises to pay a regular income until you die. It guarantees that your pension will never run out, no matter how long you live. This guide aims to let you know what options you have available when purchasing an annuity.

An interesting fact is that according to the Financial Services Authority, you could gain as much as 35% extra income from your pension\*. But in order to gain this extra income you need to shop around for the best deal in the market rather than just accepting the first offer put to you from your pension company.

\*Source: Comparative Tables Bulletin Number 6 Pension Annuities Bulletin, Financial Services Authority, October 2002

## We'll do the hard work for you

To make sure you get the most out of your pension fund...

### **We will help you understand the options available to you**

One of our Advisers will talk to you and find out where you are now and where you want to be financially. Once we know your personal situation, and have clarified the types of pensions you have and your future needs, we can then help you select the option that will work best for you in your retirement. We offer a fee-free, no-obligation service so you have nothing to lose.

### **We will shop around on your behalf to find the best deal available to meet your needs**

We will shop around to compare the rate your pension company offers against the best rates available from the other companies in the market and help you arrange the one that provides the best level of income. Our aim is to help you maximise the benefit that you receive from the money that you have saved for your retirement. Many people do not realise that they can shop around and get better rates and as a result they live on lower incomes for the rest of their lives.

### **We will see how your health can be used to your advantage**

Throughout your life you may well have been penalised due to your health or if you are a smoker. However, this is one of the few times in life when certain medical conditions or smoking can work in your favour. If you or your partner smoke or have certain medical conditions, you may be able to get a better annuity rate. Often people don't realise that these factors can work in their favour and miss out on these opportunities but our service will use these to your advantage.

## What pension schemes can our service help with?

Our service works best for people taking benefits from schemes with a total value of £30,000 or more.

We can help you maximise your retirement income if you have set up the pension scheme yourself, and/or also have savings in some types of employers' pension.

However, if your employer provides a final salary pension scheme or something similar, i.e. if your employer's pension scheme entitles you to only a specified level of pension (and possibly a lump sum) we cannot usually help with these types of pensions.

If you're unsure what sort of pension you have, don't worry, many people don't - simply give us a call and we'll be glad to assist you.

## Annuity income options available to you...

Firstly when you retire, most pension schemes allow you to take up to 25% of your accumulated fund as a tax-free lump sum. A lot of our clients use this lump sum to pay for a cruise, new car, conservatory etc. Government restrictions state that you can only benefit from the remainder of the fund in the form of an income. The most popular way of doing this is by purchasing a Conventional Annuity.

When you decide to take benefits from your pension scheme through an Annuity you can either have a guaranteed income or you can link your retirement income to investment returns.

The following is a brief look into these annuity options available to you. As mentioned, there are two main categories of annuity:

- Those that provide a guaranteed income (Conventional Annuities)
- Those linked to Investment returns.

## Conventional Annuities

A conventional annuity may well be for you if the security of receiving a **guaranteed income** is important for you.

Most people choose to receive a guaranteed income to avoid the risks involved when your retirement income is dependent on fluctuating investment returns. Basically, when you buy a conventional annuity, you buy the right to a guaranteed income for the remainder of your life.

Your existing pension company will usually offer you their conventional annuity which has a guaranteed level of income. However, it is unlikely that this offer will be the most competitive annuity rate and many people don't realise that they can shop around for a better rate. The difference between the best and worst rates available can be significant so you do need to be careful not to lose out. Letting us shop around on your behalf is highly likely to get you a better deal.

A 65-year-old male with a pension fund valued at £40,000 who shopped around for the best annuity in February 2006, would have got an annuity deal paying an income for life 14% higher than the income offered by the worst annuity rate<sup>6</sup>.

## **Haven't conventional annuities been getting bad press?**

It can sometimes seem like this is the case but we think that the press annuities have been getting is a little unfair. Advances in medicine and improvements in diet and lifestyle mean that life expectancy has been increasing and this is likely to continue. Because of this it is likely that your pension fund will have to last longer.

The Government Actuary estimates that males aged 65 in 1981 will live to age 79 on average and females aged 65 in 1981 will live to be age 83. However, they estimate that males aged 65 in 2006 will live to age 84 and females aged 65 will live to 87<sup>7</sup>

## **Conventional annuity options**

There are several options available to you when choosing a conventional annuity. Whilst these options can have benefits depending on what is important to you, there can often be trade-offs that you have to consider, we can help you work your way through the options available.

### **Option 1: Level or increasing income**

You can have an income that remains level (i.e. the same until you die) or an income that increases with time. If you would like your annuity income to increase during your retirement, this increase can either be a fixed percentage per year or you can build in annual increases linked to the Retail Prices Index (RPI). We all complain about how things seem to be getting more expensive, well the RPI is one of the Government measures which is meant to reflect changes in the cost of living. Linking future annuity payments to RPI will therefore help reduce the effect of increasing prices on your income during your retirement.

