

December 13, 2018

Retirement Income
**What Do We Need &
What Have We Got?**

Peter Brady
Senior Economist

EBRI-ERF Policy Forum #84

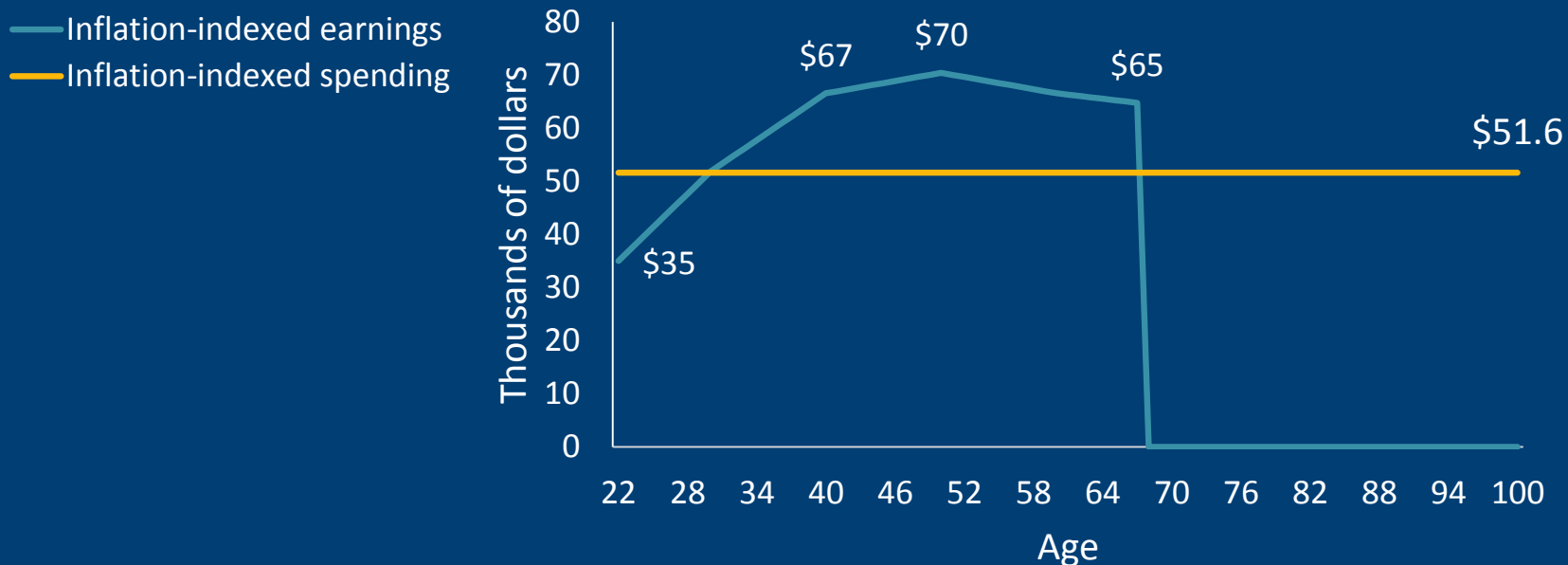
Overview of Remarks on Retirement Income

- » Why do we think retirees should annuitize their wealth?
- » What resources do retirees have?
- » What is the best way to get more annuity income?

The Annuity Puzzle

Simple Economic Models Predict Smooth Spending

Stylized example of life-cycle consumption for hypothetical worker



Source: Author and an Excel spreadsheet

Who Is Getting It Wrong, Retirees or Economists?

