

Annuities

August 11 2010



For many people who have a significant savings pot upon their retirement, handing over a large part of their amassed capital is something that does not sit well.

But that is exactly what they are currently forced to do by the Treasury. Three quarters of their pension savings must be exchanged for an annuity – a product which gives a guaranteed income – by the age of 77.

This age limit had previously been set at 75, but will be abolished from April 2011. The limit has been raised to 77 for those reaching the age of 75 on or after 22 June 2010, while the Government fine-tunes its new rules.

Somebody sitting on a modest amount may see this as a fair trade, if they hit 75 with a good bill of health and manage to get an annuity at a good rate.

However, the new Con-Lib coalition has looked at the other end of the spectrum and is taking a step which allows those with larger savings to be more flexible with their capital.

For example, somebody with a £400,000 pension pot, who is in poor health at the current age of compulsory annuities, would understandably begrudge being forced to hand over £300,000 of that capital.

The expectation might reasonably be that while they receive a few months' payments prior to passing away, the rest will simply be swallowed up by the insurance company to whom it has been paid.

A more realistic hope would be to keep that fund, and for it to be passed on to offspring upon death, and live off other means.

The suggested rules, which should come into force in April 2011, are thought by some to allow those who can show an significant annual income to hold on to their capital. To qualify, this realistically means a fund of at least £150,000 could be required.

An expected second benefit of the new changes will be the rate of tax levied on passing that fund on to heirs. Rather than the present 82%, an expected rate of 55% should be applicable, making that inheritance far more significant.

The benefits of greater flexibility at this crucial stage of life's financial management will benefit many and allows for more control over the money wisely set aside for old age.

People who have a significant pension pot, which will border on, or fall just below, that £150,000 mark need to look to increase their payments to ensure they get the full benefit of the changes.

The gap between a £140,000 pot and one of £150,000 could now mean the difference between being required to hand over £105,000 to an insurance company or not.

The incentive to be more prudent with financial planning, despite current low interest rates, is now far greater than it was six or twelve months ago and, while that is a good thing due to its potential for getting banks more active and, hopefully, lending, it holds an even greater personal payback in the long run.