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Contemplating the Pay-Out Phase

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Overview

- » Don't Forget Financial Literacy
- » Behavioral Economics Recognizes That Individuals Face Challenges
- » Nudge – the Behavioral Economics Continuum
- » Complexities Around the Pay-Out Phase
- » Saving for Liquidity Is Important at All Ages
- » Behavioral Barriers to Annuitization and Which Nudges
- » There Is No One Size Fits All
- » References

Don't Forget Financial Literacy

- » Financial literacy improves planning and outcomes.
- » It is important to take a holistic approach, educating around:
 - » Managing budgets and debt;
 - » Saving for emergencies; and
 - » Saving for long-term goals (e.g., education, home, retirement).
- » It is better to start young, in school.
- » Individuals make financial decisions every day.

Source: Lusardi, "How Can Financial Literacy Improve Retirement Planning?" (April 2015)

Behavioral Economics Recognizes That Individuals Face Challenges

- » Cognitive limitations
 - » Complexity
- » Psychological biases
 - » Loss aversion
 - » Present focus
- » Bounded self-control
 - » Procrastination
 - » Forgetfulness
- » Relative evaluation

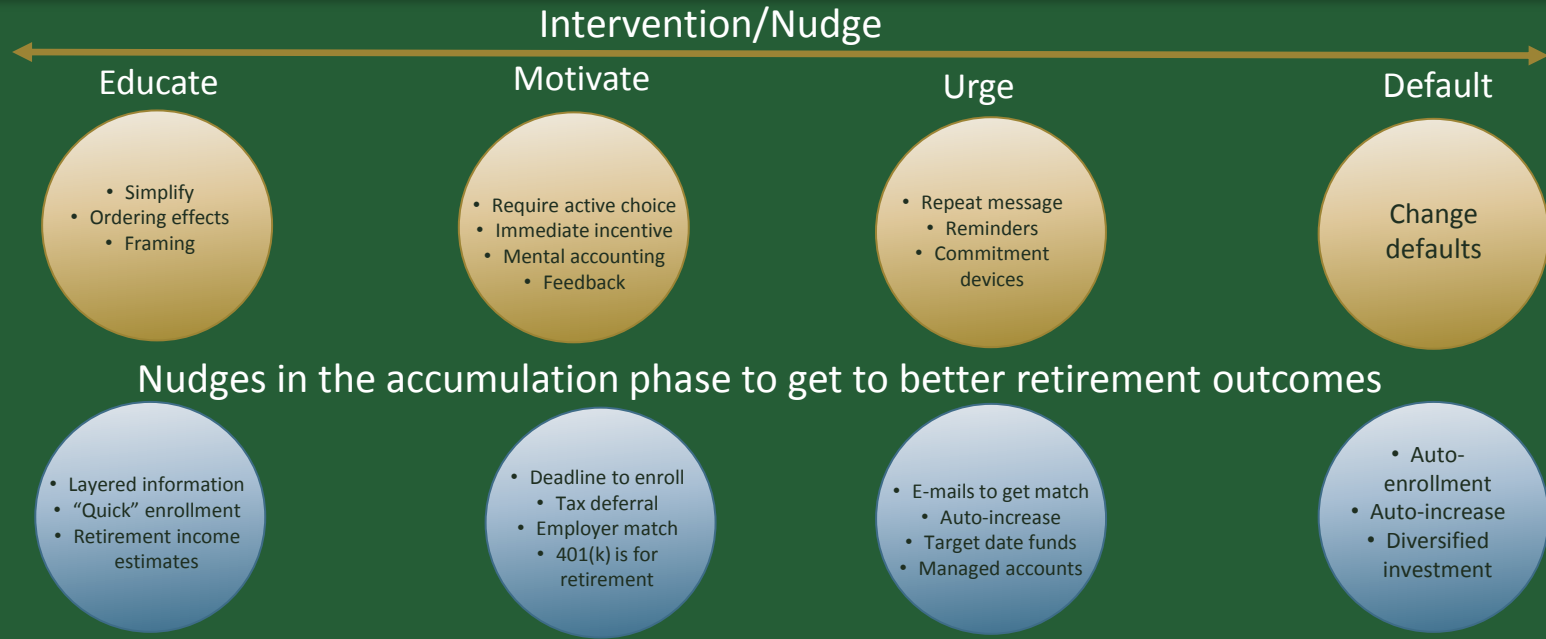
Source: ICI summary based on 2015 Investment Company Institute Retirement Summit; see Madrian (2014) and (April 2015); see also Thaler and Sunstein (2008)

Nudge

- » A nudge ...is any aspect of the choice architecture that alters people's behavior in a predictable way
 - » without forbidding any options; [and]
 - » without significantly changing their economic incentives.
- » [T]he intervention must be easy and cheap to avoid.
- » Nudges are not mandates.