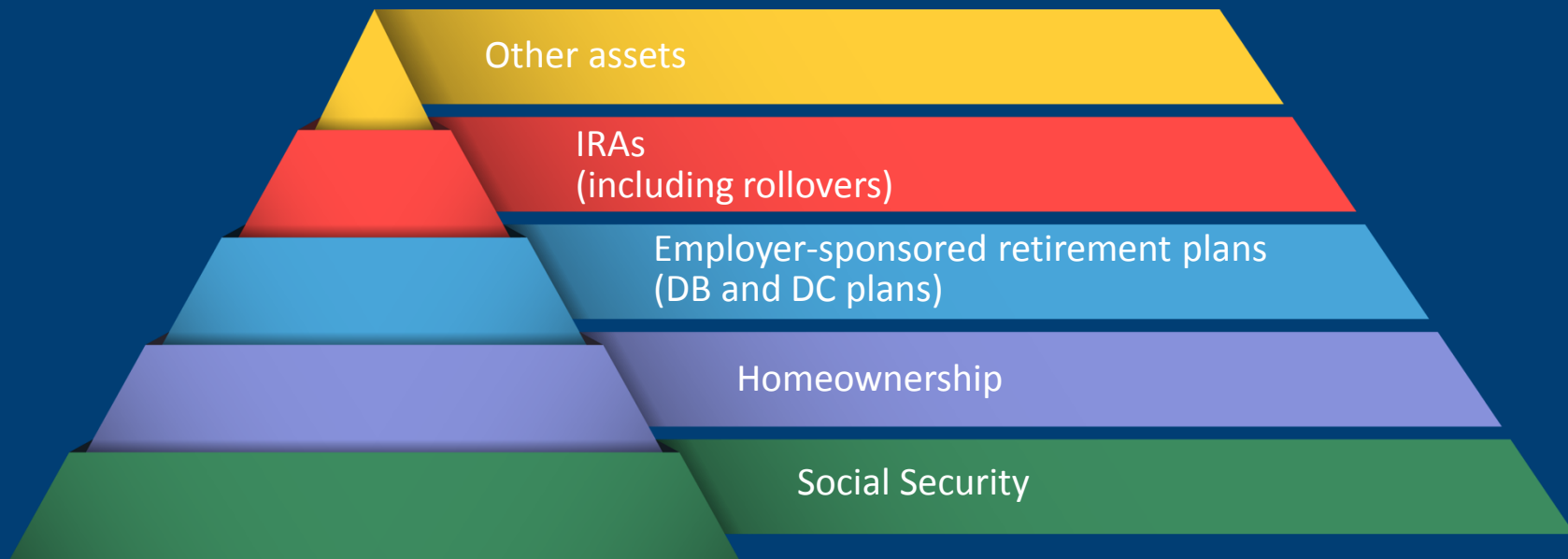
- » Simple life-cycle models ignore key aspects of retiree choices
 - » Annuity pricing
 - » Other sources of annuitized wealth
 - » Uncertainty (earnings, spending needs)
 - » Marriage
- » Reichling & Smetters (2015) illustrate why results are “robust”
 - » Results driven by mortality assumption
 - » Prediction of full annuitization disappears if:
 - » Workers learn about their health and mortality over time
 - » Health events both increase mortality risk and are costly

Reasonable Conjecture: Retirees Want Both Annuities and Investments

- » Income security requires both:
 - » Regular monthly income to cover recurring expenses
 - » Resources to tap in time of unexpected need
- » Demand for annuities related to composition of resources
 - » Social Security
 - » Home equity
 - » DB pension plans
- » Resource composition differs dramatically across households

