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Annuities central to any retirement plan: Nobel laureate

They can form core investment for retirees, especially if adjusted for inflation

By Grace Ng

SINGAPOREANS might baulk at buying life annuities, but these ought to be the centrepiece of any retirement plan, according to Nobel laureate in Economics Robert Merton.

During a visit to Singapore, the Harvard Business School professor acknowledged the sometimes poor reputation of annuities – which pay the holder a regular income for the rest of his life after he retires.

Professor Merton said annuities are sometimes seen as having "high costs and high commissions". But he cautioned Singaporeans not to confuse a "crummy version" of an annuity with the incorrect notion that they are fundamentally flawed in concept.

He said a life annuity is a helpful tool, as it provides peace of mind for policyholders who want to maintain their standard of living when they retire.

Annuities are similar in structure to a defined benefit pension scheme that pays retirees a steady stream of income for life.

The Singapore Government is proposing a compulsory annuity scheme for Central Provident Fund members aged 55 and over.

Voluntary annuities have proved unpopular in Singapore, as these involve plonking down a large lump sum in return for relatively modest regular payouts.

Prof Merton was in Singapore last Wednesday to speak to journalists ahead of the launch of the Silver Industry Conference and Exhibition. To be held here next January, the event covers the booming industry that has evolved to address the needs of the elderly. Prof Merton will deliver the keynote address, tackling issues such as how to make financial plans for a long successful life.

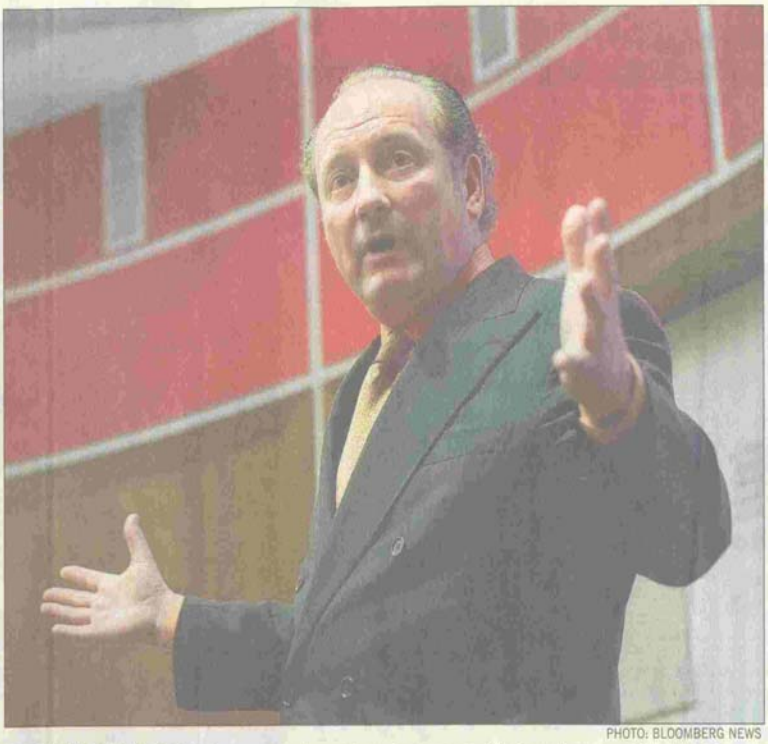
He noted that Singapore, which is actively promoting financial planning for retirement, has the potential to develop these solutions not just for its citizens but also for the Asian region.

It has a comparative advantage in serving the region and can provide an infrastructural platform for retirement tools. Its advantage comes from its strong reputation for transparency and trust, which is "a key element" of success in delivering retirement solutions, Prof Merton said.

He is well-versed in the subject – and not just because he is 63 years old and "has naturally put some thought to planning for old age". He is also the chief science officer of Trinsum Group, a global advisory and retirement solutions company that has helped multinational companies such as Philips to design employee retirement pension schemes.

Prof Merton noted that a key feature of any life annuity should be protection against inflation. Thus, the regular payments dished out to policyholders after they retire should increase in tandem with the rising costs of living.

A life annuity that is adjusted for inflation is "very efficient and can become a core part of what you're investing", said Prof Merton. But he also cautioned that people must be prepared to work much longer to support themselves over their much longer lifespans.



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IMPORTANT ASSET: Prof Merton says people need to make the most of their own human capital, which longer lifespans allow them to do as they can put in more years before they retire.

After all, a person's biggest asset is his human capital, he said.

When individuals invest, they should also take into account their own human capital. For instance, a stockbroker, who is exposed to the stock market because his job is directly linked to it, can balance the risks by investing in assets other than equities.

This is part of an optimal portfolio strategy of diversifying your assets, which includes one's human capital, Prof Merton explained.

On retirement planning, he said people should first focus on their life goals. These could include how much they want to leave their children and their quality of life when they retire.

To achieve these goals, investors should diversify their portfolios, making sure to keep costs down. Taking higher risks in investments does not necessarily reap higher returns, so keeping a lid on costs is important for enhancing returns, Prof Merton explained.

Singapore, which is actively promoting financial planning for retirement, has the potential to develop these solutions not just for its citizens but also for the Asian region, Prof Merton says.

He debunked the common perception that young investors who pour money into stocks will earn big bucks in the long run.

"The notion that, in the long run, stocks aren't risky...is not true," he said, adding that stocks could always underperform.

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