TIAA-CREF Institute

Better Lifetime Income Options: How Do We Get There?

From left: Stephanie Bell-Rose, TIAA-CREF Institute; C. Eugene Steuerle, Urban Institute; Susan Reinhard, AARP Public Policy Institute

For decades, the private pension system has focused almost exclusively on saving for retirement. Now, as millions of Americans are poised to retire, attention is turning to how retirees will make their savings last for a lifetime—and there is significant cause for concern.

To explore this issue, the TIAA-CREF Institute, the AARP Public Policy Institute and the Urban Institute sponsored a research symposium on October 10, 2012, in Washington, D.C. The symposium featured original, in-depth research by leading retirement policy experts, and more than 60 Capitol Hill staffers and other stakeholders attended. Among the questions explored:

- What are the income prospects for future generations of retirees?
- What drives some individuals to select lifetime income options and deters others?
- What has been learned about the appeal and value of lifetime income options?
- How can public policies expand the availability and selection of lifetime income options?

Key Findings

Presenters considered how lifetime income options like annuities can help consumers secure retirement income. Consensus emerged on a number of findings, including:

- For large numbers of retirees, Social Security will be their primary source of guaranteed income in retirement.
- Many consumers do not understand the insurance protection annuities provide and would benefit from better information on their investment choices.
- Having annuity options as part of the investment menu allows participants to become financially educated over their working lives to the idea of lifetime income.
- Providing regulatory relief to employers who offer in-plan lifetime income options would encourage more employers to do so.
- Consumers are interested in flexible annuity designs, including longevity insurance, bonus payments and partial annuitization.
- More research is needed to identify which consumers would benefit most from lifetime income options and to better understand women's preferences for these products.
- Improving public policies related to lifetime income options can help consumers choose the one best suited to their needs.

The symposium was held in the Senate HELP Committee hearing room in Washington, D.C. Sponsoring organizations wish to thank Senators Tom Harkin (D) and Mike Enzi (R) for their interest in the issue of lifetime income and assistance with the venue for the meeting.

James Poterba

Presentation Summaries

James Poterba, Mitsui Professor of Economics at the Massachusetts Institute of Technology and a CREF Trustee
Understanding Household Demand for Annuities: A Puzzle?

James Poterba opened the discussion by asking why so few people purchase annuities, even though most economists believe these products are an important source of financial protection in retirement. He then reviewed some possible explanations. Most retirees already receive annuity income through Social Security, and others participate in defined benefit pension plans that provide guaranteed income. Some people want to use their savings to leave a legacy for their heirs, while others prefer to reserve funds for unexpected expenses, such as healthcare costs. And, finally, many people simply don't understand the protection annuities offer; or think annuities are too expensive; or worry that their savings will be wasted if they die prematurely.

Noting that "there are numerous reasons why annuity demand might be limited," Poterba suggests focusing research on consumers who are most likely to find annuities attractive in their spend-down years. He also issued a challenge to regulators, policymakers and industry "to understand better the underlying latent demand for lifetime income products at different income and wealth distribution levels," and to learn through research how to explain the benefits of these products to consumers.

Richard Johnson, Urban Institute
Income Prospects for Coming Generations of Retirees

Richard Johnson compared projected incomes at age 70 for three groups of retirees: "pre-boomers" born between 1931 and 1935, "early boomers" born between 1946 and 1950, and "late boomers" born between 1961 and 1965. He explained that several demographic trends will affect future retirement security: People are living longer; fewer retired women are widows because the gender gap in longevity has shrunk; and retirees as a whole are becoming better educated, more ethnically and racially diverse, and more likely to be childless.

