

# A Survey of Distribution Choices and the Results of an Experiment

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# A Survey of Distribution Choices

# Introduction

- That the market for life annuities is small is a truth universally acknowledged.
- That many pension plan members and IRA holders, if they have a choice as to the form their benefit takes may choose an annuity is not.
- To help remedy this lamentable ignorance, PPI conducted a survey of older workers and retirees. To qualify for the survey, a participant had to be a plan member or an IRA holder.

# Coverage by Plan and the Role of Annuities

- We asked each participant to classify the plan they considered to be their most important as a DB, DC or IRA. If they had more than one plan, they were asked to classify their next most important plan.
- DB plans are more important for retirees than they are for older workers (see Table 1). Nonetheless 1 in 3 workers are members.
- Even more striking is the role of annuities in distributions (see Table 2).

**Table 1: Pension Coverage for Workers and Retirees**  
**(in percentage of group total)**

	Workers (1750)	Retirees (670)
DB plan With or without another plan	33	61
With DC and/or IRA	21	45
By itself	12	16
DC and/or IRA, but no DB plan	67	39

**Table 2: The role of annuities in distributions  
(percentage receiving or expecting an annuity)**

	Workers	Retirees
Any type of annuity	48	74
Life annuity	38	63
Any type of annuity when there is active choice	30	41

# Are annuities popular?

- Many members of DB plans receive an annuity automatically (they have no choice). This helps explain why such a large share of retirees receive an annuity.
- Annuity demand does not depend entirely on a captive audience. Of workers and retirees able to choose, 30 and 41 percent chose some kind of annuity (including regular payments).

# Why more people do not buy annuities

More than half of those participants with a choice avoided annuities. Their main reasons:

- Keeping money for an emergency.
- Lifelong payments not a good value.
- Fear of an early death.
- Other investments offer a higher return.
- A lack of understanding of annuities also contributes.



## Why more people do not buy annuities, 2

- Another way of explaining the lukewarm appeal of annuities is that they are simply not seen as an insurance product.
- No one who has auto insurance expects his or her insurance company to routinely pay more in benefits than it receives in premiums.
- Auto and life insurance are seen as insurance. Not so a life annuity.

# Making annuities more popular

- Encouraging partial annuitization, when the distribution choice has been “all or nothing.”
- Promoting trial annuitization, which addresses the unease entailed by the irrevocability of the annuity decision.
- Promoting in-service annuitization, or the gradual annuitization of contributions to a plan.

## Making annuities more popular, 2

- The survey found some, but not overwhelming support for these innovative alternatives.
- Older workers were more supportive than retirees, perhaps because retirees had made the leap of faith, chosen an annuity, and were happy with it.

# Conclusions

- Annuitization, as such, is more popular than the small size of the insurance market suggests.
- The default setting of the traditional plan may be encouraging members to choose them rather than a lump sum.
- However, some DC plan members would pick annuities instead of the standard option of a lump sum.

## Conclusions, 2

- There is some but not overwhelming interest in innovative alternatives like partial annuitization, and trial and gradual annuitization.
- Annuities remain poorly understood. Many potential annuitants do not see them as insurance products.

# Results from an Experiment

# Recent Policy Proposals

- In 2010, The Department of Labor and the Treasury Department:
  - Explore presenting 401(k) account information as lifetime payments
- In 2012, Treasury Department and Internal Revenue Service:
  - Proposed changes to required minimum distribution rule in 401(k) and IRAs to encourage longevity annuities.

# What is the Impact of These Policies?

- Does changing the default – or framing the choice differently – change decisions about whether to choose an annuity?
- How appealing is a longevity annuity?

Designed our experiment to address these questions....



# Experiment Design

Capture salient features of retirement distribution decision

- ✓ Structured choice to resemble distribution choice in 401(k)s and IRAs
- ✓ Design ran several weeks but exact length is uncertain – mimics retirement length
- ✓ Provided context, relating tasks/stages to working and retirement phases

# Experiment Design

## Earnings Phase:

- Perform computer tasks to earn tokens
  - ❑ Earned tokens reported as lump-sum or amount per period.