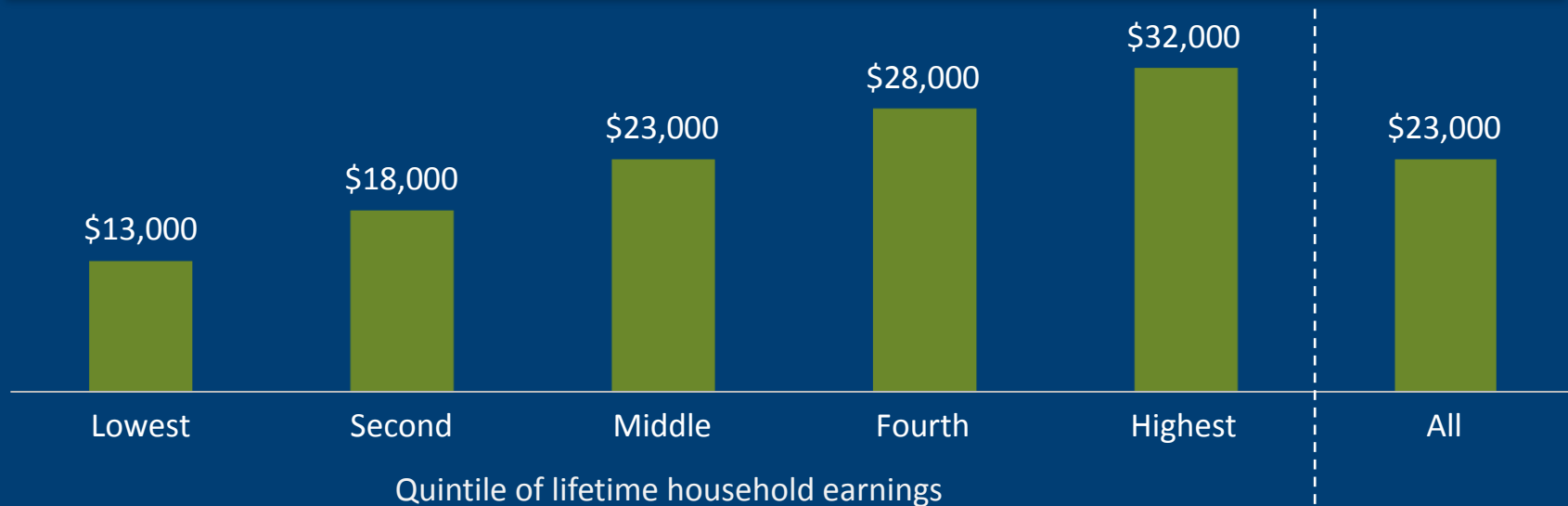
Retirement Resources

Retirement Resource Pyramid



Social Security Benefits Are Substantial

Average projected annual Social Security benefits net of income tax for workers in the 1960s birth cohort,* constant 2018 USD†



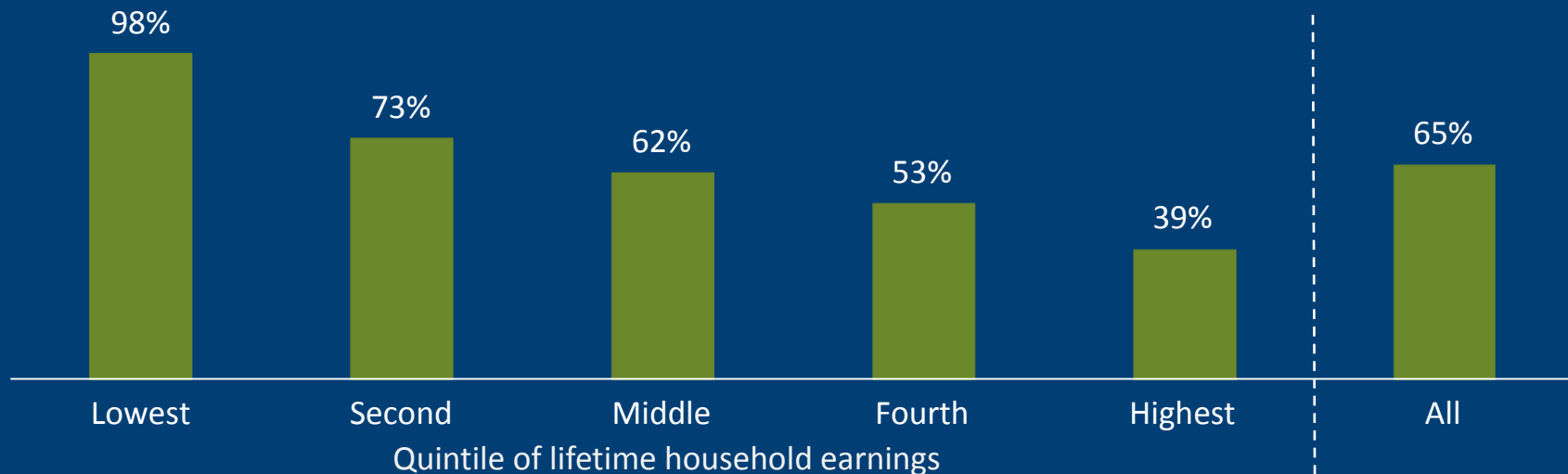
*Scheduled benefits if claimed at the full benefit age (age 67)

