Life \ **Pensions** \ Investments

All about Annuities
December 2022

Irish Life appreciates that you have worked hard to save for your retirement. Deciding what to do with your pension fund is one of the most important decisions you will have to make. There are various options available to you and now is probably a good time to seek professional advice, to ensure that whatever decisions you make are best suited to support you financially in the many years of retirement ahead.

One of these retirement options may involve the purchase of an annuity. This flyer explains in simple terms what an annuity is and how it works. We hope you find it useful. Next to the State, Irish Life pays out more pensions than anyone else in the Irish market*, so we have a lot of experience in this area. If you have any queries about annuities please contact Irish Life or your Financial Advisor, or speak to a member of our annuity quotation team who will be more than happy to help you. Please see contact details provided at the end of this flyer.

*Source: Irish Life.

What is an annuity?

An annuity is a financial product sold by insurers that pays out an income to an individual for the rest of their lives. An annuity is the only product that aims to provide a secured income for life. For this reason, annuities will especially appeal to individuals who want an investment that provides a known income in retirement.

An annuity can be purchased from the proceeds of:

- A company pension plan
- A personal pension plan
- Additional Voluntary Contributions (AVCs)
- Death benefits from an occupational pension scheme (where the annuity is paid to a beneficiary)
- An Approved Retirement Fund (ARF)
- Personal Retirement Savings Account (PRSA)

People generally invest in annuities at retirement. Most retirement plans operate by accumulating a fund of money on behalf of an individual over the period of their working life. By the time the person reaches retirement the pension fund will have achieved a certain value. This value (also, referred to as the capital sum) depends very much on the level of contributions that have been paid into the retirement plan over the individual's years of service. The higher the level of contribution, the larger the fund, although other factors like investment returns will also have a bearing on values.

Why are annuities so dependable?

Unlike some investment products, annuities are not invested in stocks and shares and therefore, not subject to the same type of volatile market fluctuations that these assets are exposed to. The attraction of annuities is that they offer consistency of income over the lifetime of the person. Market volatility may come and go but an income from an annuity is paid by Irish Life regardless of investment conditions.

What is the tax treatment on death?

When a person reaches retirement they will have accumulated a fund of money. Let's suppose the fund of money equals €100,000 and out of that amount the person takes a tax free lump sum of €25,000**. They then use the balance to purchase an annuity. The insurance company accepts the €75,000, agrees the price based on prevailing annuity rates, and will provide an income for life to that person (the 'annuitant') for as long as they live.

**The amount of available tax free lump sum will vary from person to person depending on scheme service and type of pension plan. The calculation of your lump sum depends on the rules of your product or pension arrangement and you should check this with your Financial Advisor (assumed 25% of the accumulated fund). The overall tax free cash from all pension arrangements cannot exceed €200,000. Tax free lump sums taken on or after 7 December 2005 will count towards using up the tax free amount. So if you have already taken tax free cash totalling €200,000 or more since December 2005, any further retirement lump sums paid to you will be taxable.

Annuity Example 1	
Accumulated fund at retirement	€100,000
Less tax free lump sum	€25,000
Balance available for annuity	€75,000 (the 'purchase price')
Income from the annuity	€4,000* p.a.

* €4,000 per annum payable for life based on a sample annuity rate of 5.3% for a 65 year old and excluding any 'additional features' as outlined below. Used for illustration purposes only. The actual rate will depend on the date the annuity is purchased.

Warning: These figures are estimates only. They are not a reliable guide to the future performance of this investment.

Are annuities flexible?

Yes, annuities are flexible and there are a number of additional features you can select when purchasing an annuity:

A. Single Life/Joint Life

An annuity can be purchased on a single life basis i.e. ceasing on the death of the individual, or on a joint life basis where some or all of the annuity can continue on to a second life (usually the spouse/civil partner), assuming they live longer than the main annuitant. The percentage of annuity transferring over to the second life is typically between 50% and 66% (the 'reversion rate').

B. Minimum Payment Period

Although not essential, most annuities come with a minimum payment period of 5 or 10 years. Even if the annuitant dies, after say only 3 years (in a Single Life Annuity), payments will continue to be paid into the estate of the deceased for a further 2 or 7 years respectively. In the case of annuities with a minimum payment period of less than 5 years a lump-sum may be paid by the insurance company in final-settlement**. The lump-sum will reflect the balance of payments due under the minimum payment period. If an annuity has no minimum payment period, the annuity ceases immediately upon death.

**Revenue do not allow this (lump-sum payment) feature on annuities offering a minimum payment period of more than 5 years.

C. Overlap

Overlap is relevant to Joint Life Annuities that feature a minimum payment period. Upon the death of the main annuitant, an annuity 'with overlap' will immediately commence paying the second annuity to the surviving life and in addition, will continue to pay the main annuity to the second life up to the expiry of the minimum payment period.

Annuity example 2

Tom and Mary take out a joint life annuity with a 5 year minimum payment period. The main annuity is €10,000 per annum reducing to €5,000 on Tom's death (50% reversion). However, Tom dies after only 3 years. Mary, therefore, starts to receive the reduced annuity of €5,000 straight away but in addition receives the remaining 2 of the 5 minimum payment years of Tom's annuity. In effect Mary receives an annuity totalling €15,000 in years 4 and 5, reducing to €5,000 thereafter.

For annuities that do not feature an overlap ('without overlap') the second annuity only commences upon the expiry of the minimum payment period so in the example above Mary continues to receive the remainder of Tom's annuity of €10,000 (only) in years 4 and 5 and thereafter receives the reduced amount of €5,000.

