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## Must-Read Income Research of 2013

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By Kerry Pechter      Thu, Feb 27, 2014

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*Many outstanding research papers on retirement income were published in 2013. The ten described here contain ideas that annuity product developers, annuity marketers and financial advisers can apply to their work.*

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Have you ever wondered what the retirement market would look like from 30K feet up? Or how you might respond when someone says, ‘Annuities are great—unless you love your kids’? Or, if you’re a policymaker, how to make people *eager* to work longer and claim Social Security later?

If you said yes to any of the above, then keep reading. The answers to those questions and many more can be found in the ten outstanding research articles described here, written by some of the most inquisitive retirement-minded academics in the world.

Because *RIJ* has both “town” and “gown” readers, we try to promote the exchange of ideas between the two realms. By town, we mean the executives and entrepreneurs of the retirement industry. By gown, we mean the academics who try to crack the so-called “annuity puzzle.”

So, every winter, *RIJ* publishes a list of ten praiseworthy research papers that surfaced (as working papers or journal articles) during the previous calendar year. We used to call them the “best” papers of the year, but starting now we’ll call them “notable” or “must-read.” We just can’t claim to be aware of all the good decumulation research that’s produced around the world.

Below, you’ll find synopses of the articles in the class of 2013 (in alphabetical order, by title). Of all the hundreds of eligible papers that emerged last year, it was hard to choose ten. In the end, (after soliciting nominations from experts in the field) we concentrated on articles that contain at least one idea that retirement product developers, marketers or advisers can apply to their work.

*Note:* We don’t have the discretion to provide direct links to the papers. To obtain copies, you may need to e-mail the authors, or search the article database at the National Bureau of Economic Research, or visit the websites of the journals where the articles appeared.

**“Analyzing an Income Guarantee Rider in a Retirement Portfolio.” Wade D. Pfau. [Journal of Retirement](#), Summer 2013.** Americans invested \$145.3 billion in variable annuity contracts in 2013. That one product category accounted for almost two-thirds of the premium paid for all annuities in the U.S. last year. Its main income feature is the guaranteed lifetime withdrawal benefit (GLWB) rider. This article assesses the pros and cons of the VA with a GLWB. The cons include lack of inflation-adjusted income and fee attrition. The pros include protection against wealth depletion in retirement and from panic during market downturns.

**“Complexity as a Barrier to Annuitization: Do Consumers Know How to Value Annuities?” Jeffrey Brown, Arie Kapteyn, Olivia Mitchell and Erzo F. P. Luttmer. NBER and the Pension Research Council, June 2013.**

In this deconstruction of the so-called “annuity puzzle”—i.e., Why don’t more retirees annuitize their retirement?—Jeffrey Brown of the University of Illinois and others reject the usual explanations for low annuitization rates. The most likely explanation, they argue, is that most people don’t buy what they can’t easily value, and that annuities are too complex for most people to evaluate. “Valuing an annuity is particularly complex inasmuch as it involves both uncertainty and events that will unfold far in the future,” the authors write. “As a result, individuals are only willing to buy or sell an annuity when it is an exceptionally good deal, and this tendency is strongest among the least financially sophisticated.”

**“Consumer Preferences for Annuities: Beyond NPV.” Suzanne Shu, Robert Zeithammer and John Payne. Unpublished working paper.**

The authors approach the annuity purchase as a marketing/psychology problem. They apply conjoint analysis (sometimes called “trade off” analysis) to understand consumer preferences vis-à-vis annuities. It’s a popular statistical tool for deciding the relative importance that consumers place on product attributes, such as brand and price. The authors found that an annual \$200 increase in income is a more attractive annuity feature than an annual percentage increase, that demand for annuities increases when you add a 10-year to 20-year period certain (but goes down for a five-year or 30-year period certain) and that middle-aged people like annuities more than people who are about to retire. People with middle-level numeracy and \$75,000 to \$150,000 in savings are especially amenable to annuities. “We find that careful ‘packaging’ of a given net present value into the optimal mix of the attributes can more than double demand for the product,” the authors conclude.

**“Exchanging Delayed Social Security Payments for a Lump Sum: Could This Incentivize Longer Work Careers?” Jingjing Chai, Raimond Maurer, Olivia Mitchell and Ralph Rogalla. NBER Working Paper 19032, May 2013.**

Americans tend to claim Social Security benefits sooner rather than later, thereby locking in less annual lifetime income (for themselves and often for their surviving spouses) than if they waited a few years. Policymakers would love to see people work longer and claim later. The authors of this paper, three from Goethe University in Frankfurt, Germany, and one from Penn, propose making the reward for postponing benefits a one-time lump sum rather than a larger annual income. On average, they argue, that would incentivize Americans to work 18 to 24 months longer and, in the process, help stabilize the Social Security system without adding costs or reducing benefits. Workers could use the lump sum to invest in equities, fund a bequest or buy the proverbial bass boat.

