



BeFi

BeFi Conference Topic 11

# Brainstorming on Decumulation: The Annuity Puzzle

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# Brainstorming on Decumulation: The annuity puzzle

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Very little thought goes into decumulation

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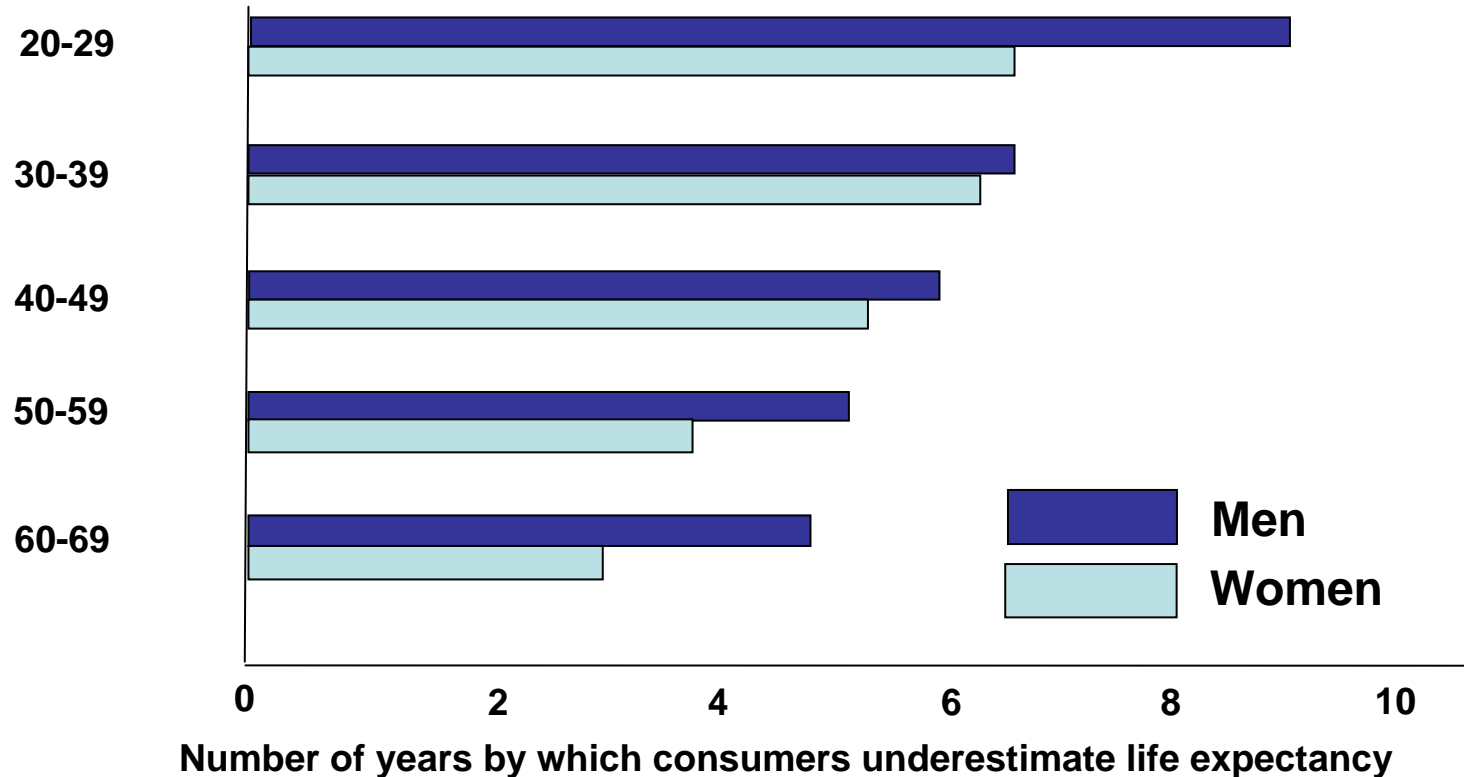
Yet it is **THE** most important stage in any pension plan

# Need to brainstorm on ...

- Is it best to annuitize?
- If so, when?
- If so, what type of annuity?
- Is there a role for government?

# Individuals underestimate how long they will live

## Age



Sources: O'Brian, Fenn, and Diacon, 2005, self-estimated life expectancy compared with GAD forecast life expectancy; Prudential analysis.

