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• FINANCIAL PLANNING •



Everything you **need to know about annuities** when creating a retirement income

When you retire, you will often have a range of choices available to you about how you take your income. One such method is an annuity.

An annuity could provide you with a way to create a guaranteed income once you retire. As a result, they may offer financial security and peace of mind over the long term.

Yet, research suggests many approaching retirement don't understand how annuities work. Getting to grips with annuities could be important when you're deciding how to access your pension. So, read on to discover the essentials you need to know.

Annuities date back to ancient Rome

While they've evolved over the centuries, annuities can be traced back to ancient Rome. Indeed, the word annuity comes from the Latin word "annua", which means "annual stipends".

Roman soldiers could receive an annuity as a form of compensation after they'd completed a defined number of years of military service. It provided a regular income to soldiers who had retired.

You can purchase an annuity, which will then provide a guaranteed income

An annuity is something you buy, often with the money saved in your pension. In return, you'll receive a regular income.

Usually, retirees choose an annuity that will provide an income for the rest of their life. This could create financial security throughout your later years. You may also opt for an annuity that pays an income for a defined period.

If you have a defined contribution (DC) pension, an annuity is one way to create a guaranteed income in retirement.

Factors including your age, your health, and the annuity rate you're offered by a provider determines the income it'll deliver. Annuity rates are usually shown as a percentage, which you can then use to calculate how much you'd receive based on the amount you pay.

For example, in a simple example, if you were offered an annuity rate of 5% on a lump sum of £100,000, the annuity would pay out an annual income of £5,000.

Annuity rates are expected to rise in 2025

There's good news for those nearing retirement – despite expectations that annuity rates would fall, 2025 could provide a good return on investment.

According to [Canada Life](#) research, government borrowing costs increased at the start of 2025, with the 15-year gilt yield standing at 5.179%, compared to 4.23% in January 2024. Annuity rates are largely linked to the return on government gilts. So, the rise could be a good indicator of annuity rates improving throughout the year.

Indeed, at the start of 2024, Canada Life data suggests a 65-year-old with no health or lifestyle conditions to declare and £100,000 to purchase an annuity would receive an annual income of around £6,400. The expected rise would mean the same person purchasing an annuity in 2025 could expect an additional income of £8,200 over a 20-year period.





Annuity options you may want to weigh up

It's not only the annuity rate you may want to consider when comparing different options either – there are different types of annuities.

Two key decisions you might want to weigh up are:

1. Level annuities v inflation-linked annuities

A level annuity would usually pay you the same annual income from commencement. In contrast, the income from an inflation-linked annuity would increase as the cost of living rises.

An inflation-linked annuity could help preserve your spending power. The rising cost of living might mean your income needs are very different in your later years, even if your lifestyle remains the same.

However, annuity rates are typically higher for level annuities. So, with this option, your income could be greater initially than if you choose a comparable inflation-linked annuity.

Understanding your retirement expenses and how they might change over the years could help you select an annuity that's right for you.



2. Single life annuities v joint annuities

If you're retirement planning with a partner, understanding single life and joint annuities could be important.

A single life annuity would provide an income to one person. If you took out a single life annuity and passed away, your partner would generally not continue to receive an income from it.

A joint-life annuity could deliver peace of mind. If you passed away first, this type of annuity could continue to pay a regular income to your surviving partner. As a result, it could be a valuable option for retiring couples. Yet, [Standard Life](#) survey revealed only 27% of over-50s are familiar with joint-life annuities.

Underlying health conditions could give you access to a higher annuity rate

In some cases, an underlying health condition could mean you're offered a higher annuity rate and, so, a higher income. These may be known as an "enhanced annuity" or "impaired life annuity".

Yet, according to a December 2023 [Standard Life](#) survey, 25% of over-50s incorrectly believe higher rates are given to those without an underlying health condition. A further 37% said they didn't know how health affected annuity rates.

This misinformation could mean some retirees haven't disclosed health conditions that could lead to an income boost.

The valuable benefits of using an annuity to create an income in retirement

A guaranteed income could provide long-term financial security

One of the most attractive features of annuities for many retirees is the certainty of income it provides. For some, a reliable income could mean they approach retirement feeling more confident and less stressed about their long-term finances.

Other ways to access your pension might mean you need to consider how to ensure your savings last a lifetime or risk running out of money in your later years.

