

LICENSE TO SPEND: WITHDRAWAL BEHAVIORS WITH AND WITHOUT EXPLICIT LONGEVITY PROTECTION

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Depleting savings in retirement is often worrisome given idiosyncratic longevity risk and uncertain market returns. Allocating savings to a strategy that provides some type of longevity protection, such as an annuity, can increase the comfort of accessing retirement savings, thereby increase spending in retirement. Recent research by Blanchett and Finke (2024)¹ demonstrates that retirees who have a higher share of their overall wealth in assets that provide guaranteed lifetime income spend more in retirement, making them more able to achieve their lifestyle goals.

This research explores withdrawal activity from a data set of 44,344 annuities sold from January 2018 to February 2021 where annuitants have a choice whether to include a living benefit with the policy. Unlike traditional annuitization requiring an irrevocable election, such as purchasing a single premium immediate annuity (SPIA), a living benefit overlays an account balance (typically within an annuity); for an additional fee, a minimum income benefit is guaranteed even if the account balance is completely depleted assuming certain provisions are met.

Annuities that have a living benefit have significantly more withdrawals, especially at older ages and among those with higher initial purchase balances. When focusing on nonqualified accounts, which are not subject to requirement minimum distributions (RMDs), annuitants who are approximately 65 years old were twice as likely to take a withdrawal within three years

following purchase when they have a living benefit and those who were approximately 80 were six times as likely. On an absolute basis, the probability of taking a withdrawal from a nonqualified annuity with a living benefit within three years of purchase is approximately 20% and 40% at ages 65 and 80, respectively, while the probability of withdrawal is only around 10% and 7%, respectively, when there is no living benefit.

While it's unknown whether the annuity withdrawals are ultimately spent by the retiree,² the evidence strongly suggests that retirees are more comfortable accessing savings that offer some type of explicit longevity protection. These findings are consistent with Blanchett and Finke (2024), among others, and have important implications for stakeholders interested in ensuring retirees who diligently save for retirement are ultimately comfortable accessing those savings.

1. https://www.protectedincome.org/wp-content/uploads/2024/06/RP-28_BlanchettFinke_v2.pdf

2. Although monies not withdrawn are definitely not spent!

RETIREMENT SPENDING IN A WORLD OF UNCERTAINTY

Retirees in the defined contribution era often retire with a lump sum of assets. These assets can either be used to fund spending or a legacy. Deciding how much to spend each year is inherently difficult because the retiree does not know how long they will live or what the future returns on their investments will be. Unknown longevity presents a tradeoff in which a retiree can either spend generously and risk either outliving savings or significantly reducing spending later in life, or spending conservatively to minimize the risk of a shortfall.

Spending less is the rational response of a risk-averse retiree to accepting the possibility of outliving their savings. The effect is analogous to an executive who must maintain a large position in a single stock. Their expected welfare is lower than an investor who can hold a well-diversified portfolio because the executive faces greater portfolio volatility with no increase in expected return. Likewise, the transfer of longevity risk to an institution allows the retiree, on average, to live better by spending more each year than a retiree who fails to transfer this risk (Mitchell, Poterba, Warshawsky and Brown, 1999). The annuitized retiree, whether through an income annuity or pension, has the same expected lifetime wealth (with an actuarially fair annuity) as a non-annuitized retiree, but a higher expected welfare from spending more while alive (and avoiding the possibility of either a higher (or lower) than optimal bequest).

Prior research suggests that defined contribution retirees have difficulty spending down their assets. For example, only 34% of 65–74 year-old households spent more than their income in 2017 (Ebrahimi, 2019), and this percentage has been declining since 2011. The 2023 EBRI Retirement Confidence notes that most retirees (49%) plan on maintaining their current level assets while relatively few (7%) plan on spending down assets. These findings are relatively consistent with research by the Society of Actuaries (2020), which noted only 18% of retirees planned to spend down financial assets in retirement. Failing to spend down savings by living only off the income produced by savings is an extreme response to longevity risk among loss-averse retirees who feel an emotional resistance to seeing their nest egg shrink, despite developing the nest egg for the purpose of funding a lifestyle in retirement.

Most research on the benefits of annuities is based on the economic efficiency of pooling longevity risk. There may be additional behavioral benefits from increasing a retiree's share of wealth allocated to guaranteed income. One explanation for lower than optimal spending is the general dislike of spending down wealth during retirement.

