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The effect of longevity drift and investment volatility on income sufficiency in retirement

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Currently in the United Kingdom, the majority of people (75%) with a defined contribution pension pot use it to buy an annuity at retirement. The advantage of this is that an annuity provides a guaranteed income for life. Since 2011, the necessity to annuitise has been removed and in 2014 the Government announced more radical proposals which allow people to withdraw their money from age 55 “how they want, subject to their marginal rate of income tax in that year”.

The effect of this change is to put more onus on the individual to ensure that they have sufficient resources to last their retirement. From an individual’s standpoint there are three main considerations:

1. Longevity risk and whether to manage this risk by buying an annuity at some point during retirement;

2. Any gift or bequest motive or plans for a major purchase at retirement;

3. The volatility of investment returns in the absence of annuitisation including potential tax liabilities.

Actual behaviour will also depend on sources of other wealth and income and the impact on receiving state support in cases where pension pots are small and there are few other assets on which to draw.

This paper is concerned with how individuals can best use their pension pots to align them to their own personal financial objectives and longevity risks. It finds that for most people, annutising at retirement is *not* the best option and that some form of income draw down is preferable.