In contrast, if you choose an annuity that will pay an income for the rest of your life, this isn't something you need to worry about.

You can choose to link your income to inflation

Even when inflation is stable, it can reduce your spending power. Linking your retirement income to inflation could be more valuable than you think.

According to the [Bank of England](#), the average rate of inflation between 2014 and 2024 was 3% a year. If you retired in 2014 with an income of £40,000, it would need to have increased by more than £13,500 over a decade just to preserve your spending power.

Choosing an inflation-linked annuity could help you manage your finances throughout retirement and mean you could continue to enjoy the same lifestyle in your later years as you did at the start.

An annuity may provide financial security for your partner

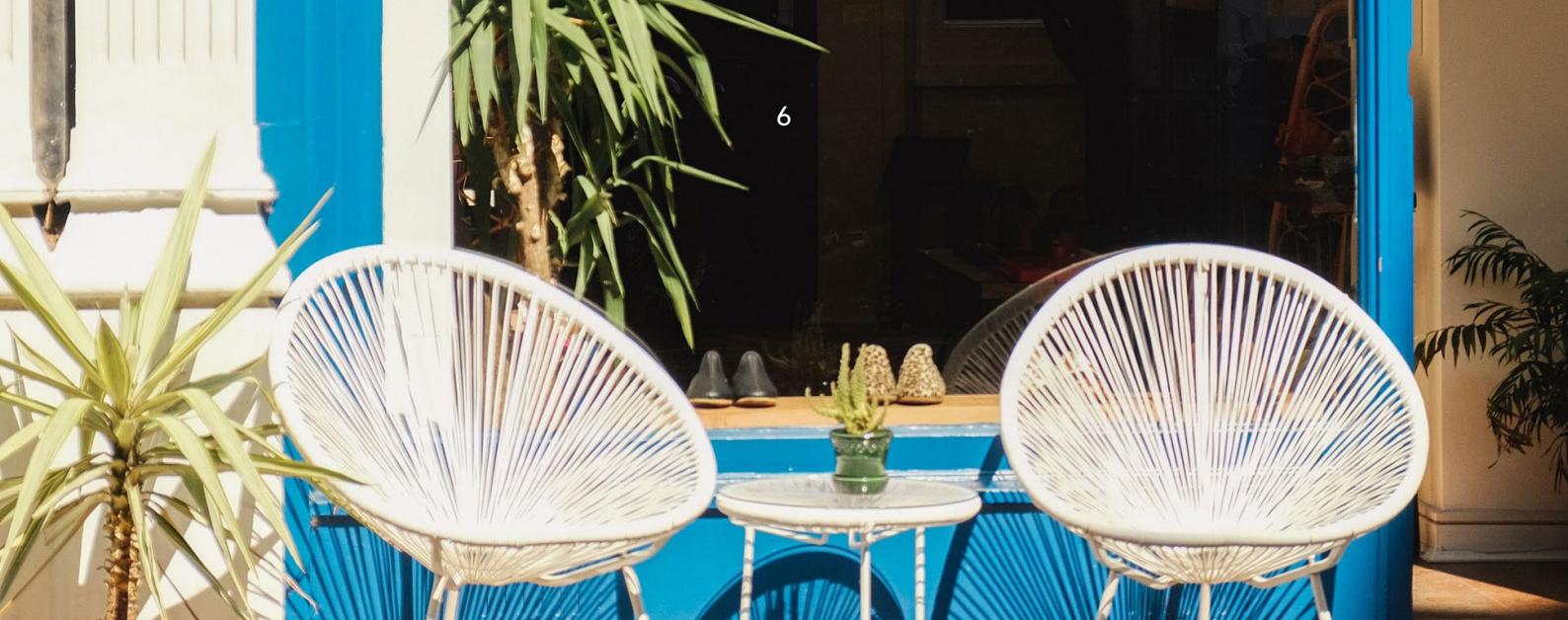
If you choose a joint annuity, it could also provide peace of mind that your partner would continue to receive a reliable income if you passed away.

For retirees who are planning with a partner, ensuring the long-term financial security of their loved one may be a priority. As well as leaving other assets to them, an annuity may help ensure they can cover essential outgoings, such as utility bills, and maintain their lifestyle.

