

# Building a better annuity solution

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## Authors and contributors



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This paper focuses mainly on the decumulation phase, by comparing various strategies to determine an optimal asset allocation within a goals-based framework. Given that this is an area where limited research and market development has taken place, the specific focus of this paper is on comparing the inclusion of deferred annuities to immediate annuities within an overall investment strategy.

The comparison was done using a model and framework introduced in Anderson & Emedocles (2016) to assess retirement income investment strategies. The model made use of assumptions specific to the South African environment to determine the lifetime spending needs being met and the expected financial reserve upon death using various strategies that include both drawdown accounts with varying asset allocations (or 'living annuities') and guaranteed life annuities. 'Lifetime spending needs being met' is defined as the probability-weighted proportion of income needs being met over a remaining lifetime with 90% confidence. 'Expected financial reserve upon death' is defined as the 50th percentile of the present value of the remaining retirement assets available on the death of the pensioner, adjusted by the present value of income support provided by dependants during the life of the pensioner in order to meet the pensioner's income needs where it falls short.

A base case for a male aged 65 years and an initial income requirement of 6.44% of retirement capital was modelled. Two alternative scenarios were introduced (i) a lower initial income requirement of 5% of initial retirement capital and (ii) assuming consumption requirements of the retiree increases at 2% above inflation after retirement to reflect an increasing consumption profile. The overall results of all three scenarios were then compared to provide insights into the properties of the blending of deferred annuities as opposed to immediate annuities with traditional asset classes in arriving at an overall investment strategy.

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