†Rounded to the nearest thousand

Sources: Congressional Budget Office and Investment Company Institute

Social Security Benefit Formula Is Progressive

Average projected Social Security replacement rate for workers in 1960s birth cohort †*



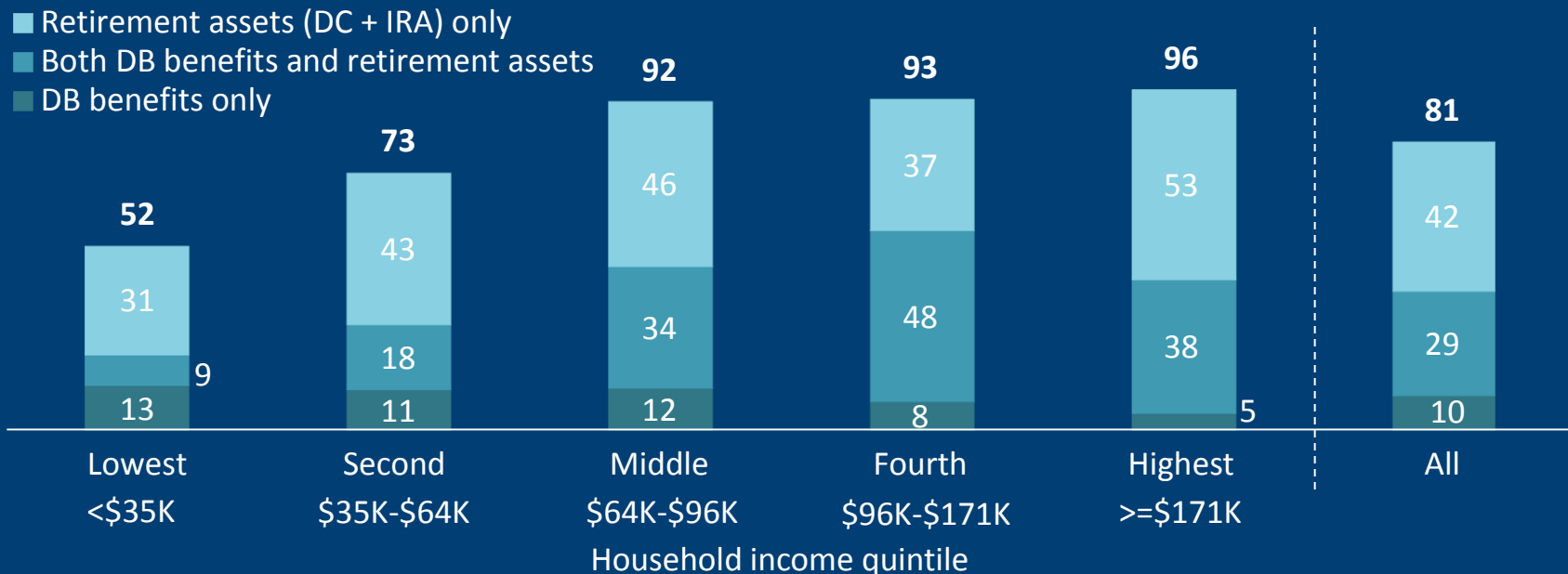
*Scheduled benefits net of income tax as percentage of average inflation-indexed earnings

†If claimed at the full benefit age (age 67)