# Is it best to annuitize?

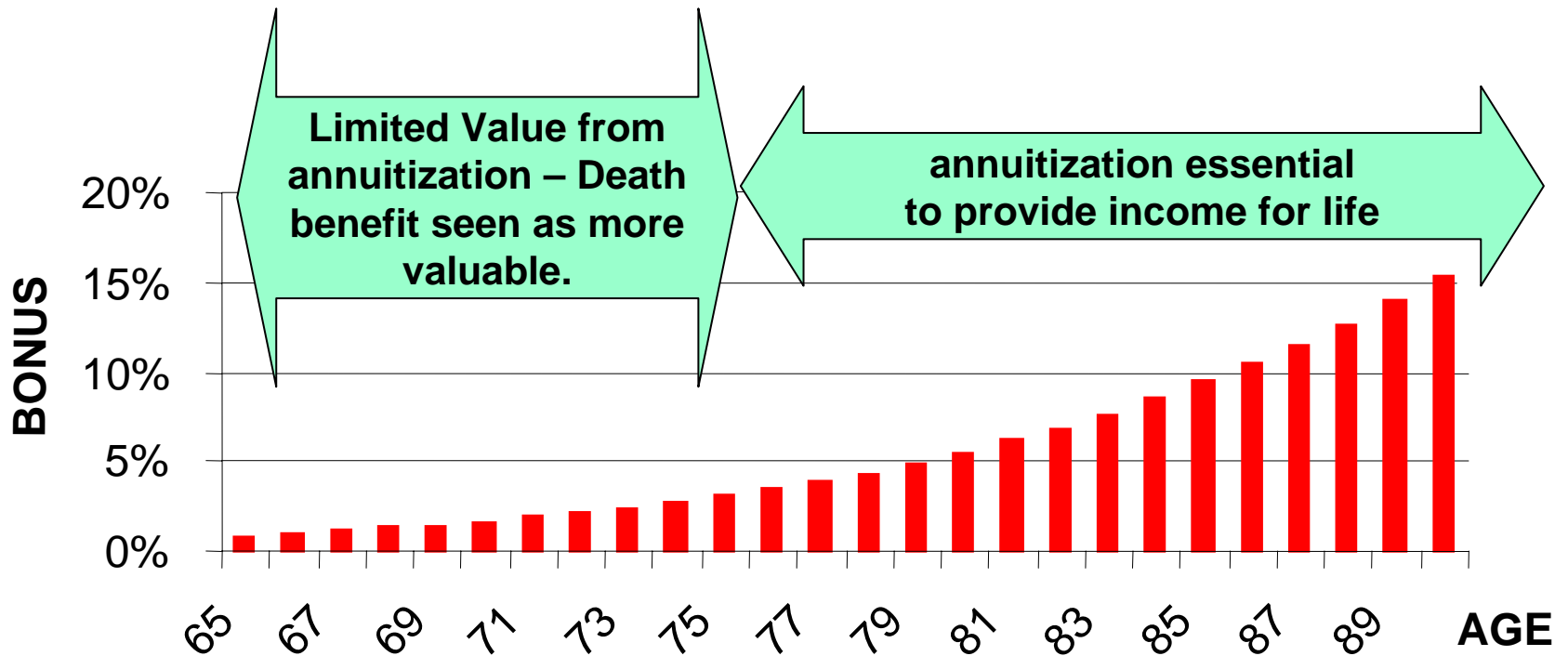
- Ever since Yaari (1965) economists have said 'YES'
- Annuities are the only financial instrument ever devised that can give lifetime income security however long an individual lives
- But:
  - They are regarded as being poor value
  - And what about bequests?

# If so, when?

- Perhaps not immediately
- Giving up the equity risk premium
- To begin with the mortality cross subsidy is very low