Retirees who are behaviorally resistant to spending down savings may better achieve their lifestyle goals by increasing the share of wealth allocated to annuitized income. This could take the form of delaying claiming Social Security retirement benefits, choosing a job with an employer pension or purchasing an income annuity. Annuities can not only reduce the risk of an unknown lifespan, it can also allow retirees to spend their savings without the discomfort generated by seeing one's nest egg get smaller.

Despite decades of research on the potential benefits on the potential value of annuities, few retirees buy them, although sales have increased dramatically recently, given the rise in interest rates. The widespread failure to annuitize despite clear theoretical benefits is referred to by economists as the annuity puzzle (Benartzi, Previtro and Thaler, 2011).

Blanchett and Finke (2024) explore how the composition of wealth is related to spending in retirement using data from the Health and Retirement Study (HRS); they find strong evidence that households that hold more of their wealth in assets that provide guaranteed income spend significantly more each year than retirees who hold a greater share of their wealth in investments. By holding household wealth constant, they show that households are spending more not because they are wealthier (since financial assets can be converted to guaranteed income through things like delaying claiming Social Security retirement benefits or purchasing an annuity), but because their assets allay the need to spend down their nest egg.

DATASET

Data for the analysis is obtained from Prudential Financial and includes a subset of annuity policies sold that give the annuitant the option whether to include a living benefit with the policy. The living benefit varies, but is typically some type of guarantee minimum withdrawal benefit (GLWB) that provides a guaranteed

Exhibit 1: Demographic Data

Qualified?	Living Benefit?	Count	Median Age	Median Premium	% Male
Yes	Yes	31,336	61	\$101,734	48.24%
Yes	No	2,019	59	\$47,433	49.88%
Yes	Yes	8,868	63	\$100,000	45.22%
Yes	No	2,121	69	\$95,924	49.03%
	Total	44,344			

income benefit should the account become depleted during the annuitant’s lifetime, assuming certain provisions are met. There is data on 44,344 policies available spanning January 2018 to February 2021.

For each policy the date of purchase is known, as are the age of the annuitant at purchase, the initial premium, the annuitant’s gender, whether the annuity was purchased in a qualified account, whether a living benefit is selected, and future withdrawals from the account. There are a total of 197,457 withdrawals available.

As demonstrated, distinguishing whether the account is qualified or nonqualified is especially important when exploring intent regarding withdrawals. Qualified accounts are generally subject to required minimum distributions (RMDs) which are an involuntary form of distribution. While originally commencing at age 70 and half, the RMD age recently increased to age 73 as required by the SECURE Act 2.0 and will eventually increase to age 75 by 2033. While withdrawal activity is reported separately for qualified and nonqualified accounts, the primary focus is on nonqualified accounts because these accounts do not have the same type of involuntary withdrawal requirements as qualified accounts.

Exhibit 1 provides some basic demographic information on the data.

Roughly 75% of annuities are in qualified accounts and approximately 90% of annuities include some kind of living benefit rider. The median ages and medium premiums also vary, and we control for these differences in our analysis. The gender representation is relatively consistent across the four groups.

PROBABILITY OF ACCESS

First, we explore the probability of the annuitant taking a withdrawal from the account in either the first calendar or the third calendar year after purchase. These are mutually exclusive periods intended to reflect how savings behaviors evolve over time.

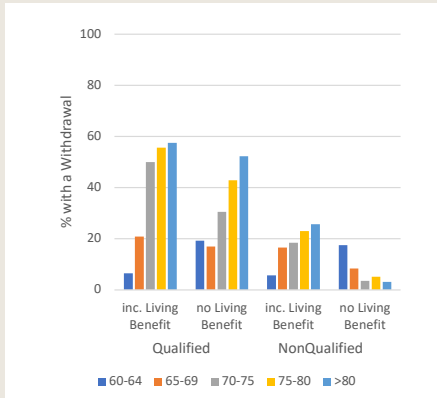
Notable differences exist in terms of account access across a variety of demographic and product attributes. For example, the following exhibit illustrates the percentage of annuitants who took a withdrawal or distribution from the policy either in the first calendar year (Panel A) or third calendar year (Panel B) following the purchase of the policy, which are grouped by age, whether or not the policy was purchased in a qualified account, and whether it included a living benefit.

