Nobel laureate weighs in on S'pore annuity debate

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(SINGAPORE) The core of any retirement plan is a life annuity which pays you a stream of income as long as you live, says Robert C Merton, winner of the 1997 Nobel Prize in economic sciences.

'My understanding is that people here don't seem interested . . . One of the reasons is that in many places where (annuities) are offered to individuals, it's really a lousy product. It has high costs and commissions; it's crummy. But don't confuse a crummy version of something with a flaw in the concept,' says Prof Merton.

A life annuity is similar in concept to defined benefit pension schemes that pay retirees an income for life, he says.
But while an annuity is a helpful tool, the biggest hedge against long-term longevity is the ability to work longer, he says.

Prof Merton of Harvard Business School will deliver the keynote address at the Silver Industry Conference and Exhibition next January. He will speak on financing a successful long life.

Prof Merton is also chief science officer of the Trinsum Group, a global advisory and retirement solutions company which has an office in Singapore. He spoke to reporters in Singapore last week.

Singapore, he says, has the potential to serve the region by providing an infrastructural platform for financial services dealing with retirement. Singapore has built up 'reputational capital'.

'A key element in being successful and delivering solutions is that there has to be trust or people won't do it,' he says.

On annuities, he says they should have a feature to protect against inflation. The biggest fear in retirement is that, thanks to longer lives, a retiree outlives his assets.

'An annuity payment can't be constant. It needs to be protected against inflation and you can't protect your standard of living if you have inflation, because you will be able to buy less with the same amount of money.'

On retirement advisory, he says it's important to keep it simple, squeeze costs down and diversify.

Keeping costs to a minimum can enhance returns, and this is a much more efficient route to returns rather than to take more risks.

'There isn't trillions of dollars of extra return to be earned for the next 40 years if you're pretty aggressive . . . One of the things you keep running into is the notion that in the long run stocks aren't risky. Let me assure you - that's not true.

'A lot of advice says that if you're young and have enough time . . . you'll earn a sure thing. You'll earn higher returns from stocks in the long run and that's absolutely false.

'It's wonderful to believe because you say, 'Oh I'll just put money into stocks then I won't have to save as much'. Then you'll find out over 30 years whether it works. If it works, you'll never know what risk you took. If it doesn't work, it's pretty awful . . . You can't substitute risk for inadequate wealth or saving.'

He says the biggest asset individuals have is their human capital. The approach towards investments should be balanced against where one's human capital is invested. A stockbroker, for instance, is already exposed to the market in his profession, and should invest differently with his personal wealth.

'Portfolio theory never says you can look at a portion of what you have and do anything that's optimal. You have to look at the whole. A big part of the whole is the human capital.'

In advising people for retirement, it is important to get people to make some key choices, which should be couched in terms that are meaningful to them, he says. These include the choice of how much to save, how long one should work, and the lifestyle one desires in retirement.

'We don't believe the asset allocation decision is meaningful to anyone. We don't talk to you about your investment, but about making choices that are meaningful to your life . . . So we change the choices from asset allocation to life choices. The plan sponsor should then monitor and be the gatekeeper.'