Source: Thaler and Sunstein, *Nudge: Improving Decisions About Health, Wealth, and Happiness* (2008); page 6

The Behavioral Economics Continuum



Source: ICI summary based on 2015 Investment Company Institute Retirement Summit; see Madrian (2014) and (April 2015); see also Thaler and Sunstein (2008)

Lessons from Behavioral Economics

- » Behavioral economics can inform decisions relating to nudging—education, motivation, urging, and defaulting.
- » Policies that identify and directly act on the behavioral barriers in place are going to be more effective than policies that don't.
- » One must be careful in choosing defaults, particularly when the population is not homogeneous and there are high transaction costs.

Source: ICI summary based on 2015 Investment Company Institute Retirement Summit; see Madrian, “Applying Insights from Behavioral Economics to Plan Design” (April 2015)

Complexities Around the Pay-Out Phase: Factors Affecting the Annuitization Decision

- » Existing degree of annuitization (in U.S., Social Security, housing, DB pensions)
- » Liquidity (e.g., lumpy expenditures, anticipated health expenses)
- » Counterparty risk
- » Adverse selection
- » Interest rates
- » Bequest motives
- » Behavioral factors

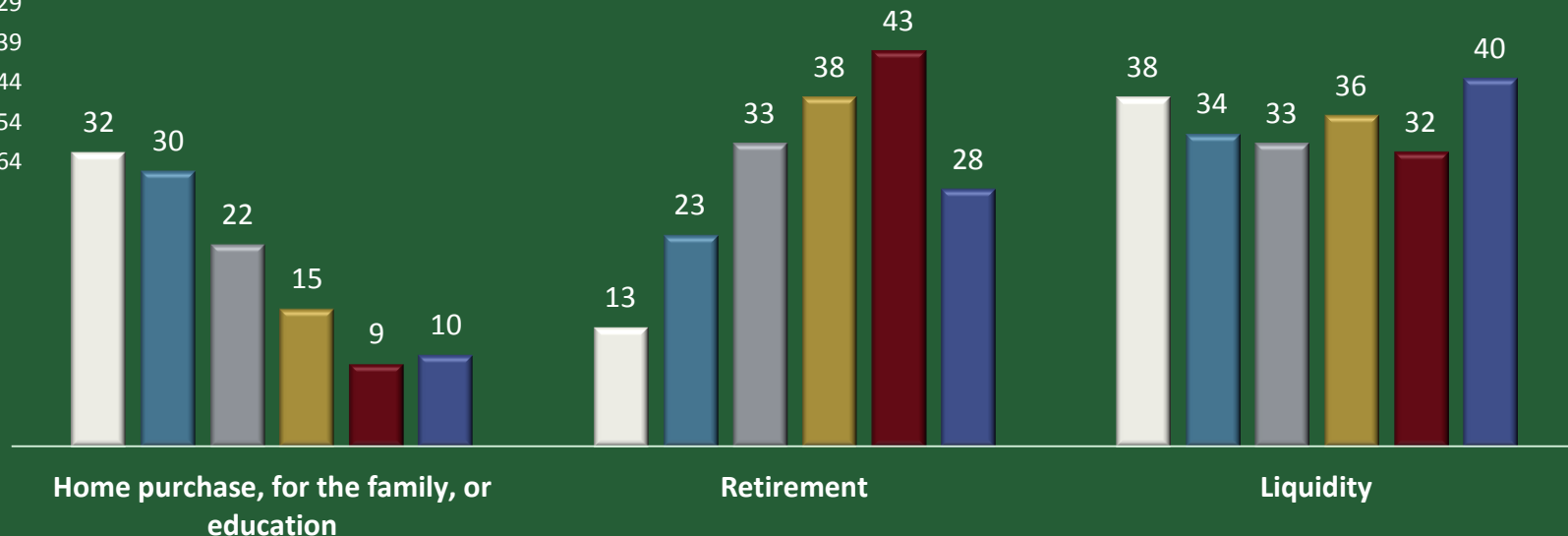
Sources: Beshears, Choi, Laibson, Madrian, and Zeldes (2012); Mitchell and Utkus (2003)