The probability of a withdrawal generally increases further from purchase (i.e., in third year versus first year), at older ages, from qualified accounts, and when there is a living benefit present. Note, these effects vary, including the probability of a withdrawal actually declines by age for purchases in nonqualified accounts without a living benefit.

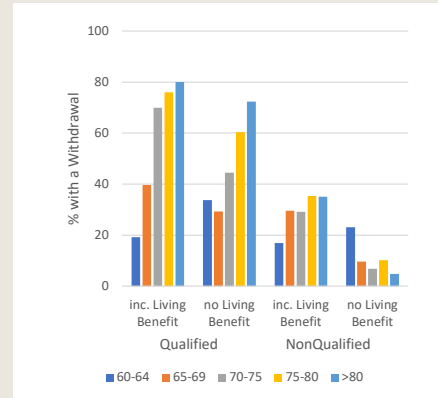
The difference between the withdrawal decisions in qualified and nonqualified accounts can likely largely be attributed to the required minimum distributions (RMDs) for qualified accounts. This complicates the ability to understand withdrawal intent because distributions are effectively involuntary.

If the focus is on nonqualified accounts, the differences in the probability of a withdrawal is approximately twice as high for those annuities with a living benefit when the annuitant purchase age is approximately 65

Exhibit 2: Percentage of Annuitants Taking a Withdrawal

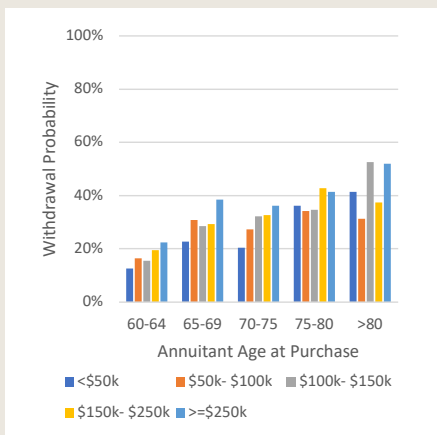


PANEL A:
FIRST CALENDAR YEAR AFTER PURCHASE

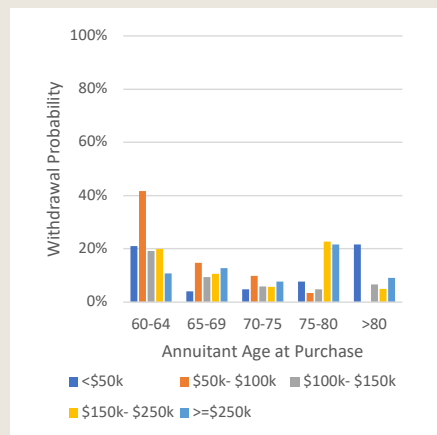


PANEL B:
THREE CALENDAR YEARS AFTER PURCHASE

Exhibit 3: Probability of Withdrawal by Purchase Age and Initial Premium in Three Years After Purchase for Nonqualified Accounts



PANEL A:
WITH LIVING BENEFIT



PANEL B:
WITHOUT A LIVING BENEFIT

and approximately eight times as high among those with a living benefit when the annuitant purchase age is approximately 80, as noted in Exhibit 3. Appendix 1 includes a comparison of withdrawals in qualified accounts (which are subject to RMDs).

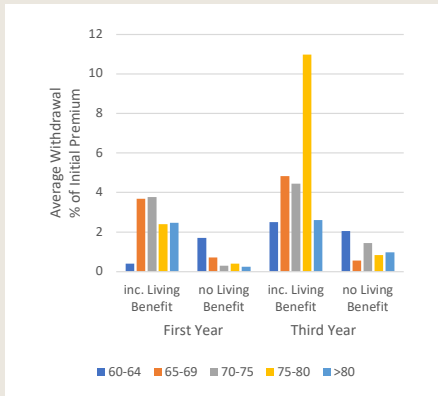
There is also evidence that a balance (or premium) is at play, especially for those with annuities, whereby those with higher balances are more likely to take a withdrawal if the annuity has a living benefit. To some extent, the opposite effect for annuitants without a living benefit.

