



TIAA-CREF institute



Better Lifetime Income Options for Retirement Security: How Do We Get There?

Presentation Summaries

Opening Remarks

“Explaining Household Demand for Annuities”

James Poterba, Mitsui Professor of Economics, MIT, TIAA-CREF Fellow and CREF Trustee

Many of the theoretical models that economists and others use to study financial behavior over the lifecycle suggest a potentially important role for annuity products at advanced ages. Yet the private annuity markets in most developed nations are relatively small. Can this observation be reconciled with theory? This overview presentation will discuss a variety of explanations, such as bequest motives, precautionary demand for liquid wealth at advanced ages, and adverse selection in the pool of voluntary annuity buyers, that may help to reconcile theory with the empirical findings.

Panel I: Prospects for Future Generation of Retirees: Looking at Alternative Options

“Trends in Retirement Income Distribution Choices by TIAA-CREF Participants: 2006 – 2011”

David Richardson, Senior Economist, TIAA-CREF Institute

Unlike most 401(k) plans, many 403(b) plans include annuities as both an investment option during working life and as a distribution option during retirement. Our research examines recent trends by individuals covered by the TIAA-CREF 403(b) plan system. Examining contribution and asset allocations by workers, we find that for the majority of participants the decision to annuitize a portion of their retirement wealth is a working life, as opposed to an "at retirement" decision. As a result, annuity income has a substantially larger role in the retirement income plans of TIAA-CREF participants when compared to 401(k) participants. Examining the retirement income choices of TIAA-CREF participants, we find that while the proportion of participants choosing annuity income as a first draw has declined over time, the majority of all TIAA-CREF retirees taking distributions include annuity income as part of their retirement income plans.

“Income Prospects for Coming Generations of Retirees”

Richard Johnson, Senior Fellow, Director of the Program on Retirement Policy, the Urban Institute

The lackluster economy, eroding traditional pensions, and volatile stock market suggest that baby boomers - those born between 1945 and 1965 - face increasingly uncertain retirements. Our projections show that lower - and moderate-income boomers will continue to rely on Social Security for most of their retirement income. While the projections reflect some good news - women will reap the rewards of working and earning more than previous generations - they also raise alarms. Between 30 and 40 percent of boomers will not have enough income at age 70 to replace 75 percent of their preretirement earnings, a common standard for measuring retirement income adequacy.

Panel II: Preserving Lifetime Income: Considering Annuities

“Valuing the Value of Annuities: Perception and Behavior”

Sandy Mackenzie, Senior Strategic Policy Adviser, and Lina Walker, Director, Health Team, AARP Public Policy Institute

What obstacles prevent individuals from appreciating the value of annuities and what policy interventions might circumvent these obstacles? This presentation will report the results from a survey of older workers and a behavioral experiment designed to systematically assess these questions. The survey sought both to gauge the popularity of life annuities and other distributional forms and to shed light on why the survey participants made the choices they did. The experiment focuses on two policy proposals aimed at increasing the attractiveness of annuities for individuals approaching retirement. First, it investigates the extent to which changing the default payout option from a lump-sum to an annuity in individually-managed retirement accounts may increase annuitization rates. Second, it evaluates the relative attractiveness of longevity annuities (also known as longevity insurance or deferred annuities) as an alternative distribution option to immediate annuities in individually-managed retirement accounts. The experiment captures the salient features of the retiree’s annuity decision in the real world using working-aged individuals.

“What Makes Annuitization More Appealing?”

Stephen Zeldes, Benjamin M. Rosen Professor of Economics and Finance, Columbia University

We conduct and analyze two large surveys of hypothetical annuitization choices. We find that allowing individuals to annuitize a fraction of their wealth increases annuitization relative to a situation where annuitization is an “all or nothing” decision. Very few respondents choose declining real income paths over flat or increasing real payout streams of equivalent expected present value, and highlighting the effects of inflation increases demand for cost of living adjustments. Frames that focus on flexibility, control, and investment risk significantly reduce annuitization. A majority of respondents prefer to receive an extra “bonus” payment during one month of the year that is funded by slightly lower payments in the remaining months. Ensuring later-life income, spending flexibility, and counterparty risk are the most important self-reported motives driving the annuitization decision. We discuss the implications of our findings for product design, choice architecture, and public policy.