<sup>6</sup>Source: FSA comparative tables

<sup>7</sup>Source: Government Actuary Dept Cohort Expectations of Life 1981 - 2054 revised 3 January 2006

<b>How inflation reduces the purchasing power of £10,000 per annum</b>			
	<b>2.5% Inflation</b>	<b>5% Inflation</b>	<b>7.5% Inflation</b>
Purchasing power after 1 year	£9,756	£9,523	£9,302
Purchasing power after 10 years	£7,811	£6,139	£4,851
Purchasing power after 20 years	£6,102	£3,768	£2,354

The table above shows how increases in the cost of living can reduce the purchasing power of a fixed income of £10,000 per annum. You can see that after 20 years of prices increasing at 5% per annum, a £10,000 fixed income would enable you to buy only a little more than a third of what it could have purchased at the point when you retired.

As you would expect there is a trade-off. If you choose an income that increases during your retirement, your starting income will be less than a level annuity.

For example, a 60-year-old male retiring in February 2006 with a pension fund of £100,000 could receive annual annuity payments of £6,186 whereas if he had linked his pension to RPI, his annuity payments would start at £3,939 (a reduction of 36%)<sup>4</sup>. If the cost of living were to increase at 2.5% per year, it would take 19 years before the annual payments of the RPI linked annuity are the same as the level pension. For the first 18 years, this man would receive less with an RPI linked annuity than a level annuity taking account of both these factors. It takes 35 years for the total payments from the RPI-linked annuity to equal the total payable from a level annuity.

## **Option 2: An income for a spouse/partner**

If you would like your annuity to continue to be paid to a surviving spouse/partner if you die first, this is called a Dependant's pension. Taking this option increases the likelihood of your annuity paying out for longer and so, as you would expect, it will reduce your annual income compared to an income with annuity that is linked to you only.

However, depending on your age, the reduction can be surprisingly small. For example, a 60-year-old male would see his annuity income reduce by approximately 14% if he chose an annuity which continued paying 100% of income to a spouse also aged 60, if he dies first.

<sup>4</sup>Source: Canada Life

### Option 3: Guarantee period

It is possible to build in a guarantee so that your annuity will continue to be paid for a specified period, even if you die before that period expires. The maximum guarantee period allowed by the Government is 10 years. For example, if you build in a 10-year guarantee period but die after 4 years, the payments will continue to be made to your estate for a further 6 years until the end of the guarantee period.

As you would expect, this guarantee reduces your starting income. To illustrate, a 60-year-old male selecting a level annuity with a 10-year guarantee would see a reduction in his income of just 1% compared to an annuity without a guarantee.

We will help you decide whether a guarantee period is an appropriate option for you.

### Option 4: Capital protection

Choosing this option means that, on death, any difference between the original amount you pay for your annuity and the annuity income you receive up until you die, is paid to your estate. It should be noted that a tax charge of 35% is deducted before the balance is paid to the estate.

At the time of going to press, rates for this type of guarantee were not available because this option is only available on annuities after 6 April 2006. However, adding this option is likely to significantly reduce starting incomes as a trade-off. We will of course consider this option when we help you decide how to take your pension.

Conventional Annuity	
Advantages	Disadvantages
Secures an income for life, either level or increasing, no matter how long you live.	Income will not increase in the future unless those increases have been secured at outset.
Income will not fall if investment conditions are poor, interest rates reduce or life expectancy increases in the future.	Will not participate in future investment returns.
Can include options such as a dependant's annuity, guaranteed period etc.	Permanent and inflexible - for example, if you accept a reduced income to provide a dependant's pension but the dependant dies first, it is not possible to reverse the decision.

## Retirement income linked to investment returns

Like any investment linked to performance returns, there is always a **risk** that the value of your savings can go down as well as up. Therefore you should only consider a retirement income linked to investment returns if you have other sources of income and therefore aren't totally dependent on the success of these investment returns to maintain your standard of living.

If you wish to link your retirement income to future investment returns instead of choosing a guaranteed conventional annuity, there are three main choices for you to consider:

- Investment-Linked Annuities
- Short-Term Annuities
- Pension Fund Withdrawals

## Investment-Linked Annuities

This is an annuity where your pension savings are invested in an investment fund from which your annuity payments are made. Therefore your annuity payments in the future will be determined by the investment performance of that fund.

You choose the investment fund at the beginning. Sometimes you can switch from that fund to another one offered by the annuity company, but there are usually restrictions placed on this option.

