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## Life annuities are more popular than retail sales suggest: AARP

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By Editor Test     *Wed, Sep 5, 2012*

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*In 401(k) plans that offered life annuities, 31% of current older workers and 25% of retirees planned to elect or had elected one, a study co-authored by Sandy Mackenzie (pictured) shows.*

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Sales of individual life annuities have always been relatively modest, prompting perennial explanations of the “annuity puzzle,” as well as speculation that, despite the Boomer retirement tsunami, Americans may never really warm up to the idea of insuring against longevity risk.

But a new [study](#) from the AARP Public Policy Institute shows that, when offered the choice between a lump sum and an annuity in an employer-sponsored retirement plan, Americans choose the lifetime payout surprisingly often—more often, that is, than retail sales data suggest.

That means there may be “more potential in the annuity market than many observers have assumed,” according to the authors of “Older Americans’ Ambivalence toward Annuities: Results of an AARP Survey of Pension Plan and IRA Distribution Choices,” which was published last spring.

“People who have defined benefit plans, and who have a choice in the matter, are likely to elect an annuity,” said Sandy Mackenzie, who co-wrote the report with Carlos Figueiredo. “Even among members of defined contribution plans, one in three say they would be willing to choose an annuity.”

### **The world according to AARP**

Even if you exclude Social Security, the study showed, annuities themselves aren’t rare in America. “Among retirees [ages 59 to 75], no less than 74% were receiving (or expecting to receive) income from an annuity of some kind, and 63% were receiving income from a life annuity,” the study found.

Among older workers [ages 50 to 75] whose most important plan was a traditional DB pension that offered a lump sum distribution option, 63% told the AARP researchers that they intended *not* to take a lump sum distribution. Of current retirees who had had a lump sum option, 87% had not taken the lump sum. Only about one in ten older workers and retirees with a lump sum option expected to choose or had already chosen the option of taking a full lump sum balance.

The tendency to choose an annuity was weaker among workers and retirees covered by 401(k) plans, and weaker still among those whose most important plan was an IRA. But even in those cases, the annuity was a surprisingly common choice.

In 401(k) plans that offered options other than lump sums, 31% of current older workers and 25% of retirees planned to elect or had already elected a life annuity. Another 24% of workers and 18% of retirees planned to elect or had elected a series of regularly scheduled payments in lieu of a lump sum. Only 11% of workers but 30% of retirees planned to elect or had elected a lump sum. One in four workers was still undecided decision.

The survey showed how stark a difference there is between current retirees and near-retirees in terms of the type of retirement plan coverage. In the survey, 61% of retirees said they had a traditional DB or cash balance plan, compared with only 33% of those who were 50 and over but still working.

### **Squaring the facts**

Mackenzie and Figueiredo can only speculate, however, why people are more amenable to the life annuity concept when it's an exit strategy from an employer-sponsored retirement plan than when it's a retail option.

"There may be a problem with the marketing of retail annuities or the way they're perceived," said Mackenzie, a former International Monetary Fund official and author of *Annuity Markets and Pension Reform* (Cambridge, 2006) and *The Decline of the Traditional Pension* (Cambridge, 2010).

"Maybe the participants feel that the in-plan annuity comes from a more trusted source. The lack of previous association with an insurance company might explain low retail sales. Our message is simply that, based on our data, the market for immediate annuities shouldn't be so vanishingly small," he said.

"There might be self-selection bias affecting the results [i.e., that people who like annuities choose companies that offer defined benefit plans], or because people may choose the annuity just because it's the default," Mackenzie added. "I don't want to overplay the results, but if you observe that the demand for life annuities as such is pretty small, then how do you square that with the fact that, even among members of defined contribution plans, one in three say they would be willing to choose an annuity?"

The AARP study joins the relatively slim body of literature on annuitization rates in retirement plans. A 2007 [study](#) by Steve Utkus and Gary Mottola of participants in two Vanguard-administered Fortune 500 plans, a traditional DB plan and a cash balance plan, found that "annuitization was popular among a small though meaningful group: 27% of older participants in the traditional plan and 17% in the cash balance plan elected an annuity." The older the participant at the time of the distribution—which didn't necessarily occur at the moment of retirement—the more likely he or she was to take an annuity over a lump sum.

The data for "Older Americans' Ambivalence toward Annuities" was collected in the spring of 2010. Some 1,750 older workers, aged 50–75, and 670 retired people aged 59–75 were interviewed. Each had to be a member of at least one pension plan or have an individual retirement account (IRA). Older workers had to have a pension plan or retirement saving account. Retirees had to have begun drawing or receiving payments from their most important retirement plan/account in the last three years.