Saving for Liquidity Is Important at All Ages

Primary reason for saving; percentage of households by age of household head, 2013

Age of household head

- 21 to 29
- 30 to 39
- 40 to 44
- 45 to 54
- 55 to 64
- 65+

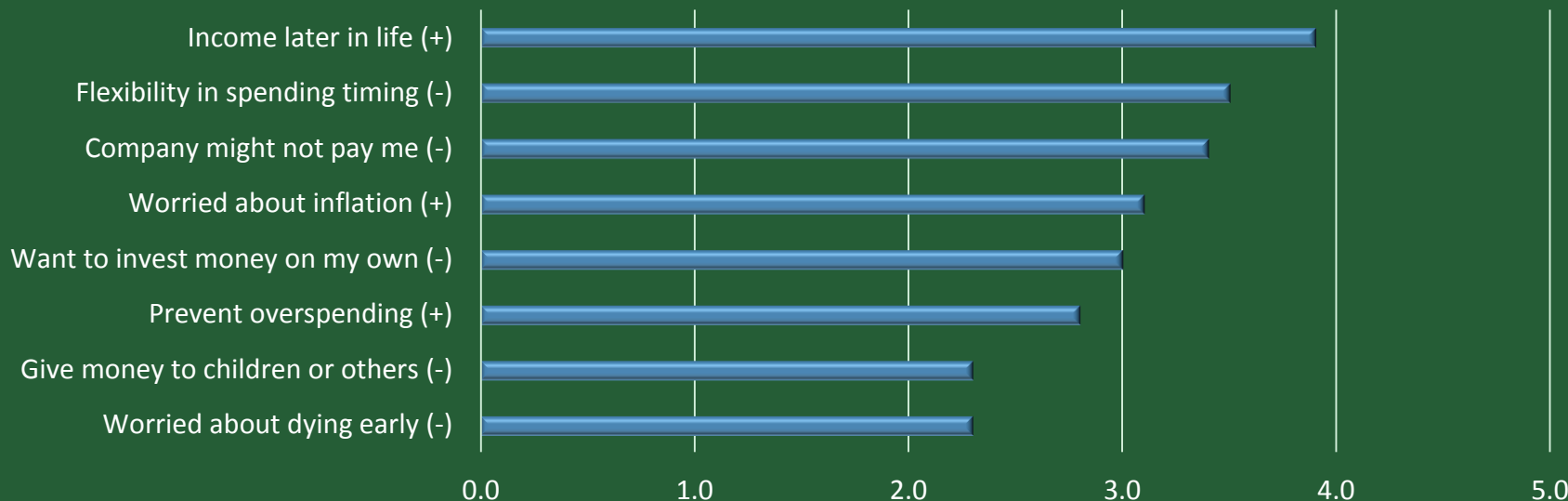


Note: Age group percentages do not add to 100 percent because other savings goals (purchases, investment, no reason, can't save) are not plotted.

Source: Investment Company Institute tabulations of the 2013 Federal Reserve Board Survey of Consumer Finances

Reported Importance of Motives for Lump Sum Versus Guaranteed Income Choices

Average rating; scale 0 = not important to 5 = very important



Note: Data presented are a summary based on two online surveys of U.S. residents age 50-75 in August 2011 and June 2012. The correlations reported (in the parentheses) are statistically significant; fraction of balance annuitized is fraction converted into guaranteed income in answer to hypothetical situations.

Source: Beshears et al., "What Makes Annuitization More Appealing?" *NBER Working Paper* (2012)

Barriers to Annuitization: The Psychology of Insurance

	Homeowners insurance	Longevity insurance
Insurable event	Fire, storm damage, theft—BAD THINGS	Live to a ripe old age—GOOD THING
Payout	Big lump sum after large loss	Dribble of income spread out over time
Premiums	Dribble of premiums spread out over time	Big lump sum today
If no event happens...	No fire—GOOD Small regret over small premiums “paid for nothing”	Die young—BAD Huge regret over large premium “paid for nothing”

Annuity doesn't “feel” like traditional forms of insurance

Source: Madrian, “Applying Insights from Behavioral Economics to Plan Design” (April 2015)

