Building Policies to Encourage Annuitization in Korean Pension Plans

One of the greatest risks facing retirees is longevity risk i.e., the risk of outliving retirement savings. In corporate pension plans, the way capable of avoiding longevity risk is the annuitization of accumulated savings. Since introducing Korean pension plans in 2005, Korean policy-makers have focused their attention on the expansion of coverage.

However, with increased longevity, the policymakers' focus on enhancing lifetime income is urgently demanding. Many previous studies consider the compulsory annuitization to be an important instrument to prevent poverty in old age. In this study, I suggest key policies for encourage annuitization in Korea as follows:

First, the government should consider adopting the compulsory annuitization with partial lump-sum up to a certain level i.e., 25% or 30%. The remainder must be converted into an income stream at some point after retirement and before the retiree reaches an advanced age. Exception is needed to avoid excess annuity for small savings. Up to the age of compulsory annuitization, the retiree may withdraw income from own account, subject to certain annual limits designed to ensure that the savings do not deplete too quickly. If compulsory annuitization policy is difficult to implement, and then the policy of default annuitization should be considered as the second best. Another alternative is suggested that tax laws should be changed to give incentive for annuitization. Partial lump-sum may be tax-free, but the remainder should be taxed as a normal income.

Secondly, there are many ways of producing an income and one
way (or product) cannot meet all financial needs of retirees. Policymakers should recognize that there is no “one-size-fits-all” option for retirement planning. In reality, there is a full spectrum of retirement income options available that range from maximum flexibility to maximum guaranteed income. Therefore, these solutions could be used in payout options and combination strategies could be more attractive.

Thirdly, Korean government should issue guidance with respect to the payout phase that financial institutions could use model disclosure for retirement income projections. A lifetime stream of income payments should be expressed on the benefit statement.

Fourthly, the transparency of annuitization market is important issue to ensure that individuals get the best price under the compulsory annuitization policy. This paper suggests building centralized information and quotation systems for annuity products to help an individual select an appropriate product at the competitive price.