WHAT IS AN ANNUITY (PENSION / INCOME FOR LIFE)?

An annuity is a pension or income for life that you purchase with some or all of your pension fund at retirement. There are a number of options available to you when purchasing an annuity. The type of pension you decide to buy and the annuity rates (cost of buying a pension) applicable when you retire will determine the level of income you can receive in retirement. For example, you may decide to use your pension fund to purchase a pension with one or more of the following options:

a) Level or Escalating Pension:

You can opt for a level annuity (fixed at the outset and the amount does not increase each year) or opt for an escalating pension which is a lower initial amount, but which will increase each year in line with inflation or by a fixed percentage e.g., 3% each year. The problem with the escalating pension is that the initial income paid to you will be considerably less than a level annuity and it will take many years for the escalating annuity to "catch-up" with the level annuity.

b) Spouse's Pension:

You can opt for a single life annuity or one that will continue e.g., at 50%, 2/3rds or 100% to your spouse, civil partner or another financial dependent following your death. Most retirees, unless they are single, will opt for an annuity (known as joint life) that will continue to be paid to their selected partner following their death. An example of this is for the annuity to continue at either 50% or 2/3rds of your own annuity for the remainder of their life. If you select the joint life option, this will result in a lower monthly income for you compared to selecting the single life option due to a lower annuity rate being applied.

c) Guarantee Period:

Most retirees will also include a feature whereby the pension will continue to be paid for a guarantee period, of either 5 or 10 years, at the full rate from the date the annuity starts. If you select a guarantee period i.e., 5 or 10 years, the monthly income you will receive (albeit minimal) will be reduced as the annuity rate applied will be slightly lower compared to an annuity rate that doesn't include a guarantee period.

If you have decided on a joint life annuity and you die within the guarantee period, (b) above, then your partner's pension will start at the end of the guarantee period.

Example:

You retire in 2022 on a pension of €5,000 per annum, with a 50% dependent's pension and a 10-year guarantee.

a) You die after 3 years payments of €5,000 have been paid.
   - There is still 7 years left in the 10-year guarantee period, accordingly, €5,000 will continue to be paid for a further 7 years after your death. The annuity will then reduce to €2,500 per annum i.e., the 50% dependent's pension will then commence.

b) You die after 15 years payments of €5,000 have been paid.
   - The annuity will continue to be paid to your dependent, but at the rate of €2,500 per annum as the 10-year guarantee period has expired and therefore the 50% dependent's pension will commence immediately following your death.

Enhanced Annuity:

You may qualify for an enhanced annuity i.e., a higher income if one of the following applies to you:

a) Lifestyle factors such a smoking or obesity.
b) A health condition such as diabetes or high blood pressure.
c) A serious condition such as heart disease or cancer.

Advantages of Purchasing an Annuity (Pension / Income for Life):

- You can buy an annuity with any insurance company.
- You are buying certainty as you are guaranteed to receive a pension for the rest of your life.
- Your pension is not affected if returns from stock markets are poor, or if you live a long time.
- You may be eligible for an enhanced annuity (better monthly payment) depending on your lifestyle and medical history, and that of your dependant if applicable.

Disadvantages of an Annuity (Pension / Income for Life):

- Once you take out an annuity, you cannot cash it in or change any of the features.
- Your pension will stop when you die, unless you have chosen a dependent's pension or a minimum payment period. Adding additional elements when purchasing your pension originally e.g., escalation, dependant's pension or increasing the minimum payment period, will result in a smaller monthly pension being paid to you.
- Your pension is subject to tax in the normal way.

WHAT IS AN APPROVED RETIREMENT FUND (ARF)?

An ARF is an ongoing investment fund. It still has the potential to earn investment returns, but nothing is guaranteed. If you choose this option, instead of receiving a regular pension via the purchase of an annuity, you can simply withdraw the money you need (subject to specific conditions), as and when required.

Advantages of an Approved Retirement Fund (ARF):

- You can buy an ARF with any Qualifying Fund Manager.
- You have flexibility and control over your pension fund during your retirement.
- You can invest in a wide range of funds.
- When you die the fund value remaining at the date of your death, passes to your estate subject to income tax and / or inheritance tax depending on who inherits the benefits.
- You can buy an annuity (Pension / Income for Life) at any stage with your ARF.

Disadvantages of an Approved Retirement Fund (ARF):

- You are taking on investment risks. This means your initial capital could go down as well as up.
- Entry charges may apply.
- Early exit penalties may apply.
- Withdrawals from your fund may cause it to run out before you die.
- All income / withdrawals are subject to income tax in the normal way.