Behavioral Barriers to Annuitization

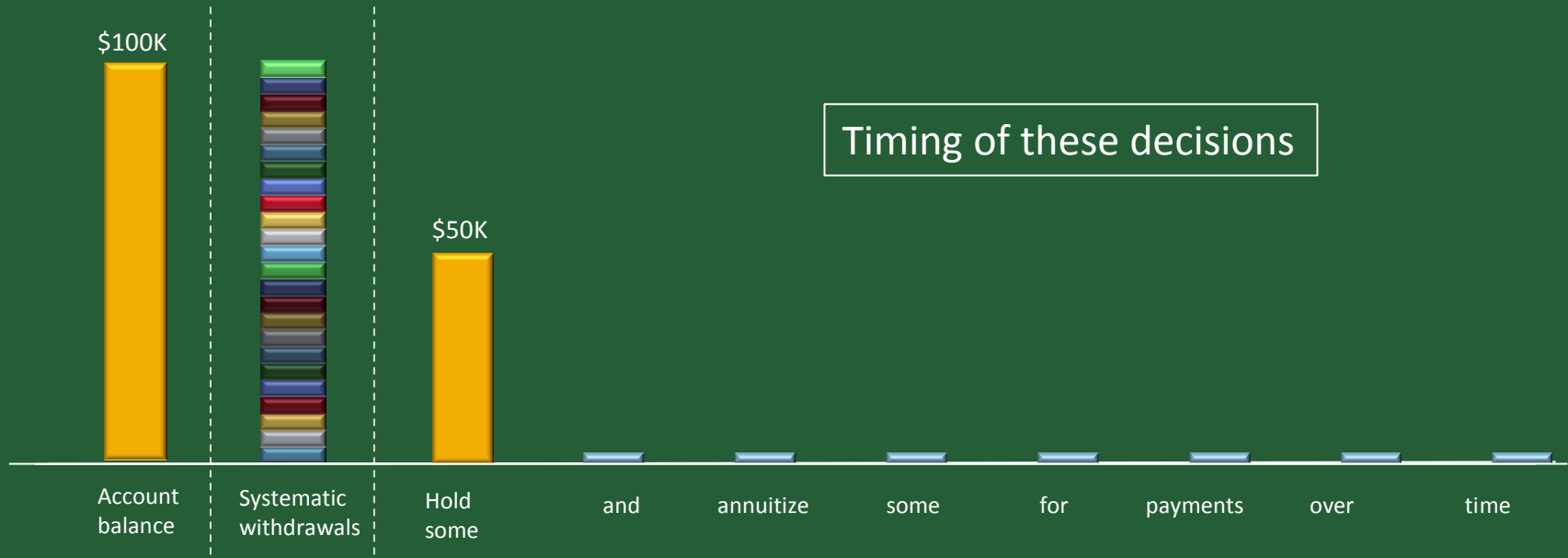
- » Losses from dying young
 - » Loom large (loss aversion)
 - » Happen sooner
- » Gains from living a long time
 - » Weighted less heavily than loss from dying young
 - » Discounted because they occur in the future (present bias)
- » Loss of control
 - » No annuity = control over wealth
 - » Annuity = no control (limited future liquidity)

Source: Madrian, "Applying Insights from Behavioral Economics to Plan Design" (April 2015)

Which Nudges?