# If so, when?

## Annual Mortality Cross Subsidy

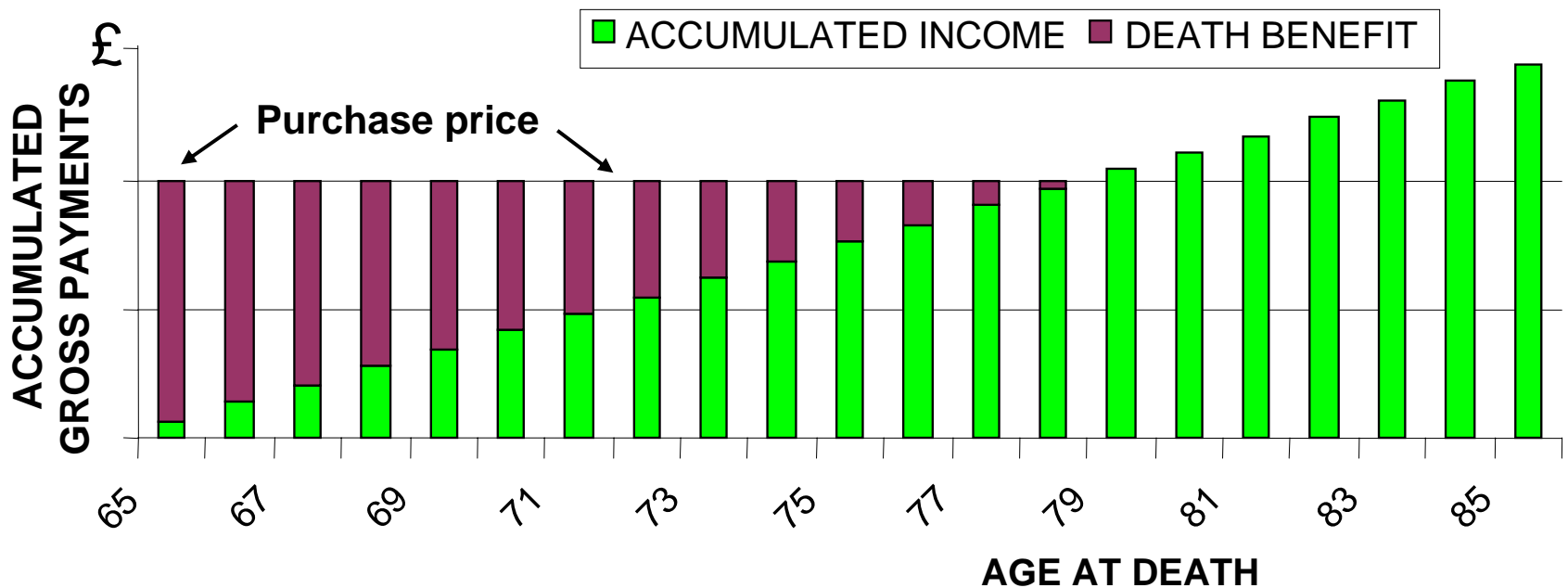


# If so, what type of annuity?

- Level
- Index-linked
- Investment-linked/ variable rate
- Money back/ premium refund

# Money-back/premium refund annuity

On death any excess of the original purchase price over the gross annuity payments already received is returned to the annuitant's estate

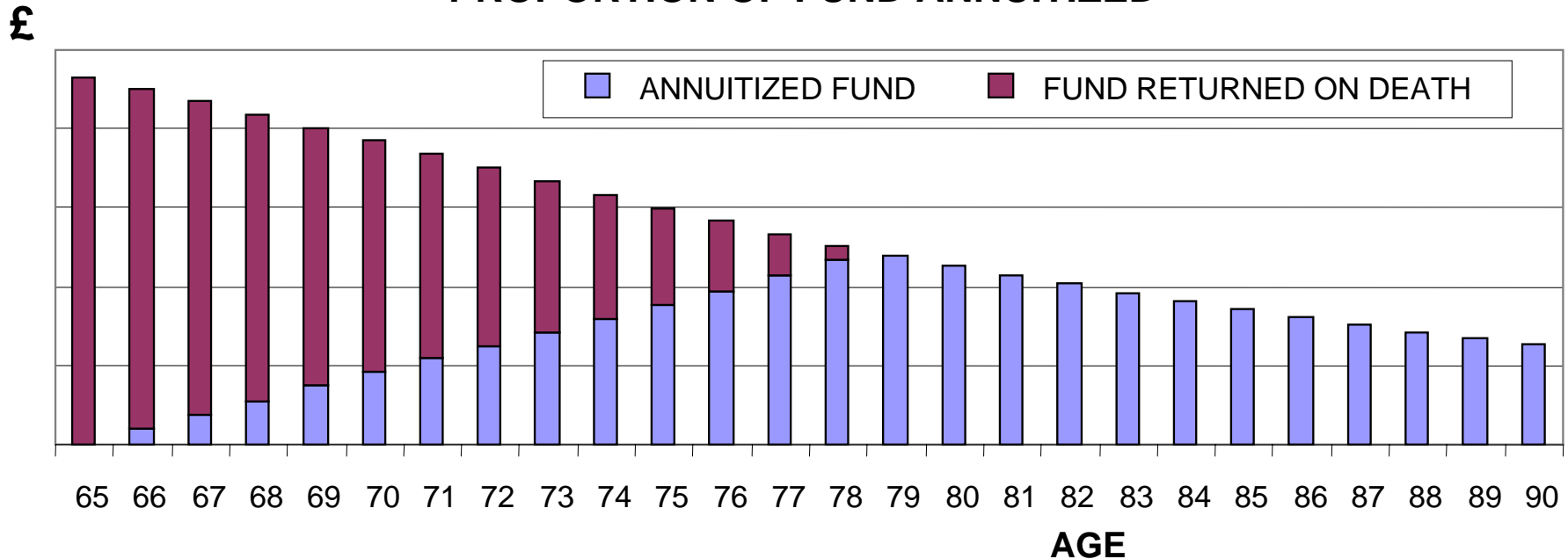


MBA allows a pensioner to lock into investment and longevity guarantees while providing death benefits in early years.

