# When to Commence Income Annuities

Jeffrey K. Dellinger, FSA, MAAA

## Abstract

The question arises as to the appropriate time to deploy income annuities—fixed or variable—to generate regularly scheduled income. Intuitive judgments based on the psychological makeup of many humans often lead to decisions that run counter to objective decisions that rely more on logic and less on emotion—and this phenomenon may particularly apply here. This paper looks at the issue of timing the commencement of income annuities from the perspective of a real-life client scenario of a RISE insurance company client.

This analysis quashes the misconceptions that one should take withdrawals from mutual funds or deferred annuities for a number of years and then purchase an income annuity later or purchase income annuities on a staggered basis merely because a given amount of premium translates into higher periodic income with advancing age. To the extent one's objective is to maximize retirement income with the potential to keep pace with inflation while minimizing the probability of outliving that income,[1,2] delaying income annuity purchase can be suboptimal.

One generally considers commencing an income annuity at points in life when one has a need to supplement income, such as scaling back to working half-time and again when scaling back to complete retirement.[3] The decision arises whether to commence an income annuity at such points or to postpone income annuity purchase until a more advanced age and consume non-life-contingent assets in the interim. The findings are that an individual desirous of maximizing retirement income should commence an income annuity at some point and that the optimal time to do so is determinable.

The ages at which such supplemental income needs arise are inconsequential in terms of value derived from income annuities—that is, there are no issue ages that provide a "better" or "worse" deal for the consumer—because income annuities are, at all ages, equivalent to the net premium applied on an expected present value basis. As will be shown, the optimal timing decision depends in large part on the ability of the benefit of survivorship present in the income annuity to overpower any product expense differential between the income annuity product and the alternative withdrawal program product.


[1] Income annuities—also known as immediate annuities—efficiently generate lifetime income from a given sum of money, which forms the premium. Other financial instruments are better at providing liquidity and at wealth transfer. This paper is directed at that portion of an individual's wealth for which the financial objective is maximizing retirement income on an inexhaustible basis (i.e., guaranteed to last a lifetime). This can be achieved where the individual retains investment risks and rewards (variable income annuity) or where the individual transfers investment risks to an insurer (fixed income annuity). Under both forms of income annuity, the individual transfers mortality risks to the insurer, removing concern about spending down retirement assets too slowly or too rapidly—a risk otherwise present in the face of uncertain longevity.

[2] For a comprehensive look at income annuities, see *The Handbook of Variable Income Annuities* by Jeffrey K. Dellinger, John Wiley & Sons, Hoboken, NJ, 2006, 776 pages.

[3] Starting an income annuity too early can result in income generation, taxation, and then the need to reinvest a portion of the proceeds.