Sources: Congressional Budget Office and Investment Company Institute

Most Near-Retiree Households Have Resources from Employer Plans and IRAs

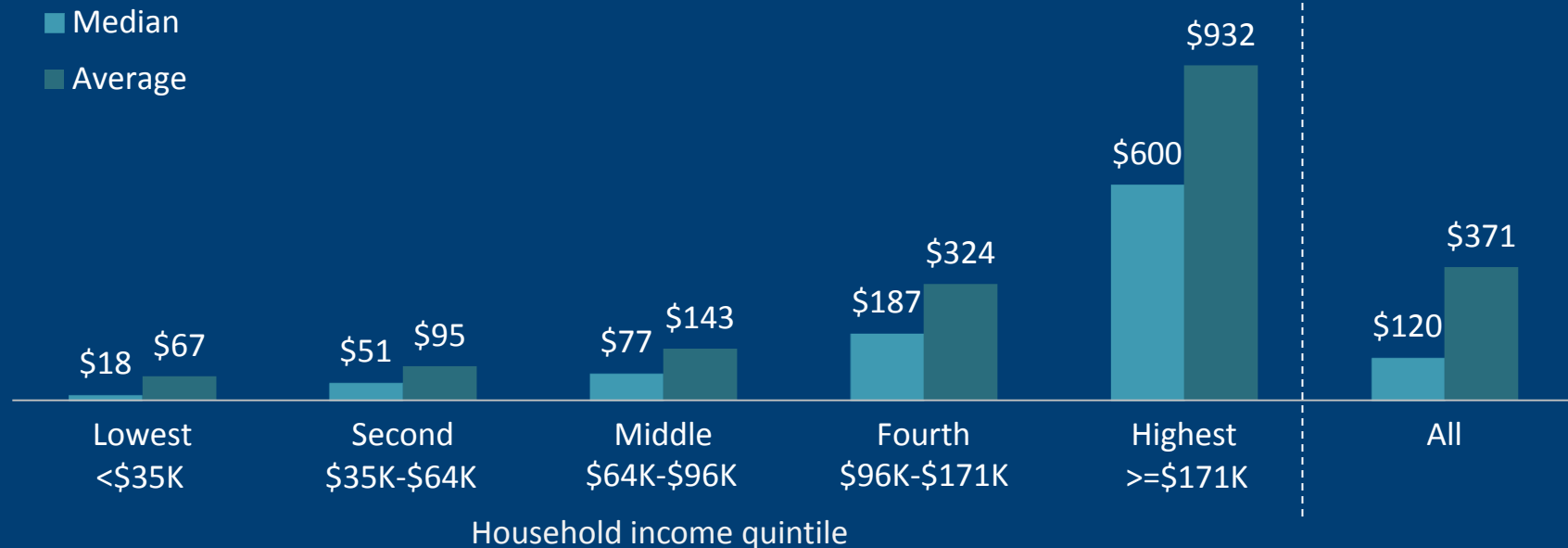
Percentage of working households aged 55 to 64, 2016



Source: Federal Reserve Board's Survey of Consumer Finances

Retirement Assets Increase with Household Income

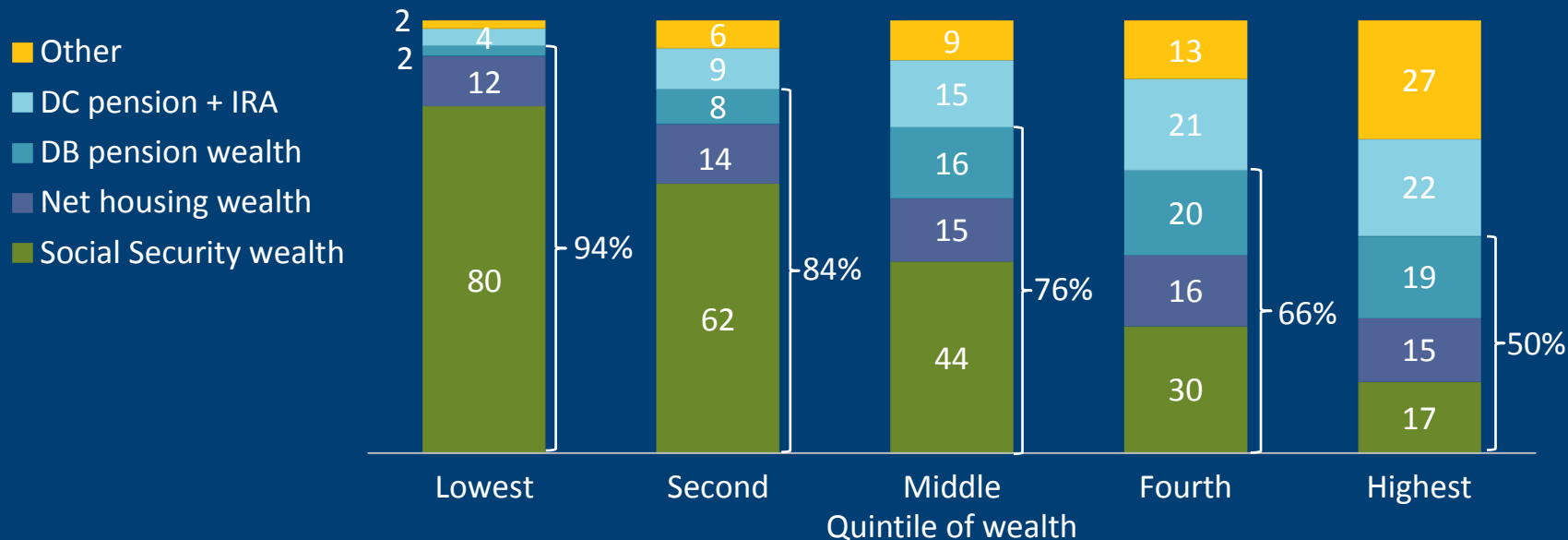
Retirement assets (DC + IRA) for working households aged 55 to 64 with retirement assets, thousands of dollars, 2016



