

What is a life annuity?

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A life annuity is a contract by which a debtor undertakes to pay a periodic sum for the duration of the life of a specified person, in return for a capital sum received. The capital is converted into an income that ceases on the death of the reference person. In the French terminology of the period, that person is the “tête” (life) on which the annuity is constituted. The recipient of the payments, the annuitant, may be the same person or a different one. An investor can thus buy an annuity constituted on the life of a third party, whose lifespan determines the duration of the payments.

For the debtor, the life annuity has an obvious advantage: it does not have to repay the capital, since its obligation expires with the life. For the annuitant, it offers a higher income than a perpetual annuity, since the payments include an element of amortisation of the capital. The level of the rate depends on the expected lifespan of the life: the older the life, the shorter the probable duration of the payments, and the higher the rate must be for the transaction to remain balanced for the annuitant. Conversely, an annuity constituted on a young life ought, by sound actuarial logic, to offer a lower rate.

The life annuity has existed in various forms since antiquity. In the seventeenth and eighteenth centuries it became a common instrument of public finance in Europe. States resorted to it to obtain funds without permanently increasing their debt, since the obligations expired with the lives. The tontine, proposed in the mid-seventeenth century by the Italian banker Lorenzo Tonti, is a variant: subscribers are divided into classes, and the share of those who die accrues to the survivors, until the class is extinguished.¹

Swiss law still recognises the life annuity contract, governed by the Code of Obligations (Art. 516 et seq. CO). It provides in particular that the annuity may be constituted on the life of the creditor, of the debtor or of a third party (Art. 516 para. 1 CO). Life annuity insurance, offered by life

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insurance companies, is today its most widespread form, under the control of insurance supervision.

Key point. A life annuity converts a capital sum into an income paid until the death of a specified person, the “life”. Its rate ought to depend on the life expectancy of that person: the younger and healthier the life, the longer the probable duration of the payments, and the lower the rate ought to be.

1 Notes

1. Wikipedia (en), “Tontine”: Lorenzo de Tonti proposed the mechanism in France in 1653, a scheme rejected by the Parlement de Paris; “The French finally established a state tontine in 1689”; nine further state tontines up to 1759. ↩

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