RETIREMENT INCOME INSTITUTE
Alliance for Lifetime Income

Who Should Read This Insight:
Researchers, annuity plan providers.

Institute Research Agenda Topic:
On-point annuities and protected lifetime income topics.

Definitions of **bolded key terms** are at the end of this article.

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Authors, Titles and Publication Dates of the Articles Addressed in the Insight
Bonnie-Jeanne MacDonald, Bruce Jones, Richard J. Morrison, Robert L. Brown, and Mary Hardy. 2013. "Research and Reality: A Literature Review on Drawing Down Retirement Financial Savings." Sponsored by Society of Actuaries, Pension Section. https://www.soa.org/globalassets/assets/files/research/projects/research-literature-review-report.pdf. Final version published in North American Actuarial Journal, 17(3), 181–215. https://www.tandfonline.com/doi/abs/10.1080/10920277.2013.821938
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Insight: IMPROVING RESEARCH METHODS TO PRODUCE BETTER FINANCIAL ADVICE FOR CONSUMERS

IDEAS IN THE INSIGHT YOU CAN PUT INTO ACTION

If researchers were to design improved economic models, those models might lead to better advice from financial professionals and to improved financial products from annuity providers. And if annuity plan providers were aware of the weaknesses in research models, they could mitigate those weaknesses by improving their recommendations to clients.

PRINCIPAL INSIGHTS

From 1999 to 2011 more than 100 studies examined the retirement savings drawdown behaviors of American and Canadian **retirees**, and proposed ways that they could and should use their savings to finance their retirements. Most of these studies analyze the trade-offs between two strategies: **annuitization** and self-managed drawdown. Both these strategies work toward managing the rate at which a retiree withdraws their savings to support their standard of living until the end of their lives. MacDonald, Jones, Morrison, Brown, and Hardy's article was written to shed light on the **annuity puzzle**, or the fact that so few people choose to **annuitize** even a portion of their accumulated savings. This behavior is puzzling to economists, who know that annuitizing retirement income will prevent retirees from depleting their savings prematurely.

The authors' review of the research suggests three methodological weaknesses among the studies: The first is that the research has examined only a limited range of self-managed drawdown strategies. The second is that almost all of the studies exclude other assets such as homes, pensions, and government transfers when assessing different strategies. And the third weakness is that most of the research ignores the well-accepted disparity between the annuitization decisions that retirees actually make and the decisions that economic models predict they will make. The authors propose that future studies should address these three weaknesses to help solve the annuity puzzle. Moreover, if future research were to use improved methods it might lead to advice from financial professionals that would better meet the needs of retirees. Future research could also lead to annuity providers developing improved financial products that can better meet the needs of retirees.

A comprehensive retirement planning strategy includes thinking about two aspects of retirement savings: how to accumulate and how to spend. That is, sound decisions about accumulating retirement income can be wiped out by a poorly chosen withdrawal strategy during retirement. Few retirees today choose to annuitize their retirement savings; reasons they offer for making that choice include their desire to bequeath savings to family members, and their confidence in personal financial abilities to manage drawing down their own funds when needed.

MacDonald et al.'s article states that retirees can draw down their savings by choosing one of three basic strategies. First, retirees can purchase an **annuity**, thus converting their savings, or more usually part of their savings, into a guaranteed income stream. Second, retirees could self-manage their assets, making all necessary decisions about how much and when they will withdraw from their savings. This approach keeps the control of retirement savings with the individual retiree, which can provide flexibility for unplanned expenses such as medical costs. But self-managing also poses the risk of an individual consuming too much in earlier years and then needing to reduce their savings consumption, and possibly even their standard of living, in later years. And third, retirees could pursue a hybrid strategy that combines purchasing an annuity with managing their own retirement savings. Although the hybrid approach retains the risks associated with annuitization and self-managing savings, the severity of those risks can be somewhat offset if retirees diversify their investments between the two strategies: annuitization and self-management.

Existing research also suggests that retirees should consider numerous factors when deciding when and how to draw down their retirement savings, including the individual- and employment-related income sources, government rules and regulations, tax implications, household budgeting, the **bequest motive**, attitude toward risk related to both investment and drawdown strategies, longevity expectations, anticipated medical and long-term-care expenses, and changes in marital status.

Given the change from employer-provided pension plans, which typically provided an annuity to individual retirement savings accounts where the retiree is responsible for making the drawdown decisions, it becomes even more important to apply evidence-based recommendations to policy decisions and financial advice. Therefore, future research should use modeling that is more exact to strengthen the evidence-based results for use by policymakers and financial professionals.

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1. Studies should include all retirement income sources comprehensively.
2. The methods should include the accumulation phase of retirement savings because accumulation affects the portfolio status at the point of retirement.
3. Research should examine a wider range of drawdown strategies.
4. Studies should attempt to bridge the gap between and among academia, industry, and the individual investor. For example, changing retirees' perspective that retirement savings is a continuing investment rather than a source of consumption means that annuity providers should encourage their clients to view savings differently. But annuity providers may shy away from this approach because it depresses demand for their other financial products not linked to life expectancy.
5. The final improvement would be for researchers to conduct surveys of current retirees in order to understand their motivations when and how they draw down their savings. Individual preferences identified through the survey data could be used to improve the economic models in explaining how individuals value annuities and how retirees can apply strategies to self-manage the withdrawals from their retirement savings.

To learn more, visit the Retirement Income Institute at
https://www.protectedincome.org/retirement-income-institute/

KEY TERMS ARE INDICATED AT FIRST USE WITH BOLD FONT.

annuitization: *The process of converting an investment into a series of periodic income payments by buying an annuity or beginning an income flow from an annuity.*

annuitize: *When you turn your current account balance into a series of periodic income payments, either for a specific period of time or for your whole life.*

annuity: *A financial product that can offer protected lifetime income and even potentially grow your money.*

annuity puzzle: *The annuity puzzle refers to the fact that few people choose to annuitize even a portion of their accumulated savings even though they have many good and rational reasons to do so.*

bequest motive: *A bequest motive is an owner's desire to give assets such as stocks, annuities, bonds, jewelry, and cash to individuals or organizations, through the provisions of a will or an estate plan.*

retiree: *Someone who has retired, regardless of age or investments.*