Diversifying income in retirement

Building a plan from multiple sources can help reduce retirement risks and address employee needs

We all know the importance of diversification when saving to help address market downturns and low interest rates. At retirement, this is also necessary to help overcome the risk that comes with longer life expectancies—running out of money. That's where annuities come in. Beyond Social Security, they're the only way for employees to receive income for life.

Steady income for everyday expenses	**Social Security** (and pension if available) The amount depends on employees' career earnings and retirement age
	Fixed annuities Guaranteed monthly income protected from market downturns[1]
Variable income for additional expenses	**Variable annuities** Guaranteed payments that vary with market performance to provide growth potential and help protect against inflation[2]
	Other investments Mutual funds, brokerage accounts, etc., offer liquidity but are also affected by market volatility and length of retirement

Income for life — Could run out

20%

more retirement income is possible by including lifetime income from both fixed and variable annuities, according to Morningstar, an independent research firm.[3]

Addressing the four key retirement risks

	Fixed Annuities	Variable Annuities	Investment portfolio
Longevity protection	✓	✓	
Market volatility	✓		
Inflation		✓	✓
Cognitive decline	✓	✓	

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[1] Any guarantees under annuities issued by TIAA are subject to TIAA's claims-paying ability.

[2] A variable annuity is an insurance contract and includes underlying investments whose value is tied to market performance. When markets are up, you can capture the gains, but you may also experience losses when markets are down. When you retire, you can choose to receive income for life and/or other income options. There are risks associated with investing in securities including possible loss of principal.

[3] Morningstar, "The Benefit of Diversified Income for Retirees: Combining Fixed and Variable Annuities," November 2019

- The potential benefits of developing a retirement income strategy considering both immediate fixed annuities (IFA) and immediate variable annuities (IVA) using a stochastic utility model using a Monte Carlo approach combined with a scenario framework.
- Households that should consider annuitization are generally those with conservative portfolios, lower levels of existing guaranteed income (i.e., Social Security benefits), higher initial withdrawal rates, higher subjective life expectancies, higher levels of shortfall risk aversion, and lower liquidity preferences.
- Certainty-equivalent" retirement income increases by 20%, on average, when incorporating annuities, although the gains differ significantly across households.
- Withdrawals are always assumed to take place at the beginning of the year. Taxes are ignored for the analysis.
- The discount rate for the IFA pricing calculation is constant and assumed to be 5%.
- The discount rate for the IVA pricing calculation is also constant for the pricing calculation and is based on the assumed interest rate (AIR) of 4%
- The pricing model for the analysis intended to target the average annuity payout, not the best possible payout available.
- For each of the 22 variables we allow for a low, moderate, and high values. Examples of the variables included were retirement age, portfolio equity allocation. Social Security retirement benefits, etc.
- With 31 billion different potential combinations across these 22 different assumptions, the authors ran 10,000 different scenarios generated from the three values randomly selected for each variable.
- The annuity allocation is assumed to never exceed 50% of the portfolio.
- Every retiree household is different. The greater the range of potential products and solutions a financial advisor has available to recommend to the household the better the retirement income strategy is likely to be. In this paper we explore the potential benefits associated with using immediate fixed annuities (IFAs) and immediate variable annuities (IVAs), with a particular focus on when each is the best fit.
- The analysis suggests there is considerable benefit to not only incorporating additional guaranteed income into retirement income strategies (consistent with past research), but also in helping retirees determine which form of guaranteed income is optimal. While many financial advisors often talk about the benefits of diversification from a portfolio perspective, the same concepts also apply to retirement income products.

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