Investment Protection Annuities

Recent Finance Act changes open up new opportunities for members of Defined Contribution (DC) pension schemes at retirement. Investment Protection Annuity is now available to a much wider group than before and offers an interesting alternative to traditional annuities.

What is an Investment Protection Annuity (IPA)?

This is a way of protecting a member's capital fund value if they die early after annuity purchase. One of the traditional fears of annuity purchase was that a member could die soon afterwards and their capital would be lost. Choosing the Investment Protection Option at time of purchase allows for the return of the "unused" capitalon death to the member's estate.

For example:

Pat has a fund of €100k (after lump sum options) and buys an annuity with Investment Protection paying €6k pa. Under a traditional annuity, if Pat died his annuity would cease and no further benefit would be paid (ignoring options like minimum guarantee period, spouses reversion etc).

Under Investment Protection, if Pat dies say after 2 years of payment (after receiving €12k in all) his estate will receive the remaining ¤88k fund.

Who can take an IPA out?

This option was always available to any person retiring who could have availed of an Approved Retirement Fund (ARF) or Approved Minimum Retirement Fund (AMRF) - that is, Self Employed, 5% Directors, Personal Pension or AVC holders etc but not ordinary DC members. The new rules introduced in the Finance Act 2011 mean this is now open to DC members also.

For DC members there is a restriction on the tax-free lump sum that can be taken when purchasing an Investment Protection Annuity. The tax-free lump sum must be taken in line with Approved Retirement Fund (ARF) rules i.e. the maximum tax-free lump sum is 25% of the fund. Under a traditional annuity the maximum tax-free lump sum could be as high as one and half time final earnings.

DC members will need to decide how this compares to the alternative traditional "maximum 1.5 times earnings" lump sum benefit and traditional annuity as the best advise will vary depending on their circumstances.

AVC members can still opt for the IPA after the "normal" 1.5 times earning formula.

What is the cost?

Naturally, this extra feature has to come at an extra cost. Based on the same details the annual income provided by an Investment Protection Annuity is lower than that of a traditional annuity. This reflects the additional guarantees associated with this type of annuity i.e. the additional benefit payable on death. The reduction in annual income depends on the case but typically varies between 12% and 18%.

Note: *you can not have a guarantee period with investment protection. You can have spouses' reversion but typically this is not chosen as the "return of fund" accrues to the estate (and hence any surviving spouse).*

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What is the tax treatment?

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What are the alternatives?

A traditional annuity provides a stable income for life and good security against outliving your funds. An ARF provides more investment flexibility and protection against early death but the recent move to 5% deemed distribution has reduced their attractiveness somewhat.

An IPA could be a good middle ground providing:

- Strong guarantees with no investment market exposure.
- Protection against both living to very old age and loss of capital due to early death.
- Good diversification from other, market exposed investments.

How do I get a quote?

Please contact us at Absolute Finance for a quote. If you have any queries on any of this content, please contact:

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