## Retirement Phase:

- “Consume” tokens (receive cash) over 4 periods
  - ❑ Each period, 2 weeks apart, up to 8 weeks
  - ❑ Receive cash payment if survive that period

# Participants' Choice

## Treatment 1:

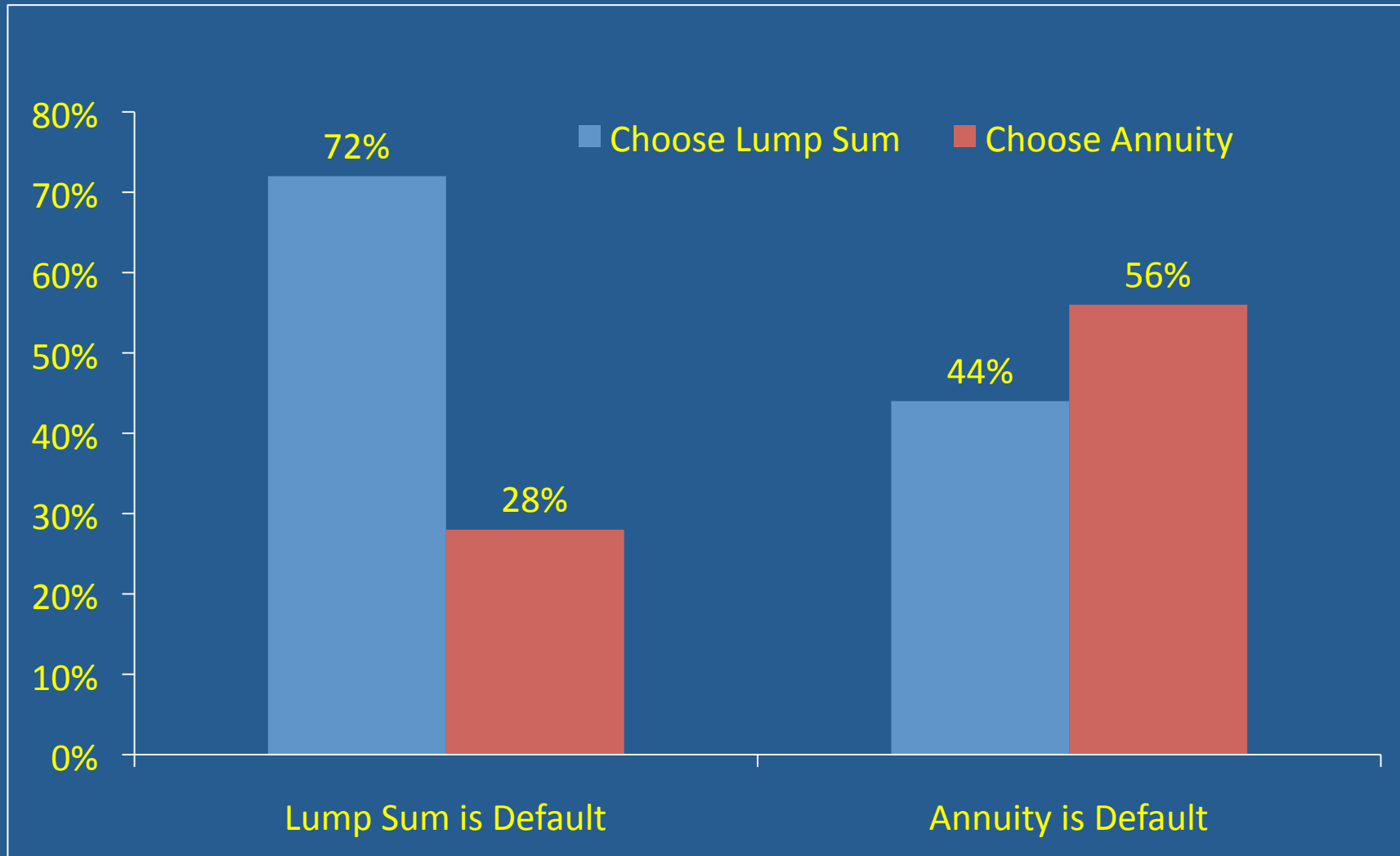
- Presented with lump sum of tokens
- Asked to allocate over 4 periods
- If survive - earned cash
- If not survive – donate to charity or keep a portion of cash
- Then, presented with immediate annuity-like alternative (actuarially fair).
  - ✓ Choose: Lump Sum or Annuity

# Participants' Choice cont'd

## Treatment 2:

- Presented with tokens per period (immediate annuity-like)
- Earned cash only if survive. No cash otherwise
- Then, presented with lump sum alternative (actuarially fair)
- Asked to allocate over 4 periods
- Asked to select charity or self.
  - ✓ Choose: Annuity or Lump Sum

