annuity rates will rise anytime soon as gilt values are likely to remain low, given the austerity measures and fall-out from the EU-zone," Grennan adds.

AllianceBernstein is one of the providers entering this temporary space, offering a relatively low cost income drawdown product called Retirement Bridge. Drawdown – where pension money remains invested but you can take out a part of it every year – is already an option for those with bigger pots who want flexibility about when they buy an annuity.

But traditionally the plans are expensive and require large pots from which to draw. Using Retirement Bridge, AllianceBernstein claims a saver with as little as £25,000 will need just 3% annual growth to cover costs.

It works by offering a white-labelled series of pooled low cost tracker funds which come to fruition at various dates in the future. Based on markets and annuity rates over every 10-year period from 1920, AllianceBernstein claims someone who does this from age 65 to 75 and then locks into an annuity would enjoy an income 20% higher than if they had simply bought an annuity at 65.

Variable annuities are nothing new; the 1990s saw them become popular because of the increasingly lower annuity rates and lower gilt yields – notice the similarities? Variable annuities, which include investment-linked, asset-backed, fixed-term annuities and income drawdown, were pioneered in the 1990s.

However, following the dotcom crash in the early 2000s, many of the big players pulled their with-profits products out of the market, as returns linked to indices plummeted. Income drawdown, introduced in 1995, also suffered with the collapse in the markets, resulting in a huge drop in popularity.

As the markets recovered, a new retirement range of products appeared: third way annuities. These products offered a mixture between drawdown and investment-linked – essentially a guaranteed drawdown product.

While variable annuities and third way products aren't a panacea, they are moving away from being a niche annuity for the wealthy. Statistics from the Association of British Insurers show alternatives to conventional annuities are slowly on the increase – rising from 11.3% in the non-advised market (and 37.5% in the advised market) in 2004, to 16.7% in the non-advised market (and 58.3% in the advised market) in 2011.

With the increase in flexibility and providers coming back to the market, we could see a healthy resurgence towards these innovative retirement products.

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Giving retirees a genuine choice

Few people give much thought to how exactly they will secure an income when they give up work. As a result, most savers in defined contribution pension schemes tend to take the first thing put in front of them, which is overwhelmingly likely to be a flat-rate single-life annuity. But with life expectancy for 65-year-olds now nearly 25 years, is an annuity which offers no inflation protection nor any safety net for dependents still fit for the job?

For instance, modest annual inflation averaging 2.5% over that typical 25-year lifespan would effectively halve the retiree's income in real terms. Yet, according to the National Association of Pension Funds, the typical annuity buyer could be losing out significantly by failing to shop around for the best annuity rate at retirement.

Giving retirees greater choice would not only allow them more breathing space to take the tough decisions that confront them, but also let them opt for potentially better alternatives to immediate annuitisation. One way to do this would be use the drawdown rules. Instead of retirees buying an annuity immediately, they would take an income from their retirement pot. In addition, if some exposure to equities was maintained, the retiree's savings would have the potential to grow, thereby offering them some protection against inflation.

Up to now, of course, the typically high cost of drawdown has made it the preserve of the wealthy retiree. But by using the age-based approach of target date funds, it is possible to offer the benefits of drawdown at a much more affordable cost than has previously been possible. It means drawdown can now become a realistic choice for the typical retiree with an average pension pot of £25,000.

The individual would use their accumulated savings to buy into a professionally-managed fund whose investment strategy would be set according to the risks and needs of their particular retiree age group. It would reflect the likely number of years for which they would need to draw an income. And it would take account of the likelihood that at some stage they may still want to buy an annuity.

We've tested how a simplified version of this fund might have performed over 10-year periods from 1920 to 2012. The results show that even in bad markets, the reduction in income compared to an annuity bought at 65 was less than 20%. In good markets, the annual income gained could be as much as 25% or more by the age of 75 – and we may be on the cusp of a particularly promising period. If the market cycle is typical in the next few years, we believe retirees could ultimately be enjoying a quarter more income – compared with annuitising at 65.

All in all, a fund like this (which we call a Retirement Bridge) would provide retirees with more choice, more breathing space and more retirement income on average. In other words, a real choice.

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