# MBA defers annuitisation

**MBAs allow annuitization to increase gradually over the early years of the contract**

**PROPORTION OF FUND ANNUITIZED**



**Money-Back annuities allow the mass market to defer annuitization without incurring the risks, costs and complexity of Income Drawdown**

All very clever....

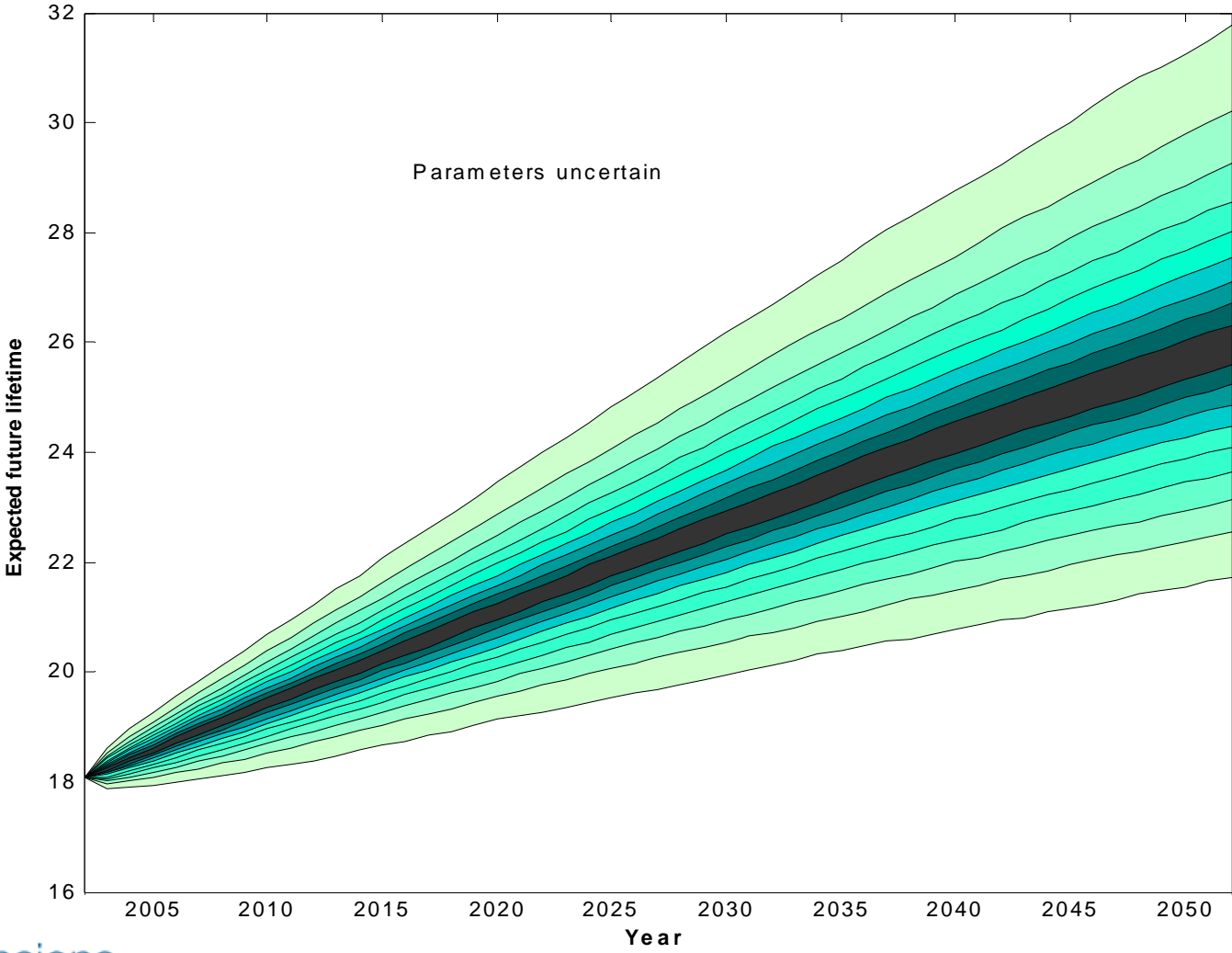
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.... but consumers are still not rushing in

# Is there a role for government?

- In improving education about annuities?
- In making annuitization compulsory by a certain age?
- In increasing the perceived value of annuities by helping to hedge an aggregate risk that annuity providers cannot hedge alone:
  - Longevity risk?

# Longevity fanchart for 65-year old males



How about this new advertising message?

- SPORT:
- Annuitize now and spend more today!

# Questions

- Is it best to annuitize?
  - What about bequests?
- If so, when?
- Is there a role for government?
  - In improving education about annuities?
  - In making annuitization compulsory by a certain age?
  - In helping to hedge longevity risk?



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