Role of Annuities in Providing Retirement Income

Lifelong Financial Security
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*The views presented reflect the conclusions of the author and do not necessarily reflect the views of the Investment Company Institute or its members.
What Are the Issues?

- **Adequacy versus asset allocation**
  - Annuitization is an asset allocation decision

- **Needs: income versus contingency**
  - Annuities provide an income stream

- **Market risk versus longevity risk**
  - Pooling of assets protects against longevity

- **Current retirees versus future retirees**
  - Are current retirees under annuitized?
  - Or is it a concern about future retirees without DB income?
Needs and Risks in Developing a Retirement Income Plan

- Needs
  - Income
  - Contingency
  - Bequest

- Risks
  - Health risk
  - Longevity risk
  - Inflation risk
  - Market risk
  - Asset allocation risk
  - Counterparty risk

- Distribution access
  - In plan
  - Out of plan (IRA; Taxable Account)

- Products and services (Advisers; Direct)

- Timing
  - Pre-/At/Post-Rollover
  - Immediate/Deferred Income
<table>
<thead>
<tr>
<th><strong>Pros and Cons of 100% Equity vs. 100% Inflation-Indexed Immediate Annuity</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Inflation Indexed Life Annuity</strong></td>
</tr>
<tr>
<td>+ Predictable payments</td>
</tr>
<tr>
<td>+ No market risk</td>
</tr>
<tr>
<td>+ No longevity risk (inclusive of inflation risk)</td>
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<tr>
<td>- Unpredictable payments</td>
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<tr>
<td>- Market returns fluctuate</td>
</tr>
<tr>
<td>- Could run out of money</td>
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<td>- Insurance company bankruptcy risk</td>
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</tbody>
</table>

**Higher Returns**
- + Higher average returns
- + Access to assets (precautionary saving)
- + Possibility of bequest

**Lower Risk**
- + Predictable payments
- + No market risk
- + No longevity risk (inclusive of inflation risk)

**Market Risk**
Various Options for Retirement Income

<table>
<thead>
<tr>
<th>Longevity Risk</th>
<th>Market Risk</th>
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</thead>
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<tr>
<td>Ladder TIPS portfolio or Annuity with fixed payout period</td>
<td>Portfolio with mix of assets or Variable annuity with fixed payout period</td>
</tr>
<tr>
<td>Combination TIPS and annuity or Annuity with guaranteed payout or death benefits</td>
<td>Various combinations of investments and annuities or Variable annuity with guaranteed payouts</td>
</tr>
<tr>
<td>Nominal annuity</td>
<td>Pure variable annuity using portfolio with mix of asset classes</td>
</tr>
<tr>
<td>Inflation-indexed annuity</td>
<td>Pure variable annuity using stock portfolio</td>
</tr>
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<td>Stock portfolio or Variable annuity with fixed payout period</td>
<td>Combination stocks and variable annuity or Variable annuity with guaranteed payout or death benefits</td>
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Many Households Already Hold Most Lifetime Wealth in Annuity Equivalent Form

Percentage of wealth by wealth quintile for households with at least one member born between 1948 and 1953; Balance sheet in 2006

- **Bottom**
  - Other: 3%
  - DC pension + IRA: 3%
  - DB pension: 8%
  - Net housing wealth: 8%
  - Social Security: 93%

- **Second**
  - Other: 8%
  - DC pension + IRA: 8%
  - DB pension: 18%
  - Net housing wealth: 8%
  - Social Security: 58%

- **Third**
  - Other: 11%
  - DC pension + IRA: 11%
  - DB pension: 22%
  - Net housing wealth: 14%
  - Social Security: 41%

- **Fourth**
  - Other: 15%
  - DC pension + IRA: 15%
  - DB pension: 19%
  - Net housing wealth: 23%
  - Social Security: 28%

- **Top**
  - Other: 31%
  - DC pension + IRA: 18%
  - DB pension: 15%
  - Net housing wealth: 15%
  - Social Security: 14%

Note: Households with top and bottom 1 percent of wealth were excluded.

Source: ICI Tabulation Derived from Gustman, Steinmeier, and Tabatabai (2009) Using Health and Retirement Study (HRS) Data
The Golden Age of Pensions?
Percentage of Private-Sector Workers Whose Employer Sponsors a Pension* Plan

Percentage of private-sector wage and salary workers, age 21 to 64, 1979 to 2007

* Pension plans include both defined benefit and defined contribution pension plans. Source: ICI tabulations of March Current Population Survey
Percentage of Individuals Receiving Private Pension* Income and Median Amount

Among individuals age 65 and older with non-zero income and not working, 1975 to 2007

* Includes payments from both defined benefit and defined contribution pension plans. Source: ICI tabulations of March Current Population Survey