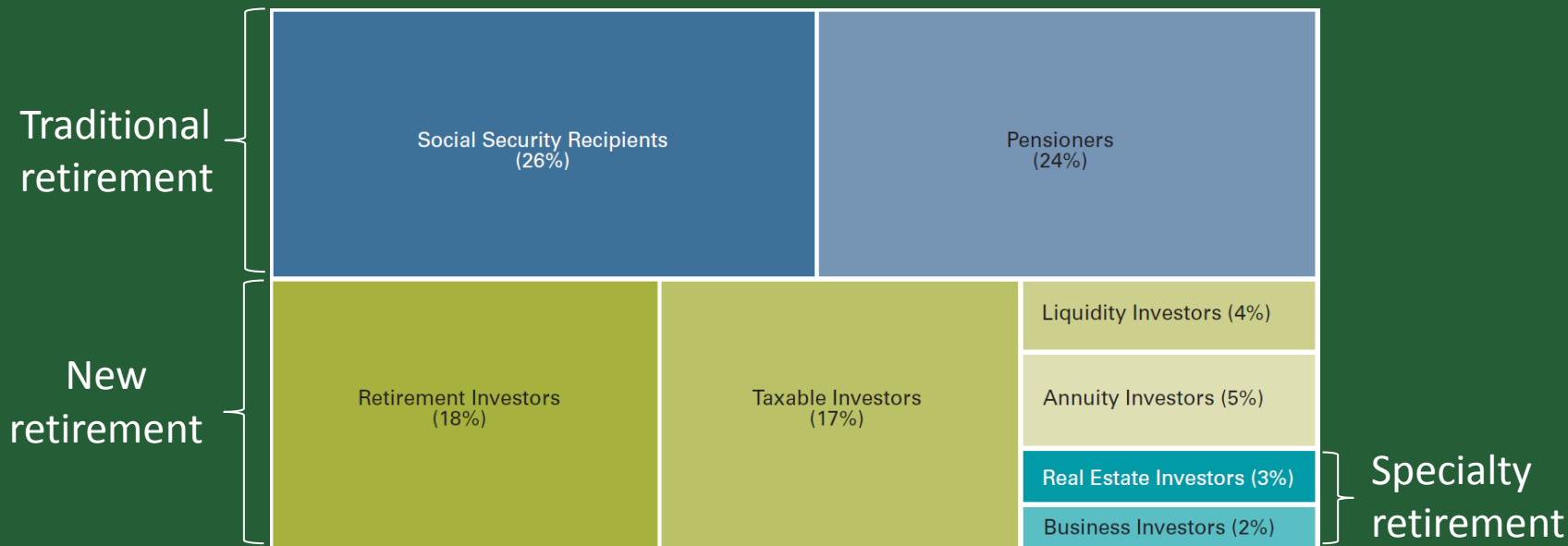
- » Need to help educate around/frame the decision
 - » Consider offering access to advice, online services; help people plan
- » Not all or nothing, but how much and when?
 - » Securing income, but covering contingencies
- » Choice architecture
 - » Need flexibility and descriptions of choices that facilitate comparison
 - » Might consider simplified or streamlined (layered) choices
- » Default?
 - » Lack of homogeneity in the population
 - » Costs

Rethinking the Retirement Balance



There Is No One Size Fits All and Many in the U.S. Are Highly Annuitized

Percentage of retired households, aged 60–79, \$100K+ financial assets



Source: Madamba, Utkus, and Ameriks, "Retirement income among wealthier retirees," *Vanguard Research* (May 2014)

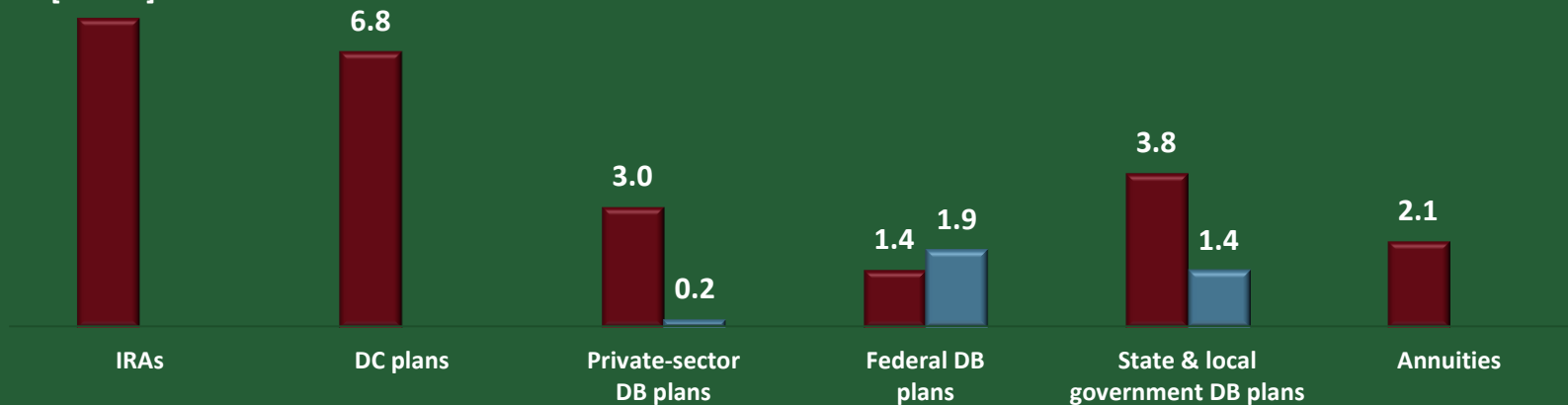
U.S. Retirement Assets and Unfunded Pension Liabilities

