How to Make Annuitization More Appealing

By Kerry Pechter *Wed, Aug 14, 2013*

In the embedded video, Brigitte Madrian of Harvard (pictured) describes the results of two surveys of older Americans about lifetime income that she and a team of other Ivy League researchers conducted. An article accompanies the video.

What makes people inclined or disinclined to annuitize their 401(k) savings or their defined benefit pensions? What features might make annuities more appealing? Does the mere manner of presentation of annuities bias people to purchase or not purchase one?

A team of Ivy League researchers and the National Bureau of Economic Research has been working on these questions for more than two years. A member of the team, Brigitte Madrian of Harvard, presented the most recent iteration of their findings at the Retirement Research Consortium meeting in Washington, D.C. earlier this month.

(A 15-minute video of Madrian's presentation is embedded in this story.)

In part, the study reinforced what annuity marketers and defined benefit pension sponsors already know: that adding flexibility, such as partial annuitization and variable income streams, would be popular.

The most counter-intuitive finding was that people might want inflation-adjusted annuities to a greater degree than current sales suggest. The researchers warned that the findings are based on responses to hypothetical survey questions, not on actual behavior. Two surveys were conducted among people ages 50 to 75, on in August 2011 and the other in June 2012.

In the conclusion of their paper, the authors write:

> To increase annuity demand, annuity providers could design products that give beneficiaries more flexibility and control. Our bonus annuity is an example of personalization that increases flexibility and control without compromising longevity insurance.
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> Another example is an annuity with multiple annual bonuses. Such bonuses could either be pre-selected at the time the annuity was purchased or selected at the beginning of each calendar year. In fact, the payout stream for a given year could be made completely flexible without creating a substantial adverse selection problem. Problematic adverse selection would only arise if inter-year reallocations were allowed, so that a beneficiary could drain his entire annuity following a significant adverse health event.
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> Other forms of personalization and flexibility could also be adopted, such as limited penalty-free early withdrawals and even asset allocation flexibility (adopting some features of the variable annuity market). Of course, there is a tradeoff between greater flexibility/control and greater complexity. Too much flexibility may drive some consumers away from annuities.

Finding the optimal mix of flexibility and simplification is a significant challenge.

We also find that most consumers prefer partial annuitization of their retirement nest egg to either 0% or 100% annuitization. We find that the availability of partial annuitization raises the average fraction of wealth that ends up annuitized.

Framing changes may also increase the appeal of annuities, especially frames that make the option of partial annuitization salient. In addition, frames that downplay investment attributes of annuities may increase annuitization rates. Regarding choices about COLAs, discussing the implications of inflation for purchasing power over long horizons increases demand for rising nominal payment paths.

Finally, participants report that fears of counterparty risk play a large role in their annuitization choices. By adopting regulations that reduce this fear, policy makers may create moral hazard problems from consumers disregarding the financial stability of annuity providers, but they may also increase overall demand for annuities.