The 5 minute money guide to:

Fixed Term Annuities

What’s in a name?

To start, we need to explain that the terminology used within this part of the Financial Services market as it can be somewhat confusing.

Fixed Term Annuities are a type of product that can be used by anyone who is looking to generate an income from their pension fund. There have been and are also products known as variable or flexible annuities which fit into the same type of category. The product we are covering here comes into the category of being an alternative to a traditional lifetime annuity.

In describing the various factors and benefits of fixed term annuities we will use the term “investor” to describe the individual who will be using the annuity to generate an income for themselves.

How Fixed Term Annuities work

The essential factor in explaining fixed term annuities is to focus on the part of the title: “fixed term”. This highlights the main aspect – which is that the income level is set for the investor for a selected fixed period (for example five years).

A traditional lifetime annuity will set the income for the remainder of the investor’s life.

The difference therefore is that the fixed term annuity allows an investor to ‘lock in’ their income for a shorter period. This has the advantage of **not** locking down the income for life which many investors find is potentially too long a period with too many uncertainties.

The investor therefore commits a sum of money from their pension fund and this produces a fixed income each year for the next five years (if five years is the selected period).

The remainder of their pension fund remains intact and invested.

At the end of five years the investor (who is now five years older) can then choose another fixed term annuity, a lifetime annuity or an income drawdown product.

This cycle can continue throughout their retirement years.

Unlike a traditional lifetime annuity that balance of the fund which is not generating an income remains available as a lump sum for the investor’s dependents on death.

This is a simple headline explanation of this product. There are technical aspects which may be relevant not covered here. Any investor wishing to explore this option should ensure they get advice before entering into any arrangement.

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The Benefits of Fixed Term Annuities and why they are a viable option for many investors at retirement

One of the major requirements investors pinpoint at retirement is that they need flexibility. For just about everyone retiring there is always a degree of uncertainty with respect to the future financial pathway. It is not just that the investor may have uncertainty in their own future position (with respect to their life expectancy and their health for example), the overall economic picture will be uncertain. Retirement could well be over many decades, who knows what inflation will be in the future, what interest rates will be – and so on.

It is because of this uncertainty that the traditional annuity path – the lifetime, fixed annuity presents possible disadvantages. These traditional annuities lock down the income rate, set the rate, fix it, for the duration.

Here is a summary of the main reasons why a Fixed Term Annuity may present a better option:

- The Fixed Term Annuity simply fixes the rate for ***a short period*.** This means that should general, market rates improve in the meantime, the investor can possible access a better income once the fixed term has expired. The Fixed Term Annuity avoids the lock down, a potential trap for long term retirees. They avoid this trap.

- One of the problems with a lifetime annuity is that it cannot be undone, once done. An investor who buys a lifetime annuity who then subsequently suffers serious ill health cannot then access an improved income based on their consequently reduced life expectancy. However a Fixed Term Annuity investor who has a fresh start after five years (or whatever other term is chosen) could then get an enhanced income level based on their health position.

- Likewise a lifetime annuity forces long term decisions to be made at the point the annuity is constructed. For example the investor may decide to incorporate a spouse's pension entitlement, an income for their spouse to continue after their death. This will reduce the investor's own rate of income during their lifetime. However if the spouse dies first this extra benefit is not required and the investor will have lost out on their own income level. A Fixed Term Annuity does not have the same need to build in long term benefits which may never be accessed.

- The death benefit position generally with a Fixed Term Annuity, more often than not, is going to be better. Because only a portion of their pension fund is used (to pay for the short term income) the remainder of the fund is kept intact for the benefit of the investor's beneficiaries should he or she die early on after they retire. With a lifetime annuity there is no equivalent lump sum death benefit.

There are many aspects to all of this, however we hope it is clear that the option of a Fixed Term Annuity as an alternative to a lifetime version, is a very valid option and for many investors will be a compelling one.

Getting advice and help

To ensure the right choices are taken individuals should pay high regard for getting the best and most appropriate advice. The annuity decision making process involves a number of considerations, an assessment of the pros and cons of different options, possibly some number crunching and a reflection against other options and requirements.

There are two reasons why seeking out advice generally works:

1. The best advisers are full time professionals, trained in these areas, they will have access to software and research and will be experienced in annuities and all that goes with it. They should be able to add considerable value to the decision making as a consequence.
2. As with anything of this type, getting an outside view and one that is reflective is almost always beneficial. Somebody else, particularly a professional, is likely to offer a good perspective of the individual's position and requirement.

In many respects it may be that the **single, most important, job** any individual has is to pick the right and the best adviser. This selection and decision may well be the one thing above all others that ensures the best income position is achieved when the annuity has to be considered.

5 minute money guide series from Get Financial Advice

This guide to Fixed Term Annuities is part of a series of such guides being developed by Get Financial Advice to provide an easy reference for readers.

The purpose of these **'5 Minute Money Guides'** is to get the most important elements of the subject across to the reader in a concise manner. They are the equivalent of a newspaper article which aims to provide an overview of the subject area covered. The intention is to give the reader food for thought, hints and ideas, they are not meant to replace bespoke advice or to provide advice.

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