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“Funding post-retirement income”

ABSTRACT: When planning post-retirement individual income, some basic features of the life annuity product should be accounted for. In particular:

(a) a life annuity provides the pensioner with an unflexible income, in the sense that, if the whole fund available at retirement is converted into an annuity, the annual income is stated as determined by the annuitisation rate;

(b) a more flexible income can be obtained via a partial annuitisation of the fund, or partially delaying the annuitisation itself; the part of income not provided by the annuity is obtained by drawdown from the fund;

(c) the annuity product relies on mortality cross-subsidy, as each life annuity in a given portfolio (or pension plan) is annually credited with a share of the mathematical reserves released by the deceased annuitants, according to the mutuality principle.

From feature (c) a strong point in favour of life annuities as a tool for post-retirement income clearly emerges: the annuity product guarantees the income (and, in most cases, its annual amount) until the annuitant dies: Conversely, from feature (a) a point against the life annuity product arises, as, if no other resources are available to the pensioner, the income profile cannot be changed (e.g. to meet costs related to temporary sickness).

Feature (b) shows the way towards more flexible income profiles. The present paper deals with some aspects of possible "combined" solutions in defining the structure of post-retirement income. Several issues are focussed, from both the points of view of the annuity provider and the annuitant. In particular, the following aspects are addressed: the presence of the longevity risk, its impact on annuity pricing, the "mortality drag", income drawdown versus annuitisation.