The simplest form of an investment-linked annuity is one where your first annuity payment is made up of only the capital element (some of your original capital returned to you), which means it would be in the region of 60% to 70% of the starting income from a conventional level annuity. Future annuity payments will be higher if the investment fund you link your income to increases in value, and they will be lower if the investment fund decreases in value. It is possible to arrange for the starting annuity to equal the starting annuity from a level conventional annuity, but only by taking anticipated investment performance in advance. If you take a level of anticipated future performance in advance, and this performance is not achieved, future annuity payments will fall. There are two main types of investment funds you can link an investment-linked annuity to:

- With Profits Annuity
- Unit Linked Annuity

## With Profits Annuity

A **With Profits Annuity** is linked to a With Profits fund.

A With Profits fund invests in a professionally managed portfolio of shares, bonds, commercial property etc. Though these investments fluctuate in value, a With Profits fund uses a system of controlling the returns passed on to investors, so that it can smooth out the inevitable fluctuations. From time to time the insurance company declares a rate of return; a 'bonus'. This bonus rate is intended to be less than your share of the overall performance of the With Profits fund when investment conditions are good, in order to hold back some reserves for when conditions and returns are not so good. This is called 'smoothing'.

You would normally choose an Assumed Bonus Rate (ABR) at the outset in order to have a starting income comparable to that of a conventional annuity. If actual bonus rates exceed your ABR, your income will rise, and if actual bonus rates are lower than your ABR, your income will fall.

There are some risks that are specific to With Profits Annuities that you need to appreciate:

- If you die before your contribution to smoothing has been paid back to you, you will be worse off than if you had invested in a similar fund that did not have a smoothing mechanism.
- With Profits funds provided guarantees in the past to previous investors. Sometimes these guarantees can reduce the returns available to be passed on to newer investors in the With Profits fund.
- Most With Profits annuities provide an option to convert to a conventional annuity if you should wish to do so at a later date. However, it is unlikely that you will have an option to take advantage of more competitive annuity rates offered by other insurers. Remember there could be a difference of up to 35% between the worst and best annuity rates at any time.

These are just some of the risks specific to With Profits Annuities. Each insurer produces a document that explains all of the risks of that insurer's fund in more detail and you should always read and understand this document before deciding whether to purchase a With Profits annuity.

With Profits Annuity	
Advantages	Disadvantages
There is usually a guaranteed minimum level of income (usually 60% to 70% of the income from a conventional annuity), although this guarantee can reduce investment returns.	Income will fall in the future if bonuses are lower than your assumed bonus rate.
Allows you to share in the investment returns produced by shares, bonds etc. while the fund invests in those assets subject to the insurer passing on those returns by declaring bonuses. If actual bonus rates exceed your assumed bonus rate, your income will increase in the future.	Bonuses can be reduced by risks other than investment risks, for example guarantees enjoyed by other policyholders, certain business risks of the insurer etc. Also, if people live longer than expected, the minimum income guarantee can cause investment returns for annuitants to be reduced.
Can include options such as a dependant's annuity, guaranteed period etc.	There is usually an option to convert to a conventional annuity but only on the insurer's terms, which will be determined at that time of conversion, and these should not be assumed to be attractive.
	There is likely to be no option to switch to another investment fund. The closure of the With Profits fund and/or the impact of guarantees within the fund could cause the mix of assets invested in by the fund to change, even if that causes investment returns to reduce.

## Unit Linked Annuity

A **Unit Linked Annuity** invests in an investment fund other than With Profits, for example, a Managed fund. Returns are not smoothed like a With Profits annuity would be so each annuity payment fluctuates directly in line with the fund performance.

There are no declared bonuses and so you would normally choose an Assumed Growth Rate (AGR) for your income. If investment performance exceeds your AGR, your income will increase and if investment performance does not exceed your AGR, your income will reduce. The lack of a smoothing mechanism or guarantee and the lack of exposure to other non-investment risks makes these products more transparent than With Profits annuities.

However, the investment choice will be restricted to just the investment fund, or range of investment funds, offered by your chosen annuity company.

This lack of investment freedom can create problems in the future if the annuity company reduces the range available and/or the funds become unattractive for any reason. These products are also unlikely to offer any option to switch to a conventional annuity.

Unit Linked Annuity	
Advantages	Disadvantages
Returns are directly linked to your chosen investment.	Income will fall in the future if investment performance is lower than your Assumed Growth Rate.
Allows you to share in the investment returns produced by the assets held in the underlying investment fund.  If actual performance exceeds your Assumed Growth Rate, your income will increase in the future.	There is no guaranteed minimum income level.
Can include options such as a dependant's annuity, guaranteed period etc.	There is usually no option to convert to a conventional annuity at any time.
	You are restricted to the investment fund(s) available from time to time, even if they become unattractive to you.
	There is no smoothing mechanism so income could fluctuate dramatically.