Your income is protected from market volatility

As the income an annuity provides is confirmed at the outset, it could shield you from the effects of investment market volatility.

With other options, your pension may remain invested during your retirement. This means your pension could be affected by short-term movements, which may impact your income.



The potential drawbacks of choosing an annuity

An annuity may not be as flexible as alternatives

An annuity isn't the only way you can turn your retirement savings into an income and, compared to some alternatives, an annuity may provide less flexibility.

For example, if you choose to access your pension through flexi-access drawdown, you'd be able to adjust your income to suit your needs. So, you might increase the amount you withdraw to fund a home renovation project, a holiday, or simply to boost your disposable income.

As a result, if your income needs may fluctuate throughout retirement, an annuity might not be the right option for you.

Your wealth doesn't have an opportunity to grow further

One of the benefits of an annuity is that your money isn't exposed to market volatility. However, on the other hand, you also miss a potential opportunity for your pension to grow further.

Usually, your pension is invested. Throughout your working life, this provides an opportunity for your pension to grow over the long term. If you don't purchase an annuity, the money in your pension will often remain invested until you withdraw it, so it has the potential to deliver returns.



As the average retiree is likely to spend several decades in retirement, it could mean you miss out on significant growth by opting for an annuity.

There may be high fees associated with purchasing an annuity

Purchasing an annuity may come with a cost, such as an administration fee, which might be a one-off or ongoing cost.

It's important to be aware of the cost of buying an annuity to avoid unexpected charges. Fees vary between providers, and comparing options could help you understand which annuity may be right for you.

It's also useful to note that alternatives to annuities are also likely to come with fees.

You usually cannot reverse the decision once you've purchased an annuity

Before you take out an annuity, you should feel confident that it's the right choice - you can't usually reverse the decision or later switch providers.



4 useful questions to answer if you decide to purchase an annuity

1. Do you want to purchase an income for the rest of your life?

As many retirees want to create long-term financial security when they retire, it's common to choose an annuity that would provide an income for the rest of your life.

However, in some circumstances, an annuity that would provide an income for a defined number of years could be valuable too – for example, if you had other assets you've earmarked for your later years. Alternatively, you might find that a flexible income is better suited to your plans.

2. Would an inflation-linked annuity be useful for your retirement?

Over a retirement that may span several decades, inflation could have a huge effect on your income needs. Yet, it's a factor many nearing the milestone overlook.

A report in [FTAdviser](#) found that half of savers aged over 40 planning for retirement haven't factored in the impact of inflation.

High inflation throughout 2022 and 2023 has highlighted why it's important to consider how outgoings could change. Retirees who didn't consider inflation might find that an income that provided a comfortable lifestyle just a few years ago no longer stretches as far.

The past longs for someone with whom to make poetry
The singer, someone with whom to make a song
The dancer, A tall, thin man, with a voice
With the words, someone to be in his story
I long for
coffee in a rainy day
coffee in the morning
coffee in the evening, the deepest words of my heart
but most of all,
I long for someone
to be deeply known
I long for the depths of my soul to be peered into
and for him to say
I still want you.

3. Do you want to provide an income for your partner?

If you're retirement planning with a partner, the decision of whether to choose a joint annuity could be an important one.

It can be difficult to think about you or your partner passing away, but it's a step that may ensure the surviving partner is financially secure.

4. What proportion of your pension would you use to purchase an annuity?

If you decide to purchase an annuity, you don't have to use all your pension to purchase one – you may choose to leave a portion of savings in your pension to access flexibly or as a lump sum.

As part of your retirement plan, you might want to understand if other priorities could affect how you want to access your savings. For instance, would a long-term retirement goal rely on being able to withdraw a lump sum from your pension in the future?



Contact us to talk about how to create an income in retirement

Annuities are just one option to consider when you're retiring. We can help you understand whether an annuity could be right for you, as well explain the alternatives you may also want to consider.

Please contact us to arrange a meeting to talk about your retirement goals and how you may use your assets to create an income.



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Please note: This guide is for general information only and does not constitute advice. The information is aimed at retail clients only.

A pension is a long-term investment. The fund value may fluctuate and can go down, which would have an impact on the level of pension benefits available. Your pension income could also be affected by the interest rates at the time you take your benefits.

The tax implications of pension withdrawals will be based on your individual circumstances, tax legislation and regulation, which are subject to change in the future.