Network for Studies on Pensions, Aging and Retirement

Investment risk with guarantees after retirement

"Combining a fixed and variable annuity has added value for participants"

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The Premium Schemes (Improvements) Act (Wet verbeterde premieregeling, Wvp) allows for continued investing following a person's retirement date, but this is not without risks. We assess a number of continued investment strategies via a simulation study based on financial scenarios of De Nederlandsche bank (the Dutch central bank). We compare alternative ways of managing and spreading equity risk over time. We also study the effect of interest rate shocks on the benefits and indicate how the interest rate risk can be partially hedged.

Principal Findings

- Combining a fixed and variable annuity in a Wvp scheme has added value. If offers a median benefit equal to a standard Wvp contract, but also provides a guaranteed lower limit of the benefit and opens the possibility of gains from high stock returns.
- This combination is valuable for participants with highly diverse risk aversion and is relatively insensitive to uncertainty about average returns.
- A number, though not all, of the variants examined are allowed within the current legal framework.

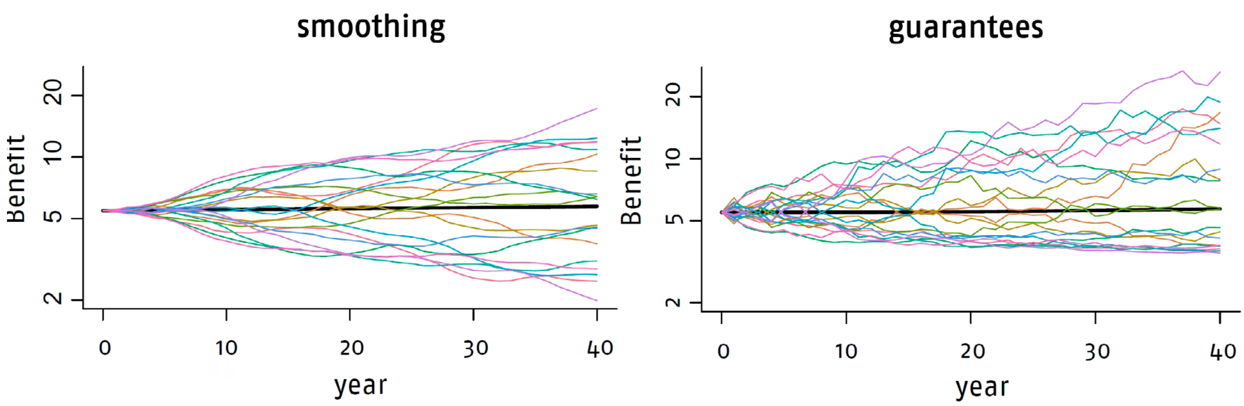

Figure: "Left: A Wvp contract that allows for smoothing provides certainty in the first years following retirement. Right: A contract with guarantees) limits the downside risk of the annual benefit with the possibility to gain from stock returns."

Key Takeaways for the Industry

A contract with a guaranteed pension, for example 75% of a fixed annuity, is an appealing option when it is difficult to determine risk aversion and time preference of participants.

Want to know more? Read the paper
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