Trillions of dollars, end of period, 2015:Q2

■ Assets (\$24.8 trillion)

■ Unfunded liabilities (\$3.5 trillion)

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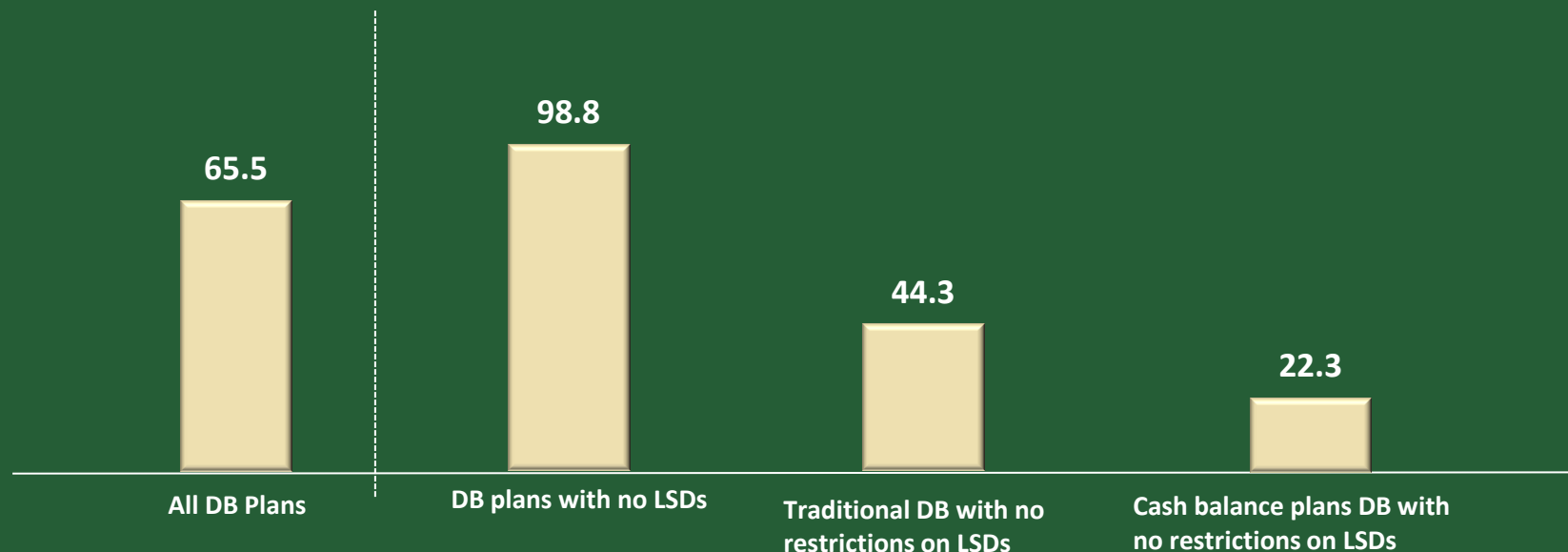


Note: For definitions of plan categories and a complete list of data sources, see Tables 1 and 2 in "The U.S. Retirement Market, Second Quarter 2015." Some data are estimated. Components may not add to the total because of rounding.

Source: Investment Company Institute, *The U.S. Retirement Market, Second Quarter 2015* (September 2015)