# Switching the Default to Annuity Increases Annuity Take-Up

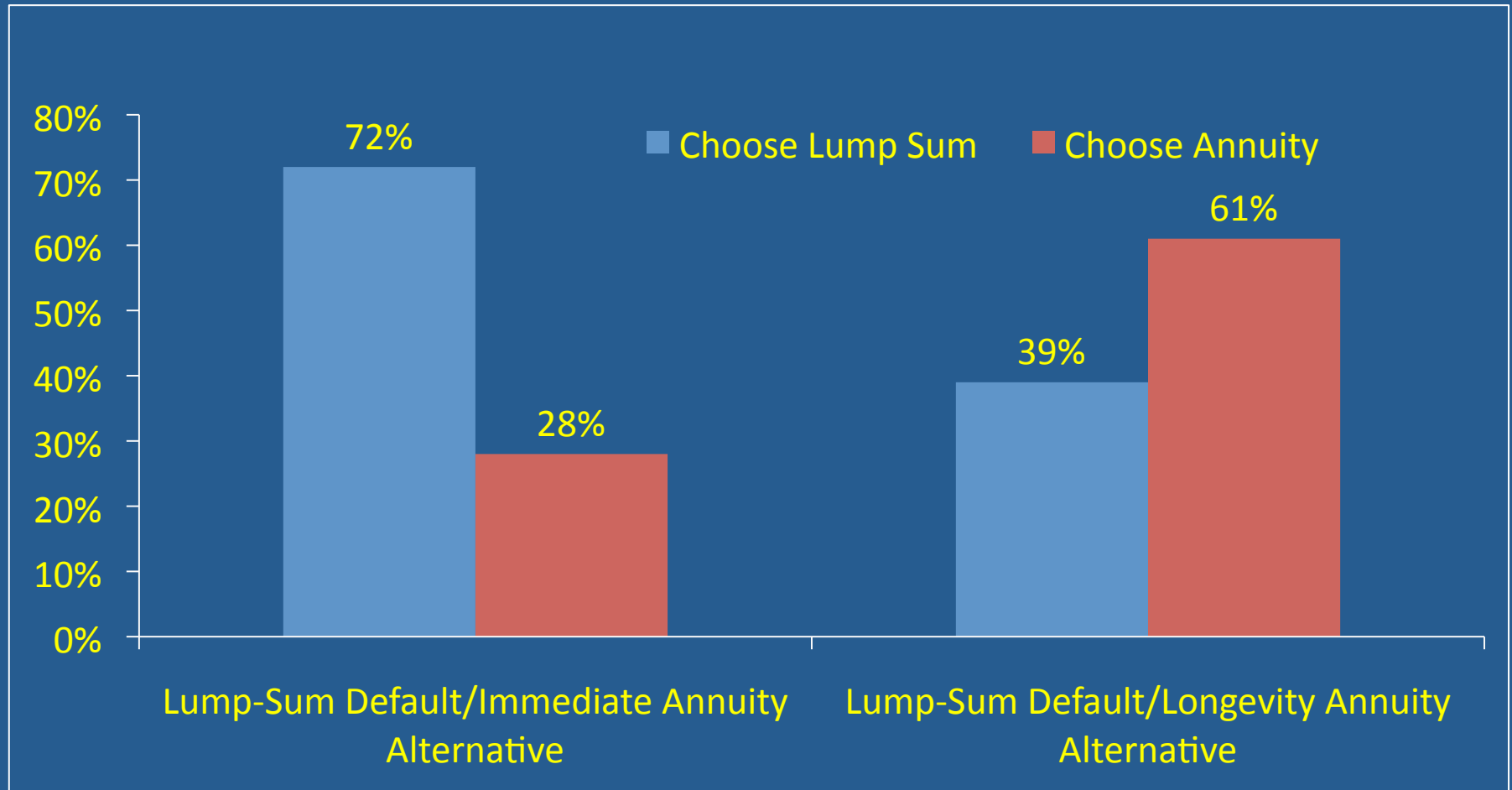


# Participants' Choice with Longevity Annuity

## Treatment 3:

- Starts with lump sum as default
- Then, presented with longevity annuity-like alternative.
- Exchange portion of lump-sum for payments in period 3 and period 4
- Remaining lump sum tokens allocated as they wish
  - ✓ Choose: Lump Sum or Longevity Annuity

# The Longevity Annuity is Even More Popular than the Default



# Conclusion

- Potentially, could improve annuity take-up rates with changes to default setting and encouraging longevity annuity
- Must deal with design issues if through plan sponsors
- Ensure sufficient protections for consumers
- Other consumer concerns – eg: mistrust of insurance companies, pessimistic about survival