
What's In Their Wallets?

By Kerry Pechter *Wed, Jun 25, 2014*

Vanguard inventoried the wealth and income of affluent older Americans and found that a surprising number of them are still receiving defined benefit pensions. Income-wise, Vanguard identified eight types of affluent retirees.

Income from defined benefit plans, like rays of light from distant, dying stars, is still streaming into the households of older Americans. Despite the conventional wisdom about the end of DB, most affluent retiree households are still receiving a substantial amount of their income from DB pensions.

That was one of the key findings of a just-published 2012 [survey](#) by the Vanguard Center for Retirement Research, and it may help explain why more people aren't buying income products.

The Vanguard survey was more detailed than most. It involved interviews with retired or semi-retired people ages 60 to 79 in about 2,600 U.S. households about their sources of retirement income. The households had to have at least \$100,000 in financial wealth. They were asked to identify the precise locations and amounts of their bank, brokerage and retirement accounts.

"We were able to get very high-resolution data on a granular scale," said Steve Utkus, who co-authored a report on the survey with Anna Madamba and John Ameriks. "That's quite novel."

Vanguard has an obvious interest in this type of information. The Malvern, Pa.-based financial services firm manages some \$2.72 trillion in assets through varied retail and institutional businesses. It's one of the largest full-service retirement plan providers and a leading direct marketer of no-load mutual funds and ETFs.

The more it knows about its customers' sources of retirement income and how they intend to draw down their money (the subject of a forthcoming report based on the same survey), the better able it will be to develop the products and services—systematic withdrawal plans, guided income programs, annuities, payout mutual funds—that they're going to need.

Pension prevalence

In sorting out the result of the survey, Vanguard identified eight categories of affluent U.S. retiree households by their primary source of retirement income. The categories (and the sources) were Social Security, Pensions, Retirement accounts, Taxable accounts, Annuities, Liquid assets, Real Estate and Businesses.

Of these, the biggest groups were those who relied mainly on Social Security (26% of the sample) or Pensions (24%). The richest and smallest groups were those who got most of their income from Real Estate (3%) or Businesses (3%). The groups with the most financial assets were the ones who depended mainly on Retirement (18%) or Taxable (17%) accounts. The two most conservative groups were the Annuity owners (4.5% of the sample) and Liquidity investors (4.5%).

Representing about one-third of older American households, those surveyed had median financial assets of \$395,000. Their median total non-housing wealth was \$1.1 million, but only when the lump sum values of Social Security benefits and pensions were counted as wealth.

The most striking finding of the study “was the fact that half of the population of even this affluent group still has most of its wealth tied up in Social Security and defined benefit pensions,” Utkus told *RIJ* in a recent interview.

“The idea that retirees have no pension assets—that will occur down the road,” he said. But it’s not true yet. About 71% of the households in the study, which was conducted with the help of Ipsos, a Paris-based market research firm, had pension income. About one in four got more than half (53%) of their income from pensions. The median annual pension was \$20,000.

Eight Types of Affluent Retirees, Ages 60-79	
Type of retiree (% of total sample)	Main sources of wealth and income
Social Security recipients (26%)	70% of total non-housing wealth is present value of Social Security (58%) and pensions
Pensioners (24%)	70% of total non-housing is present value of pensions (53%) and Social Security
Retirement investors*† (18%)	Median financial holdings, \$749,050
Taxable investors*† (17%)	Median financial holdings, \$934,000
Liquidity investors (4.5%)	69% allocation to low-yielding assets
Annuity investors (4.5%)	77% of total non-housing wealth comes from annuities (45%), Social Security (23%) and pension
Real estate investors*† (3%)	Higher than average total non-housing wealth, but mainly in illiquid real estate assets.
Business investors*† (3%)	Higher than average total non-housing wealth, but mainly in illiquid business assets.
*Most affluent of the groups. †Defined by Vanguard as part of the “New Retirement.” Source: “Retirement income among wealthier retirees,” Vanguard Center for Retirement Research, May 2014.	

“Our gut feeling that it will take 10 to 15 years, at least a decade, for pension income to drop significantly,” Utkus added. “Most of the phase-out in defined benefit plans has been in freezes for new hires or freezes on accruals. A decade from now it may look very different. But there are still a lot of people who are getting meaningful benefits from DB pensions.”

Another surprising finding: affluent older Americans still have a lot of their money tied up in ultra-conservative assets. “We found a high degree of conservatism. A lot of households have their wealth concentrated in either Social Security, pensions, certificates of deposits and variable annuities. That shows a very high level of risk aversion,” Utkus said. A deeply risk-averse fraction (4.5%) of those surveyed, whom Vanguard identified as “Liquidity” investors, held 69% of the invested assets in liquid accounts.

Only 4.5% of those surveyed held the largest chunk of their savings in annuities. These “Annuity” investors held almost half (45%) of their total non-housing financial wealth (\$848,000) up in annuities—primarily variable annuities with living benefits, Utkus said. Of the eight types of affluent investors that Vanguard identified, only this group had more than 4% of their wealth in annuities.

Lessons for advisers

Advisers who are looking for likely clients might concentrate on the 35% of the study group that had the highest levels of financial wealth: the Taxable investors, whose median financial assets were \$934,000, and the Retirement investors, who had about \$750,000. Business owners and Real estate investors had the highest income and the most total non-housing wealth, but most of their wealth was illiquid.

The more affluent the retiree, the more sources of retirement income they will have, Utkus said. This fact will tend to make decumulation more complex and more individualized. “Those who work with affluent clients should realize that there’s incredible complexity here,” he said.

Taxable, Retirement and Annuity investors were the most likely to have worked with a financial intermediary, the study showed. Taxable investors were strong planners, were more likely than average to have an estate plan, long-term care insurance and a high bequest motive. Retirement investors had the highest likelihood of having created a spending plan before retirement. Both of those latter groups were likely to be well educated and in good health.

These were the results of the first part of a two-part study. The second part assesses the various ways in which retirees spend down their retirement savings.

“Our goal with the first study was to understand who this group is. The second study, still in progress, will look at drawdown behavior,” Utkus said. “For that we somewhat arbitrarily chose 100 people. We’re looking for deeper lessons about drawdown strategies. We’re looking to see how drawdown from IRAs might differ from drawdown from 401(k)s and from drawdown from non-retirement taxable accounts. We’ll look at who is doing systematic withdrawals and who is making ad hoc withdrawals.”