Noting that "how well people do in retirement largely depends on how much they earn during their working years," Johnson observed that rising disability rates for early and late boomer men will cut short their working lives compared to pre-boomers. More able-bodied people, however, are working into their late 60s – particularly women, whose work histories will be substantially longer than those of prior generations. While income levels for many men are stagnating, women are earning substantially more than they once did, though still typically less than their male counterparts. As a result, Johnson expects that about two-thirds of late boomer women will qualify for Social Security benefits based solely on their own earnings (not their husband's), compared with about two-fifths for pre-boomers, thus raising average benefit levels.

Comparing retirement outcomes, Johnson projects that early and late boomers will have higher average incomes in retirement than pre-boomers. However, more than a quarter of early and late boomers will have difficulty maintaining their pre-retirement living standards in old age, and retirees will fall further behind workers. Fully 35% of late-boomers will receive incomes at age 70 that fall below a quarter of the average annual wage, compared with only 11% of pre-boomers. Johnson concluded by emphasizing the importance of the lifetime income provided by Social Security for those with little retirement wealth.

David Richardson, TIAA-CREF Institute
Trends in Annuity Choices by TIAA-CREF Participants

David Richardson discussed how plan design can influence annuity demand and provided data on recent trends. "There is no single annuitization decision," Richardson said. "Instead, people must decide whether, how much, when and how to annuitize their retirement savings." He noted that most TIAA-CREF plan participants tend to answer the first two questions during their working lives, because unlike most 401(k) plans, 403(b) plans offered by TIAA-CREF include fixed annuities as both investments and as payment options.

Richardson reported that in 2010 about 50% of TIAA-CREF plan participants were placing, on average, about 40 cents of every dollar contributed to their retirement savings into the TIAA Traditional annuity. In addition, about 60% of workers covered by the TIAA-CREF system had some assets invested in TIAA Traditional. However, he also noted that these participation rates were lower than in previous years. Some

From left: David Richardson, Eugene Steuerle, Anna Rappaport, Richard Johnson participants, especially women who had once invested in annuities, have turned to target-date funds, which first became available in 2004.

Richardson noted that, in recent years, about 40% of TIAA-CREF participants choose annuity income as part of their first distribution from their retirement assets, with an equal proportion opting to take a required minimum distribution as a first draw. Overall, about three in four retirees have annuity income as part of their distribution strategy, which is a significantly higher annuitization rate than the economy-wide rate of fewer than one in 10 retirees. He also reported that women are almost twice as likely as men to choose a single-life over a joint-life annuity. However, about 80% of both men and women also opt to have a certainty period (where payments continue even in the event of death) as part of their annuity contract.

Richardson concluded that, because of plan design, annuitization is a working-life decision for most TIAA-CREF plan participants, not an at-retirement decision. As a result, annuity income plays a large role in the retirement income plans of these participants.

Anna Rappaport, Anna Rappaport Consulting
Prospects for Future Generations of Retirees: Discussion of Papers and Related Research

Anna Rappaport noted four important policy issues related to lifetime income: understanding and addressing barriers to annuitization, enabling decision-making over time, enhancing availability of good options and effective consumer guidance for the middle market. She suggested that fiduciary liability often deters employers from offering annuities and other longer-term income options, and she endorsed providing safe harbors and otherwise reducing employers' liability exposure to encourage this practice.

Rappaport noted that financial advisers frequently steer consumers away from lifetime income options, and she stressed the importance, as a policy matter and aid to decision-making, of creating a culture supporting lifetime income during people's working years as well as offering a range of options at retirement. Lastly, she suggested that consumers need easy and economical access to good lifetime income products and help in understanding both the value of income guarantees and the trade-offs.

Sandy Mackenzie, AARP Public Policy Institute
AARP study on Older Americans' Ambivalence Toward Annuities

The next group of speakers presented new research on how consumers think about lifetime income options. Sandy Mackenzie reviewed the results of a recent AARP study that included a survey of over 1,700 workers aged 50-75 as well as 670 retirees aged 59-75. All had to be a participant in an employer-sponsored plan or have an individual retirement account. Six in 10 retirees and three in 10 workers participated in a defined benefit plan that could pay them an annuity in retirement.