ANNUITY WITHDRAWAL RATES

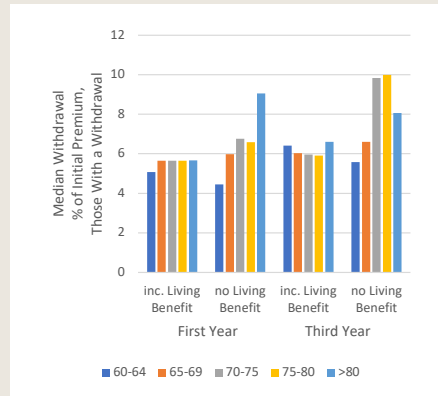
Next, context is provided on how the withdrawal percentage varies in the presence of a living benefit. For this analysis, the focus is on withdrawal rates, defined as the total withdrawals divided by the initial premium, either the first or third year following purchase.

Exhibit 4 illustrates the withdrawal percentage, based on the initial premium, for nonqualified accounts based on either all policies in the dataset (Panel A) based on the age at purchase, status of a living benefit,

Exhibit 4: Withdrawal Rates from Nonqualified Accounts



PANEL A:
FIRST CALENDAR YEAR AFTER PURCHASE



PANEL B:
THREE CALENDAR YEARS AFTER PURCHASE

and year of analysis, as well as the median withdrawal rate among those annuitants taking a withdrawal (Panel B).

The overall withdrawal rates for those contracts without a living benefit are notably lower than those with a living benefit (Panel A); however, this is expected given the varied overall levels of annuitants taking withdrawals noted in the previous exhibit. Of note, however, is that the median withdrawal rates are not materially different regardless of whether the annuity included a living benefit (Panel B). In other words, living benefits appeared to result in a higher probability of taking a withdrawal, but not necessarily a higher withdrawal rate among those annuitants who take a withdrawal.

No difference is evident in withdrawal rates by initial premium and purchase age levels within the nonqualified accounts, although the sample is admittedly small for certain groups given the relatively low probability of a withdrawal in retirement.

CONCLUSIONS

Taking withdrawals is the first step in spending one’s retirement savings. (You can’t spend what you don’t withdraw, after all.)

Determining the appropriate withdrawal amount from a portfolio during retirement requires an incredibly complex series of calculations that most retirees are likely unable to preform without help. Even those retirees who do have a sense of how much to withdraw

from their portfolio (e.g., 4% of the balance at age 65), may be afraid to do so given the significant number of uncertainties and idiosyncratic risks for retirees.

One way to solve this problem is to allocate savings to some type of product that provides income that is protected for life. This includes things like delayed claiming of Social Security retirement benefits, as well as potentially purchasing an annuity that provides explicit longevity protection. This research demonstrates that retirees are significantly more comfortable accessing retirement savings when there is some kind of explicit guarantee associated with longevity.

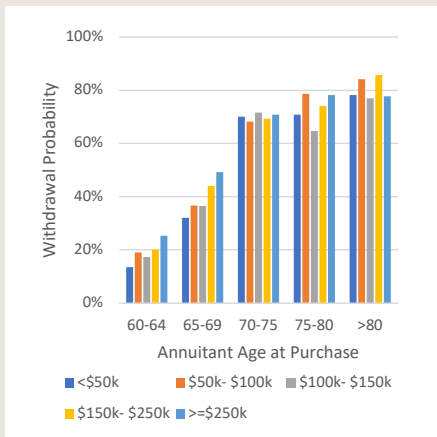
These findings have important implications for a variety of stakeholders. For example, while defined contribution, or DC, plans can help employees accumulate wealth to fund retirement, these findings suggest a balance that has no explicit longevity protection may be behaviorally difficult to draw upon to fund retirement savings. Future research should explore various strategies and products for converting DC plan assets into a stream of protected income in retirement.

AUTHOR

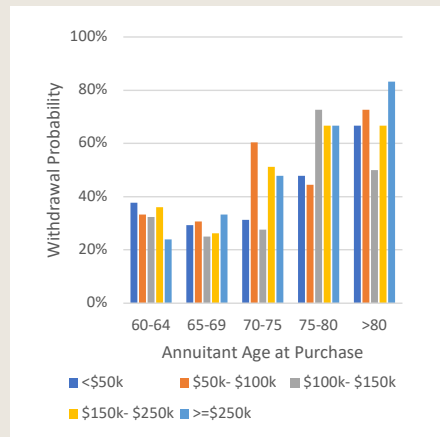
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APPENDIX

Appendix 1: Probability of Withdrawal by Purchase Age and Initial Premium in Three Years After Purchase for Qualified Accounts



**PANEL A:
WITH LIVING BENEFIT**



**PANEL B:
WITHOUT A LIVING BENEFIT**

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