## Pension Fund Withdrawals (sometimes known as Income Drawdown)

Some retirees opt not to take a guaranteed income through Conventional Annuities or receive their income linked to performance through Investment Linked Annuities and instead choose to take withdrawals directly from their pension fund.

Simply put, pension fund withdrawals is where you (normally) take your 25% tax-free lump sum but do not purchase any form of annuity.

In this instance, if you require a regular income, you take withdrawals from the remaining 75% of your pension fund. This route is suitable for people who have larger amounts in pension arrangements, typically at least £100,000, as well as

having sufficient resources to be confident of always being able to maintain their preferred standard of living in retirement, whatever happens to the value of their pension funds in the future, consequently, pension fund withdrawals are usually only suitable for clients with a higher risk profile.

There are very complex and strict rules relating to pension fund withdrawal to enforce the general principle that pension plans receive tax benefits to provide an income in retirement, not to enable the members to accumulate capital that can be passed on to others.

By not purchasing an annuity, you are taking the **risk** that future investment returns and changes to annuity rates may mean that purchasing a conventional annuity might have proved more profitable. If you decide to take withdrawals instead of an annuity, you will need expert advice at outset. You will also need expert advice each time you review your decision, which should be at least annually, so that you can review your investment mix and decide whether to continue taking withdrawals or purchase an annuity.

Pension Fund Withdrawals	
Advantages	Disadvantages
There are very few restrictions relating to what you can invest in, although there can be tax penalties to pay if you invest in certain assets that you, or someone associated with you, can use or enjoy.	The value of your fund and therefore the income available from it will fall in the future if investment conditions are poor.
Allows you to participate in the investment returns by the assets held in the pension plan.	There is no guaranteed minimum income level.
If you use a self-invested pension, you can invest in any assets you choose without being restricted to a fund or funds offered by one pension company (subject to tax implications in some circumstances).	If you cease taking withdrawals and purchase an annuity in the future, that annuity could be less than the annuity you could have had if you had purchased one at outset.
If you decide to cease taking withdrawals in the future and purchase an annuity, you can do so with any annuity company you wish.	Expert advice is essential when you make your decision. Also, expert advice is essential at least every year to enable you to keep your arrangement under review. This need for reviews and advice means that the cost of running these schemes can have a significant impact.
Allows you to vary the amount you receive each year, for example, if you wish to semi-retire.	If you die after age 75 where you have not yet purchased an annuity, there are restrictions on how any remaining funds can be used and these restrictions might make this route unattractive.

## Short-term Annuities

Another option is short-term and flexible annuities which are a recent development. A small number of products have been around for a short period where you can use some of your fund to buy a short-term annuity and then revisit your decision later.

## What happens next?

Your financial security for the remainder of your life throughout your retirement depends on the pension income decision that you are about to make. As this guide has illustrated there are many often complicated options available to you and you need to make sure you make the right decision. We can help. We have a highly qualified team that can help and guide you through making this important lifetime decision. Don't delay as every month you delay this decision could mean that you lose a month's worth of valuable income from your pension.

## Simply



Contact one of our Retirement Income Specialists on  
**0800 085 0277**  
who will guide you through what our service can offer you



For further information on Skipton Financial Services Limited and Medical Insurance Agency please visit our websites at  
**[www.skiptonfs.co.uk](http://www.skiptonfs.co.uk)**  
**[www.mia.co.uk](http://www.mia.co.uk)**



Complete the attached reply-slip, and return (no stamp required) to:  
**Skipton Financial Services Limited, FREEPOST  
NEA4129, Skipton, North Yorkshire BD23 2BF**  
One of our Specialist Advisers will then contact you at the time/or dates that you have specified.



# Retirement Income Service

Adviser Name (if known): \_\_\_\_\_

Please complete all your details below and place in an envelope (no stamp required) and return to: Retirement Income Services, FREEPOST NEA4129, Skipton, North Yorkshire BD23 2BF

Name: \_\_\_\_\_

Address: \_\_\_\_\_

\_\_\_\_\_ Postcode: \_\_\_\_\_

Telephone Number: \_\_\_\_\_

Email Address:\* \_\_\_\_\_

Mobile:\* \_\_\_\_\_

\*Only provide your email address or your mobile number if you would like to be contacted by either of these media.

Marital Status: Single  Married  Widowed  Registered Civil Partnership

Date of Birth:

Current Occupation: \_\_\_\_\_

I am retiring on: \_\_\_\_\_

I would like to discuss improving my retirement income: Yes  No

Pension Fund Value: £\_\_\_\_\_ Age at Retirement:

This is my only pension: Yes  No

This is part of my pension plan: Yes  No

I would like a retirement income specialist to contact me: Yes  No

Preferred date/time for contact: \_\_\_\_\_