A surprising result of the survey was the relatively high interest in annuitization among plan participants compared to that typically found in private insurance markets. Mackenzie and his co-author found that 41% of retirees had selected or said they intended to select an annuity instead of a lump sum, as did some 30% of workers. Among those who chose not to take an annuity, common reasons cited were the desire to save money for an emergency, the belief that annuities are not a good value and a fear of not living long enough to benefit from an annuity. Accordingly, Mackenzie observed that many people seem to view annuities as investment products that generate a return instead of insurance products that protect retirement income.

Lastly, the survey probed people's reaction to several policy proposals designed to make lifetime income options more appealing, including partial annuities, trial annuities and gradual annuitization. Respondents expressed moderate enthusiasm for these proposals, with workers more favorable than retirees.

From left: Lina Walker, Eugene Steuerle, Stephen Zeldes, Sandy Mackenzie, David John

Lina Walker, AARP Public Policy Institute
Results of an Experiment

Lina Walker showed that offering immediate annuities as a default distribution option or providing longevity annuities in 401(k) plans could increase annuity take-up rates. Walker and her co-authors conducted a series of experiments to test ways of boosting demand for annuities. They found that when participants were offered a lump sum as the default option with a life annuity as the alternative, 72% chose the lump sum and 28% picked the annuity. When the choices were reversed, 56% chose the annuity. The researchers also tested the appeal of longevity annuities that begin payments at older ages. When participants were offered a longevity annuity instead of an immediate annuity as the default, 61% selected the annuity.

Walker concluded that such experiments can help retirement plan providers broaden the popularity of annuities. She cautioned, however, that since the goal is to increase the welfare of retirees, a key policy challenge is to identify which groups would benefit most from lifetime income options.

Stephen Zeldes, Benjamin M. Rosen Professor of Economics and Finance at Columbia University and a TIAA-CREF Institute Fellow
What Makes Annuitization More Appealing?

Stephen Zeldes presented new research based on two internet surveys of Americans aged 50 to 75. The first survey was done in 2011 with 1,000 participants who were asked to imagine they were about to retire from a company that would provide pension payments for the rest of their lives. The second survey was conducted in 2012 with roughly 4,000 participants who were asked to imagine they had accumulated $500,000 in retirement savings and were given the choice of taking payment in either a lump sum or an annuity. Using these hypothetical scenarios, Zeldes and his co-researchers tested various payment options to gauge participant preferences.

They found that the major obstacles to choosing an annuity were participants' fears of losing control over their savings as well as worries that the annuity provider would fail. Allowing partial annuitization (rather than just an "all-or-nothing" choice) increased annuitization rates. The vast majority of individuals preferred a payout stream that was flat or rising in real terms rather than one that declined over time (with the same expected present value). Also, a majority preferred to receive an extra "bonus" payment in a month of their choosing (funded by lower payments in the other months). A key finding was that changing framing, i.e., how the payout choice is presented, can matter. Highlighting the loss of flexibility and control reduced annuitization take-up rates, as did describing annuities as an investment option, rather than as an insurance policy. The authors also found that explaining and highlighting the effects of inflation substantially increased the demand for cost-of-living adjustments in lifetime income streams.

David John, The Heritage Foundation
Annuities Need To Be Rebranded

During a discussion of this research, David John observed that annuities need to be rebranded and their design made more flexible to attract consumer interest. He wondered whether increased demand for lifetime income options reflected the post-2008 economic downturn, which left many people with a smaller appetite for risk. He also noted that concerns about insurance company failures reflected a need to review state guarantee systems.

In terms of policy proposals, John supports giving plan participants information about how their savings balances would translate into annuity income, and he suggests also adding information about Social Security benefits. He is interested in creating plan default choices that provide lifetime income options, which could include longevity insurance, and endorses the goal of providing some relief from fiduciary liability to employers who offer lifetime income options.

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