Guide to annuities

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For those approaching or already in their retirement, it is a great opportunity to release yourself from the shackles of full-time work and embrace all the things that you've always wanted to do. You've probably never had this level of free time so it's definitely a good idea to make the most of it.

Annuities can help in this regard. But just what are they and what do you need to know about them before investing in one?

What are annuities?

Annuities are essentially contractual agreements with an insurance company to pay you a set income to survive on in your later years.

To get an annuity you must give the insurer a portion of your pension savings. This is the amount which you've saved up over your working lifetime. Once you reach retirement age, the funds are released to you but you are only entitled to take up to 25% as a tax-free lump sum. The rest needs to be used to provide you with regular income for the rest of your life.

Annuities are paid to you by the insurer at set intervals. These are usually monthly, quarterly or annually.

Do I need an annuity?

An annuity represents the chance to do everything that you've always wanted and embrace the opportunities that your new life offers.

Up until April 2011, UK rules stated that you had to buy an annuity by the age of 75 years. Now you have the choice to buy an annuity or take a 'flexible drawdown' or 'capped drawdown' pension. These are a continuation of an unsecured pension which allows you to draw pension benefits without taking an annuity.

If you qualify for a flexible drawdown then there are no income limits – you can draw as much income as you like but the more you take now, the less you'll have left. With a capped drawdown, there is a maximum figure you can withdraw each year.

It is worth noting that you are not restricted to investing in just one annuity. You can buy multiple annuities with your pension pot if desired.

What affects annuity rates?

Annuity rates are affected by many things. As well as economic factors, annuity rates can also be affected by life expectancies with some reports claiming that drops in annuity rates could be a direct response to growing life expectancies.

Other things which affect annuity rates include:

- Who you buy your annuity from
- The type of annuity you choose
- How much your pensions savings amount to
- Your age
- Your current state of health
- Your location

Gender does not play a part in determining annuity rates following the EU Gender Directive from December 2012.

What do you need to consider when choosing an annuity?

When choosing an annuity, there are many things which need to be given serious thought. These include:

- Who you buy your annuity from – all consumers have the right to shop around so don't feel you have to take the annuity offered by your pension fund provider

- How much you can expect to receive – will this be sustainable to live on?

- How you would like to receive your annuity income – your main choices are a level annuity which pays a set amount over the rest of your life or an increasing annuity which gives you a bigger amount of income each year.

- How often you will receive your annuity income – monthly, quarterly or annually?

- When to buy an annuity – what age will you need to start drawing your income? What age will you stop working at and retire?

Why does it help to get professional annuity advice?

If you're looking into buying an annuity then it's important you get help from those in the know. As with any area of personal finance, annuities can be complicated and difficult to understand – especially when there are so many options open to you.

To ensure you make the right decision for you, it is highly recommended that you seek professional annuity advice from reputable firms.