Retirement Income
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Vanguard Answers a Retirement Riddle

By Kerry Pechter *Wed, Mar 18, 2015*

Why do so many affluent retirees pinch pennies, when could enjoy life more? Sellers of annuities and long-term care insurance may be interested in the answers that Vanguard and a team of academics came up with.

"You can't take it with you," goes the old saying. So why do so many retirees die with so much unspent savings? Leaving too much is better than dying broke, for sure; but the hoarding tendency suggests that many retirees don't enjoy their final years as much as they could.

It's a tendency that infects the upper-middle class more than the rich or poor, and it may help explain the low demand for income annuities, which maximize guaranteed lifetime spending. It may also indicate that demand for some new form of insurance for long-term care (LTC) expenses might be greater than current LTC insurance sales indicate.

There's been a long-running debate about the tendency to hoard. Some experts believe that retirees hoard wealth for "bequest motives"—so they can leave more money to their heirs and beneficiaries. Others believe that retirees hoard to self-insure against the chance that they'll require years of nursing home care.

A new academic study, initiated by Vanguard, entitled "Long Term Care Utility and Late in Life Savings," may provide a tie-breaking answer: It's most likely a fear of potential long-term care costs that drives retirees to clip coupons, dine out at 4 p.m. to catch the "Early Bird Special" and forego those once-in-lifetime vacations to wherever.

"It's not that they don't care about their families," said economist Andrew Caplin of New York University, who was one of the authors of the Vanguard study. "But if it comes down to it in the last year, and they had to choose between uncomfortable year versus comfortable year, they would choose to spend the money on making it more comfortable."

The study confirms the common sense intuition that, for people who can pay for one or the other but not for both, that personal medical care takes precedence over bequests, Caplin told *RIJ*. "For people in the upper middle class, 75th percentile of wealth, health care was regarded as a necessity and bequests as a luxury," the study said.

Aside from its headline findings, several aspects of this research are noteworthy:

- It was conducted at the behest and with financing by the Vanguard Group, a company

that specializes in low-cost, direct-sold mutual funds. It does not own a life insurance company or emphasize the sale of annuities or long-term care insurance. But it is one of the country's largest retirement plan providers and rollover IRA custodians. Over the past 18 months it has experienced far larger fund flows than any other investment company, according to Morningstar data.
- Second, the research is based on a survey of almost 8,000 affluent Vanguard clients—a group whose attitudes and responses the researchers considered more indicative of the potential behaviors of the wealthiest 50% of older Americans than the Federal Reserve's Survey of Consumer Finances or the University of Michigan/National Institute on Aging's Health and Retirement Study (HRS), which have been used for similar research in the past.
- Perhaps most significant, the researchers concluded that a large market may exist for what they call Activities of Daily Living Insurance (ADLI). Unlike traditional long-term care insurance (LTCI), which pays nursing home bills, ADLI would provide income, to be spent on in-home care or for general needs, when a person needs chronic care.
- The research may also help solve the so-called "annuity puzzle" by explaining why people would rather hoard lump sums than maximize their monthly income in retirement. "LTC and the utility derived from expenditures when in need of LTC contribute substantially to the lack of demand for annuities in a large fraction of the population," the researchers wrote.

The study was conducted by John Ameriks of The Vanguard Group, Inc., and economists Joseph S. Briggs and Andrew Caplin of the New York University, Matthew D. Shapiro of the University of Michigan and Christopher Tonetti of Stanford University's graduate school of business.

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