Annuity Rates Vary with DB Plan Design

Percentage of workers age 50–75 making payout decisions, 2010

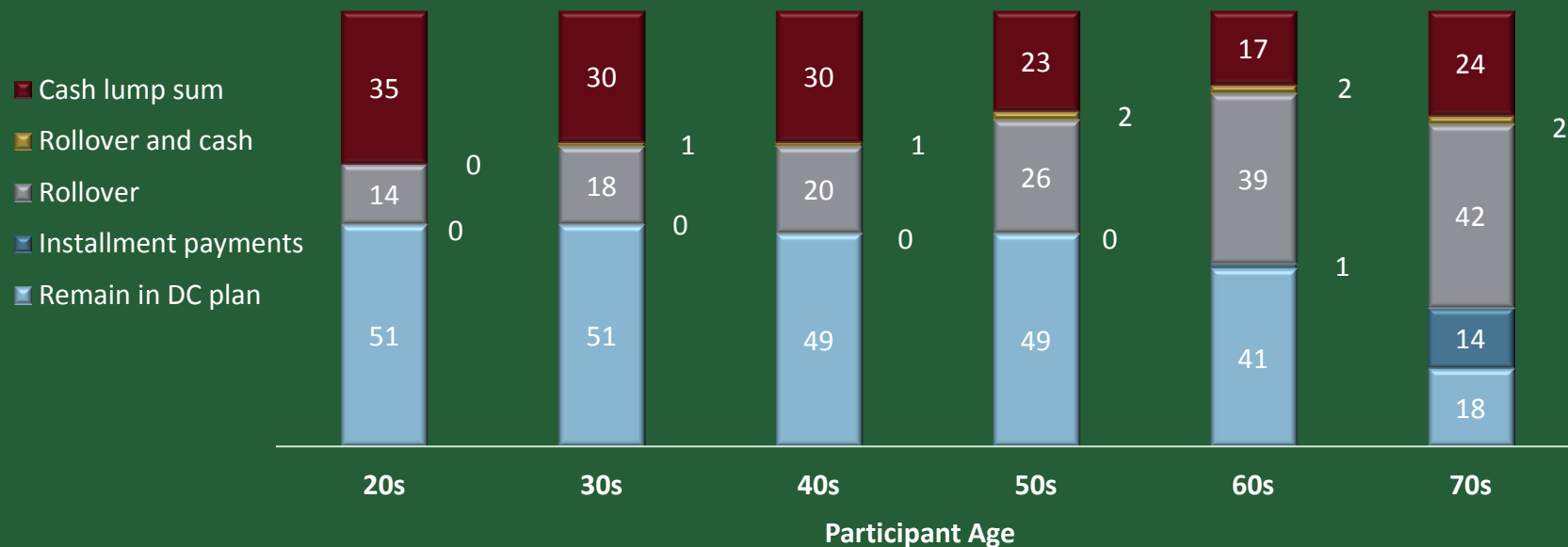


LSDs = lump-sum distributions

Source: EBRI analysis of Aon Hewitt data; see Banerjee, "Annuity and Lump-Sum Decisions in Defined Benefit Plans: The Role of Plan Rules," *EBRI Issue Brief* (January 2013)

DC Plan Participants Tend to Preserve the Assets

Percentage of participants with termination dates in 2014 by age



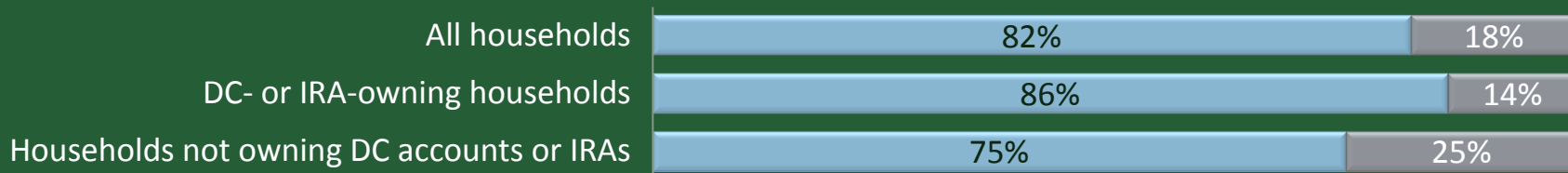
Source: Utkus and Young, *How America Saves, 2015: A Report on Vanguard 2014 Defined Contribution Plan Data* (2015)

Large Majorities of Americans Want to Keep Flexibility in DC Plan Distribution Features

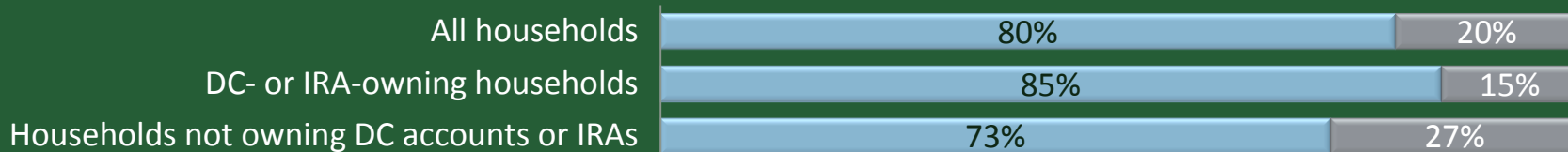
Percentage of U.S. households disagreeing or agreeing, fall 2014