D. Escalation

Annuities can pay a flat level of income each month or they can pay an income that escalates in the course of payment by a fixed pre-selected percentage or by a percentage that's linked to the Consumer Price Index (CPI)

Will choosing these additional features affect the rate?

Yes, choosing any of the above options will impact on the amount of income payable from an annuity and this will depend on the type of options selected. In Example 1 we show a show an annuity, which returns a notional rate of 5.3% per annum. You can expect this rate to decrease when you choose additional features.

The retiree in this example buys an annuity with a purchase price of €75,000 (after taking the tax free lump sum). By choosing some of the options mentioned earlier, the typical effect on the annuity rate would be as follows:

Type of Annuity	Sample Annuity Rate	Gross Income*
Single Life annuity	5.3%	provides an income of €4,000
Joint Life (50% payable to spouse)	4.9%	Provides an income of €3,650
Joint Life (50% plus 3% escalation)	3.2%	Provides an income of €2,400

Some features affect rates more than others. You can see from the above example that choosing an annuity with escalation has quite a significant bearing on rates.

*Figures are shown gross before any deductions for tax. For more details on taxation, please see overleaf. Please note that it is not possible to add additional funds to the Capital Sum on retirement in order to cover the cost of these additional options. They must be taken out of the original fund.

Warning: These figures are estimates only. They are not a reliable guide to the future performance of this investment.

What happens if I die?

What happens in the event of death depends on the type of annuity selected.

Type of Annuity	Upon death
Single life no minimum payment period	The annuity ceases.
Single life with minimum payment period	The annuity is payable for at least the duration of the minimum payment period and thereafter ceases upon death.
Joint life/no minimum payment period/50% reversion/no overlap*	50% of the annuity continues to the second life for their lifetime and ceases on the death of the second life.
Joint life/with minimum payment period/50% reversion/with overlap*	The main annuity is payable for at least the duration of the minimum payment period. 50% of the annuity is payable to the second life from the date of death of the main annuitant even if this occurs within the minimum payment period. The second annuity ceases on the second death.
Joint life/with minimum payment period/50% reversion/no overlap*	The main annuity is payable for at least the duration of the minimum payment period. 50% of the annuity is payable to the second life upon the death of the main annuitant but will only commence at the end of the minimum payment period. The second annuity ceases on the second death.

*Note: These examples assume that the second life does not pre-decease the main annuitant. In such an event the annuity ceases on the death of the main annuitant, barring any minimum payment period.

Can I cash in my annuity?

No. Under current Revenue rules it is not possible to cash in or surrender an annuity. Neither is it possible to alter any of the features of the annuity (e.g. the rate of escalation or switch from single life to joint life) once the annuity has been purchased. Annuities are designed to provide security and consistency of income during retirement. Once the initial set of options are chosen they cannot be changed or amended later. For this reason you are strongly advised to seek professional advice before purchasing an annuity.

What about tax/Universal Social Charge (USC)?

Income from an annuity is taxed in the same way as any other income so the rate of tax and USC will depend on individual circumstances. All death benefits paid under an annuity may be subject to income tax and/or inheritance tax.

In all cases it is the responsibility of the annuitant to contact their local Revenue Office to ensure their annuity is taxed correctly before payments commence. The Revenue Commissioners can tell you the correct rate of income tax that you should pay on your annuity.

Any tax credits should be assigned to Irish Life (Pension Payments) under tax reference 0087900D. Until we receive a Tax Credit Certificate from the Revenue Commissioners telling us what rate of tax to apply, Irish Life is obliged to deduct Income Tax from your retirement income at the emergency tax rate.

Can my income increase while in payment?

Irish Life offers a number of different options around how your income can vary while in payment. The preferred option must be chosen at the outset.

Fixed Increases

Under this option the regular income for life is fixed from the outset (either flat or fixed increases apply e.g. 3% p.a).

Advantage: You know exactly the amount of income you are going to receive for the rest of your life.

Disadvantage: It is not inflation-proof and offers no protection against the effects of higher than expected inflation. As time goes by, its purchasing power may diminish if inflation exceeds any increase.

Inflation Linked Increases

The income from this type of annuity escalates in the course of payment as Consumer Price Index (CPI) varies. The rate of escalation is usually capped at a maximum rate e.g. CPI max 5% p.a

Advantage: The purchasing power of your income is somewhat protected against the effects of inflation.

Disadvantage: Choosing escalation on your income will impact on the initial amount of pension you can expect from your fund. The amount would be less than if you choose a pension with no escalation.

Additional Options

Irish Life annuity products also offer the features mentioned earlier, for e.g. providing for a Dependant's Annuity, incorporating a minimum payment period into the contract.

How do I get a quote?

Your Financial Advisor can arrange to do a quotation on your behalf. You should note that quotations are usually only valid for 14 days. After that time you may need to get an updated quotation. Alternatively you can check our website www.pensionchoice.ie

What information do I provide if I decide to purchase an annuity?

If you decide to purchase an annuity, you should complete an annuity proposal form, provide your PPS number (this is required for administrative purposes and to assist in the payment of benefits), evidence of age and evidence of marriage or civil partnership (if a Dependant's Annuity is payable). You should then arrange for payment of the purchase price of the pension to be submitted (if the funds are not with an Irish Life scheme).

Irish Life's Strengths In Annuities

Only the State pays more pensions than Irish Life. On average we pay out over €300 million to over 43,000 pensioners.*

- Our annuity support team is highly regarded by our customers and pension professionals
- Irish Life's solvency margin as of December 2021 is 159% (the legally required minimum is 100%)*

*Source: Irish Life.

Further information about Irish Life's financial strength can be found in our Solvency and Financial Condition report available on our website: www.irishlife.ie/solvency-and-financial-condition-reports/

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