'Financial Services for the Greater Good'

By David Lindorff *Tue, Jul 26, 2011*

Andrew Carnegie, founder of the non-profit Teacher's Insurance & Annuity Association, now TIAA-CREF, could not possibly have foreseen how his group annuity would lead to today's profitable trillion-dollar variable annuity industry.

Back in 1918, when World War I was raging in Europe and the US federal budget was a mere $12.6 billion, industrialist Andrew Carnegie created the Teachers Insurance and Annuity Association (TIAA) to provide retirement security for university professors.

Today, $12.6 billion is what the IRS spends on taxpayer audits each year, while the 2011 US budget is $3.82 trillion. And Carnegie's creation, now TIAA-CREF, has grown into the retirement plan for 3.7 million active and retired teachers, professors, researchers, and others nationwide.

A not-for-profit company that's ranked No. 87 on the Fortune 500, with $453 billion in managed assets (including $383 billion in its group variable annuity contract), TIAA-CREF pioneered the use of annuities for retirement planning, and its well-educated plan participants continue to favor them.

The company has always taken a fairly conservative, straightforward approach to retirement planning, without offering its participants "a lot of bells and whistles," David Richardson, principal research fellow at the TIAA-CREF Institute, told RIJ recently. Richardson delivered a presentation on his research on TIAA-CREF participant behavior at a Pension Research Council meeting last spring.

Initially, TIAA's only investment option was a fixed premium guaranteed deferred annuity. Then, in 1952, as the US economy boomed and inflation flared, the company created the College Retirement Equities Fund (CREF), the first variable annuity, to allow professors to participate in the rising stock market. A plain vanilla product at first, CREF eventually featured options like systematic withdrawals and interest-only withdrawals. Richardson said, "As we've added options, people have opted for them."

Along the way, "The definition of retirement has changed. People are working longer, and they don't retire all at once. They go into phased retirement," he added. This is especially true in higher education, where universities often encourage older faculty members to step back from full-time to part-time teaching after they reach 65 or 70.

Recently, the TIAA-CREF Research Institute studied its participants' retirement planning and investment behavior. While the plan's mix of retirement products is different from most other firms (participants can contribute to a deferred income annuity during the accumulation period) and its participants behave a bit differently, the results should prove useful to companies on the for-profit side of the retirement business.

One striking finding was that TIAA-CREF participants seem increasingly concerned about avoiding losses should both they and a spouse die. "It's odd," said Richardson. "We public policy people are worried about people outliving their retirement benefits. But people seem to be more worried about dying young, and not leaving anything for their children or relatives."

Why "odd"? Because "our participants tend to live longer than the general population. They are more educated, stay active and pay more attention to their health," he said.

Year after year, the study shows, nearly 80% of TIAA-CREF participants who choose annuities opt for a guaranteed payment period, which assures that payouts continue for a certain number of years even if the annuity holder (and spouse) dies in the meantime. Richardson added, "And remember, these guarantee options are expensive. You pay a premium for them."

A second surprise in the survey involves the investment behavior of TIAA-CREF participants under age 35. Because its members see retirement as something distant, this group in general has tended to opt for greater risk in hopes of building up a larger nest egg over time. Indeed, that's what financial advisors and portfolio theorists tell younger clients to do.

In this survey, however, the under-35 group shows a big shift in 2010 from investments in equities into balanced funds— to 40% in equities and 24% in balanced funds in 2010 from 45% in equities and 8% in balanced funds in 2006. (Some of the money going into balanced funds in this group also came from fixed and guaranteed income investments, which fell to a combined 31% from 39% over the period.)

"But the balanced category is basically composed of target-date funds," says Richardson, "and for people in that younger age group, a balanced fund is probably even riskier than an equities fund" in terms of whether it will enable them to achieve their long-term goals. He attributes the change to the financial crisis.

"After the 2008-9 market crash, people may just be saying, 'I give up. Here's a life-cycle fund, and I won't have to think about it,'" he said. Most of the people opting for target date funds put all their assets in them.

A similar if less pronounced shift away from equities and annuities into balanced funds has occurred among the 35-44 and the 45-53 age brackets, with equities dropping to 40% from 52% for the first group and to 43% from 49% for the second.

Yet, especially for those aged 35-44, the move to target date funds could also be more risky than just investing in equities alone would be, based on historical performance. In the older age cohorts, the shift out of equities was minimal. The percentage of investors who moved into guaranteed or fixed annuities actually rose slightly.

It remains to be seen, said Richardson, whether the rebalancing of allocations observed in TIAA-CREF participants' portfolios would persist. "When you have a big event like 2008, there is always a question of how long people will continue to respond to it. So far, people have stayed out of equities," he noted.

In fact, the shift towards a more conservative investment posture predates the 2008 crash, and extends through last five years covered in the study (see P. 5 of the presentation referenced above). The percentage of those participants putting 100% of their assets in equity products dropped steadily over the period, to 8.2% in 2011 from 12.1% in 2005.

The percentage putting over 50% of assets into equities also fell, to 31.4% in 2010 from 39.2% in 2005. Over the same period, the percentage that put between one percent and 50% of assets into equities fell to 24.6% from 28%. The percentage that put no assets in equities rose from to 35.7% in 2010 from 20.7% in 2005.

"There can be a lot of inertia in these kinds of decisions," said Richardson.

Richardson's data also shows a trend toward delaying the first annuity payment by TIAA-CREF participants, which suggests that they may be working longer. In 1986, 54.3% of first life annuity payments were taken between the ages of 56 and 64. In 2009, that portion dropped to 38.2%. Between 1980 and 2009, the percentage starting payments at age 65 dropped by more than half, while the percentage taking at age 66 or later increased from 13.5% to about 47%.