■ Disagree ■ Agree

The government should require retirees to trade a portion of their retirement plan accounts for a fair contract that promises to pay them income for life from an insurance company



The government should require retirees to trade a portion of their retirement plan accounts for a fair contract that promises to pay them income for life from the government



Source: ICI tabulation of GfK KnowledgePanel® OmniWeb survey data (fall 2014); see Schrass, Holden, and Bogdan "American Views on Defined Contribution Plan Saving," *ICI Research Report* (January 2015)

Sources of Information Consulted for Rollover Decision

Percentage of traditional IRA-owning households with rollovers, mid-2014



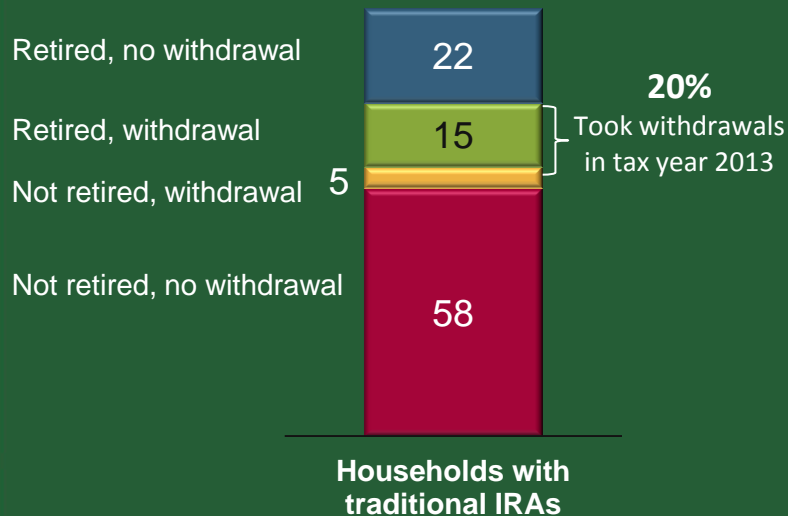
*Multiple responses are included.

Note: Other responses given included: myself, other online information, bank, books and magazines, seminars sponsored by a financial institution, and a phone representative from a financial services firm.

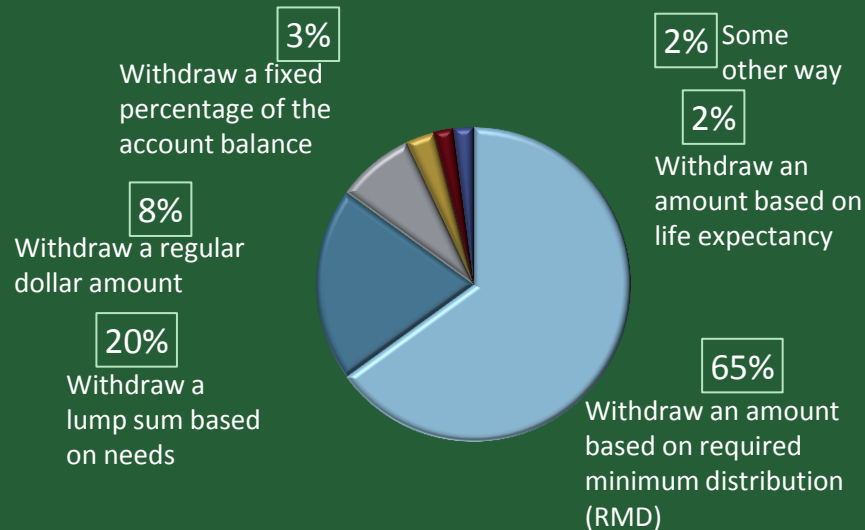
Source: Investment Company Institute IRA Owners Survey; see Holden and Schrass, "The Role of IRAs in U.S. Households' Saving for Retirement, 2014," *ICI Research Perspective* (January 2015)

Withdrawals from Traditional IRAs Are Infrequent, Retirement Related

Percentage of U.S. households with traditional IRAs in mid-2014



Percentage of traditional IRA-owning households with withdrawals in tax year 2013



Note: The household was considered retired if either the head of household or spouse responded affirmatively to the question: "Are you retired from your lifetime occupation?" Households that made withdrawals exclude those that closed and no longer own traditional IRAs.

Source: Investment Company Institute IRA Owners Survey; see Holden and Schrass, "The Role of IRAs in U.S. Households' Saving for Retirement, 2014," *ICI Research Perspective* (January 2015)

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