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Assessing Investment and Longevity Risks within Immediate Annuities

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Life annuities provide a guaranteed income for the remainder of the recipient's lifetime, and therefore, annuitization represents an important option when choosing an adequate investment strategy for the retirement period. While there are numerous scientific articles studying annuities from the pensioner's point of view, thus far, there have been few contributions considering annuities from the provider's perspective. In particular, there are no surveys on the general risks within annuity books. The present paper aims at filling this gap: Using a simulation framework, it provides a longterm analysis of the risks within annuity books. More specifically, the mutual as well as the respective impacts of systematic mortality risk and investment risk on the insurer's financial situation are studied. The key finding is that under the model specifications and using annuity data from the United Kingdom, the risk premium charged for longevity risk seems to be very high relative to its characteristics. Possible explanations as well as economic implications are provided, and potential caveats are discussed.

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