BEAT LONGEVITY RISK WITH A RETIREMENT ANNUITY

What pension providers don't want consumers to know

An innovative strategy to manage longevity risk at retirement is to transfer some or all of your retirement savings from your pension fund administrator to a Retirement Annuity managed by an insurance company.

There is no doubt that pensions provide a great mechanism to invest the money that you save while working. Most pensions are structured to maximise growth during your younger years when you can afford to take on more risk, developing more conservative strategies designed to manage risk and secure gains as you age.

Since you have little control over how pension fund administrators invest your savings, however, pension funds run the risk of asset devaluation. Combined with inflation risk, pensions run the risk that your hard-earned savings might not be enough to enjoy a secure, independent retirement.

Pensions operate on the principle of investing your savings while working so as to provide an income, sometimes monthly pay-outs, when you stop working. Nigerian law requires employers to contribute an amount equivalent to five percent of employee income to a pension fund managed by an independent pension fund administrator during their employees' working lives. This amount is augmented by a second mandatory contribution of three percent from employees' own earnings.

The funds are accumulated and at retirement can be invested by the employee in either a Programmed Withdrawal or a Retirement Life Annuity option.

Programmed Withdrawals on retirement are managed by the Pension Funds Administrator. Programmed Withdrawals allow pay-outs to be drawn from the money accumulated in the fund at retirement, until it is finished. As people live longer due to better nutritional and health information and practices, however, longevity risk – or finishing all the money in your retirement fund before you pass on – is a very real prospect for many retirees living on Programmed Withdrawals.

The second option, Retirement Annuities, allow you to transfer some or all of your pension pot to a Retirement Life Annuity managed by an insurance company, such as Coronation Life Assurance Limited, when you retire. Since Retirement Annuities are insurance products, when you purchase a Retirement Life Annuity you purchase an agreed and guaranteed monthly income that will keep paying out until the day you die, regardless of whether your funds run out. As such, Retirement Life Annuities provide an excellent mechanism to manage longevity risk. Retirement Annuities also manage inflation risk by including an annual escalation mechanism. Through the escalation mechanism, Retirement Annuities can adjust monthly payouts in line with inflation.

However, the availability of these two options above does not prevent earning adults from, also, purchasing other forms of annuities while still working. The advantages of augmenting mandatory pension contributions while still working means that, at retirement, you can combine your pension pot with your private annuity earnings to provide a much larger monthly pay-out which will last, indefinitely, until you pass on. Coronation Life Assurance Limited offers this type of annuities and they are called Deferred Annuities. They allow employees to save independently while still working.

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At retirement employees can withdraw the funds from their Deferred Annuities and purchase an additional or larger Life Annuity guaranteed to pay out till employees pass on.

Unlike Programmed Withdrawals, Retirement Annuities include an additional death benefit should the policy holder die within the first ten years of taking up the policy. Similarly, the Deferred Annuity also provides a death benefit if the policy holder dies while still making contributions. As such, in addition to managing longevity and inflation risk, Retirement and Deferred Annuities allow employees to leave a substantial legacy to their loved ones when they have passed on.

While Programmed Withdrawals are without doubt an essential retirement safety net for Nigerians, transferring pension savings to a Retirement Annuity upon retirement, or even contributing to an independent Deferred Retirement Annuity while still working, present Nigerians with the means to secure permanent security of income in their golden years.