**“The Floor-Leverage Rule for Retirement.” Jason S. Scott and John G. Watson. *Financial Analysts Journal*, September/October 2013.** In this paper, two researchers at Financial Engines propose a retirement risk management technique that calls for building a retirement portfolio roughly along the lines of a structured note. The rule that the title refers to—“floor-leverage”—suggests that a retiree invest 85% of his or her wealth in safe, income-producing floor assets such as an income annuity or a bond ladder. The other 15% would be invested in a triple-leveraged equity fund, where the costs and mechanics of leverage are built into the NAV of the fund. This technique is suggested as an alternative to a 4% systematic withdrawal plan or a bucketing strategy. “It’s for people who want material upside but who also want

security,” Scott told *RIJ* last autumn. “You’re trying to concentrate the risk in the risky assets and create safety in the floor asset.”

**“Legacy Stabilization Using Income Annuities.” Matthew B. Kenigsberg and Prasenjit Dey Mazumdar. *Journal of Retirement*, Fall 2013.** Conventional wisdom has it that income annuities and bequests play a zero-sum game: The more lifetime income the parents buy, the less money they can leave to the children. In this paper, the authors, both from Fidelity Investments, show evidence for the reverse: that annuities can protect a potential bequest from the risk that parents will live long enough to consume all their wealth. In short, annuities have the potential to relieve rather than intensify inter-generational tension by unlinking the parents’ deaths from the transfer of wealth.

**“Optimal Portfolio Choice with Annuities and Life Insurance for Retirement Couples.” Andreas Hubener, Raimond Maurer and Ralph Rogalla. *Review of Finance*, February 2013.** This paper evaluates the use of term life insurance and annuities in retirement by couples. It finds that term life insurance becomes most important when the wife is younger than her husband, when the husband’s pension income ends when he dies, and when the wife has little additional liquid savings to fall back on. (The paper doesn’t evaluate the use of whole life policies for bequest purposes.) The availability of Social Security’s generous joint life annuity currently crowds out much of the need for private annuities, the authors suggest. But they say that demand for private annuities could rise if Social Security benefits are reduced and as the number of retirees with defined benefit pensions declines.

**“Optimizing Retirement Income: An Adaptive Approach Based on Assets and Liabilities.” Yuan-An Fan, Steve Murray and Sam Pittman. *Journal of Retirement*, Summer 2013.** Advisers of retirees know that most financial plans will undergo periodic changes or “course corrections” in response to market performance or new personal circumstances. Recognizing that, analysts at Russell Investments suggest an “adaptive” approach to retirement investing. Taking a cue from pension fund risk management and echoing the principle of constant proportion portfolio insurance (CPPI), the model calls for assessing a client’s funded status at specific points during retirement and adjusting the equity allocation as needed. “The adaptive model suggests that retirees should consider adapting their exposure to equity based on their level of wealth relative to the value of their spending goal, instead of maintaining a constant mixture of equity and fixed income,” the authors write. The model suggests reductions in equity allocations for retirees who are barely funded and more aggressive equity allocations for those who are well funded.

**“Recent Changes in the Gains from Delaying Social Security.” John B. Shoven and Sita Nataraj Slavov. NBER Working Paper No. 19370, August 2013.**

In 2013, Social Security’s reputation changed significantly. Our national pension was no longer villified as a poor investment, as it often was during the reform debates of the mid-2000s. Instead, many people realized that the rate of gain in income from delaying Social Security past full retirement age was much greater than the return on safe assets. In addition, many people began to discuss the “file-and-suspend” strategy by which primary earners can receive spousal benefits while delaying their own benefits. Shoven and Slavov’s paper explains when and how (as well as for whom and by how much) Social Security benefits became more generous. “If the primary earner was born in 1951,” they write, “a one-earner couple could

gain more than \$85,000, and a two-earner couple could gain more than \$100,000 through optimal claiming relative to claiming at 62... For singles born in 1951, the gains from delay are more than \$30,000 for men and more than \$50,000 for women.”

**“The RIIA Balance Sheet: The Head Office Perspective.” Elvin J. Turner and Larry Cohen.**

***Retirement Management Journal*, Vol. 3, No. 2, 2013.** This article describes the “topology” of the retirement market. Using a kind of multi-dimensional prism, it reveals the many segments of the market, their attributes, and their relationships to one another. Consumers are segmented by age and asset levels, household assets are segmented by financial and other types of assets, distributors are segmented by their revenue models, and products are segmented by individual annuities, retail mutual funds and defined contribution plans. This article, based on ideas that the members of the Retirement Income Industry Association have been refining for a decade, provides a roadmap for people who are trying to orient themselves within the complex retirement marketplace.

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