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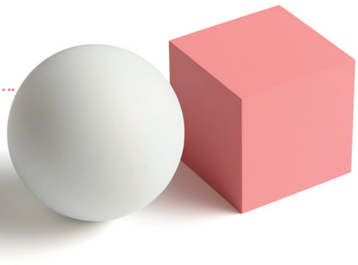
MORTALITY CROSS-SUBSIDY AND MORTALITY DRAG



'Mortality cross-subsidy' and 'mortality drag' are two things your adviser might mention when you're discussing your retirement income options. So, what do they mean?

Well, both terms are linked to your life expectancy. The first is a benefit associated with guaranteed income for life solutions, also known as annuities. And the second is a factor linked to non-guaranteed products, such as income drawdown.

When you're deciding on a retirement income solution, you need to consider them both, as they could affect the amount of income you'll get when you retire.

Mortality cross-subsidy
Is a benefit that comes with buying a guaranteed income for life solution.

If you buy a guaranteed income for life, your provider will estimate how long you're going to live – also known as your life expectancy. This is usually a calculation based on your age, perhaps where you live, and often your health.

A guaranteed income for life solution uses a 'pooled-risk' approach. Your provider assumes that some people who buy this pooled-risk product will die sooner than expected. As a result, they'll 'subsidise' the people who buy the same product but live longer than expected.

The benefit of this 'mortality cross-subsidy', for the people who live longer, is that they'll continue to receive income for the rest of their life. This income is essentially paid for by the people who buy this product then die early. It's this cross-subsidy – or pooled risk – that allows your provider to offer this income guarantee.

Many guaranteed income for life plans also include optional benefits (payable when you die) to make sure customers who die earlier than expected can protect some of their savings.

Mortality drag
Is a factor that applies to income drawdown.

If you invest into an income drawdown plan, there isn't the same pooled risk as you get from buying a guaranteed income for life. So, with drawdown, there's no cross-subsidy. With no pooled risk in place, you're essentially going it alone. This means you won't benefit from other retirees dying earlier than expected. In other words, there's no one supporting your income if you live longer than you thought you would.

For each year that you stay in drawdown, you'll lose the cross-subsidy you would have had with a pooled-risk solution, such as a guaranteed income for life. This is known as the mortality drag.

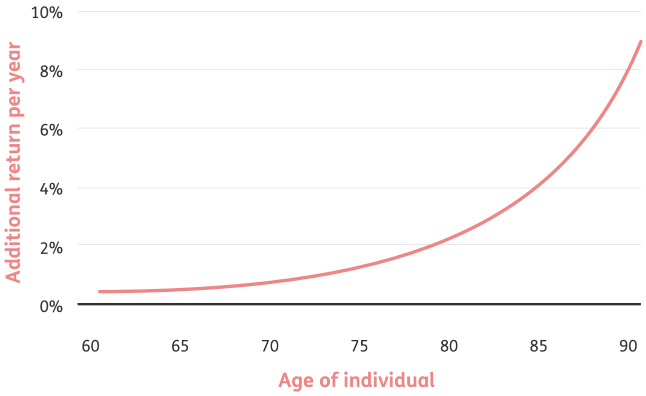
To compensate for this loss, the investment returns you'll need to maintain an equivalent level of income will have to increase.

As you get older, the effect of this 'mortality drag' increases. As a result, your drawdown pension fund will need greater investment returns each year to match the income you could have otherwise received.

So how do these two concepts work and relate to each other?

Both have an impact on certain financial decisions you make. For example, they could affect the age you choose to exit from an income drawdown plan. Or they could have an impact on the investment portfolio you require to achieve the growth rates you need as you get older. This could potentially change the required growth rates from what you thought was realistic to unlikely.

Additional return required to remain in drawdown and match an equivalent level of income available from a guaranteed income for life solution purchased at 60



Based on CMI mortality (PXA08 and the CMI 2017 longevity improvements model with a 1% long term mortality assumption, and assuming a 50:50 male to female mix at age 60).

This chart shows that for someone entering drawdown at 60, the additional growth required is relatively low and easy to match. Then as they get older, the growth required increases ever more sharply.

For example, you can see that at 80, you'd need around 2% more investment growth on your pension than you did at 60. You'd need this just to get the same level of income that could have been provided by a guaranteed income for life solution.

By 85, you'd need to be getting over 4% more. And if you remain in drawdown until you're 90, you'd need your fund to be growing by an extra 9% per year.

Summary

Understanding the effects of mortality cross-subsidy and mortality drag is important. It can help you decide whether the growth you're likely to need from your investments is achievable. Knowing the effects of the two factors can also help you work out if you can get a higher income from a guaranteed income for life solution (because it incorporates mortality cross-subsidy).

Deciding which retirement option suits you best doesn't have to be a single 'all or nothing' choice. There are several options your adviser can discuss with you. For example, you might choose to buy a series of guaranteed income for life solutions over time. This could include some elements of both guaranteed income for life and income drawdown, to provide security and flexibility.

Still not sure? Your adviser can explain the impact of mortality cross-subsidy and mortality drag on your options in more depth. And they'll be able to help you work out what this means for you when you're sorting out your retirement plans.

How can you secure a guaranteed income for life?

A guaranteed income for life is secured by a pension annuity. This income is secure and fixed, regardless of how the financial markets perform and how long you live. There are no investment risks with a guaranteed income for life. And there's no risk of you outliving your pension fund. This isn't a one-size-fits-all product either. You can tailor your guaranteed income for life solution to meet your individual needs and circumstances – for example, you can choose to protect the value of your pension savings so you can pass money on to your loved ones.

FOR MORE INFORMATION

Call: **01737 233297**
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Email: **support@wearejust.co.uk**

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