Source: Federal Reserve Board's Survey of Consumer Finances

Many Near Retirement Are Already Highly Annuitized

Percentage of comprehensive wealth by wealth quintile, * 2010

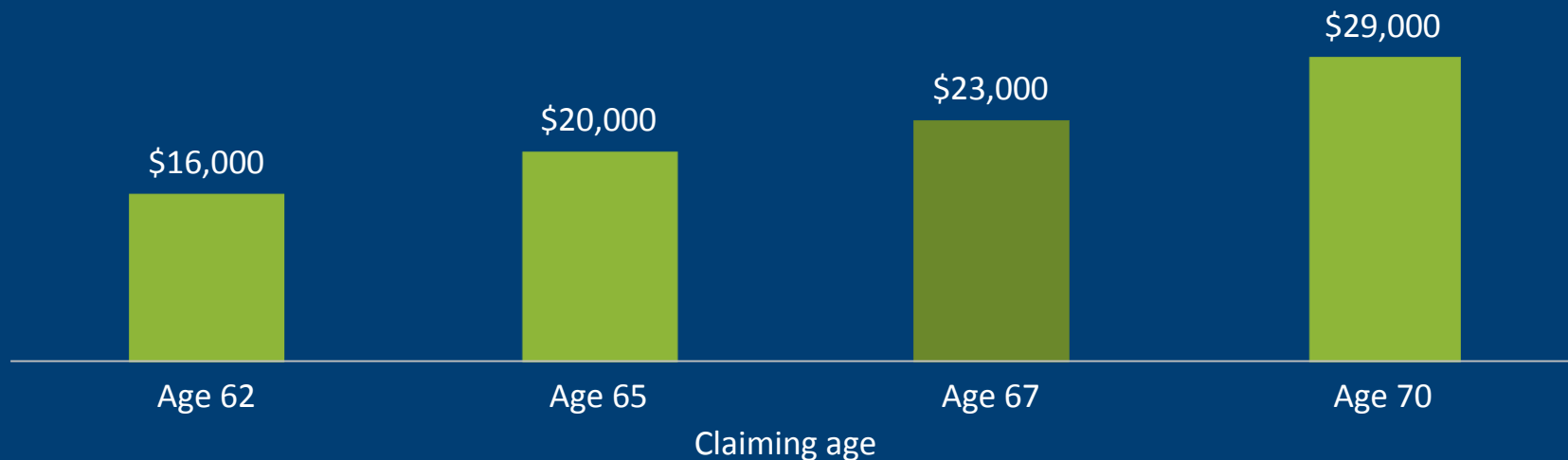


*Data represent households with at least one member aged 57 to 62 and exclude the top and bottom 1 percent.
 Source: ICI tabulation derived from an updated Table 3 of Gustman, Steinmeier, and Tabatabai (2009)

The Best Way to “Buy” Annuities

Social Security Benefits Adjust Based on Claiming Age

Average projected Social Security benefits net of income tax for workers born in the 1960s,* constant 2018 USD †



*Scheduled benefits if claimed at the full benefit age (age 67)

†Rounded to the nearest thousand

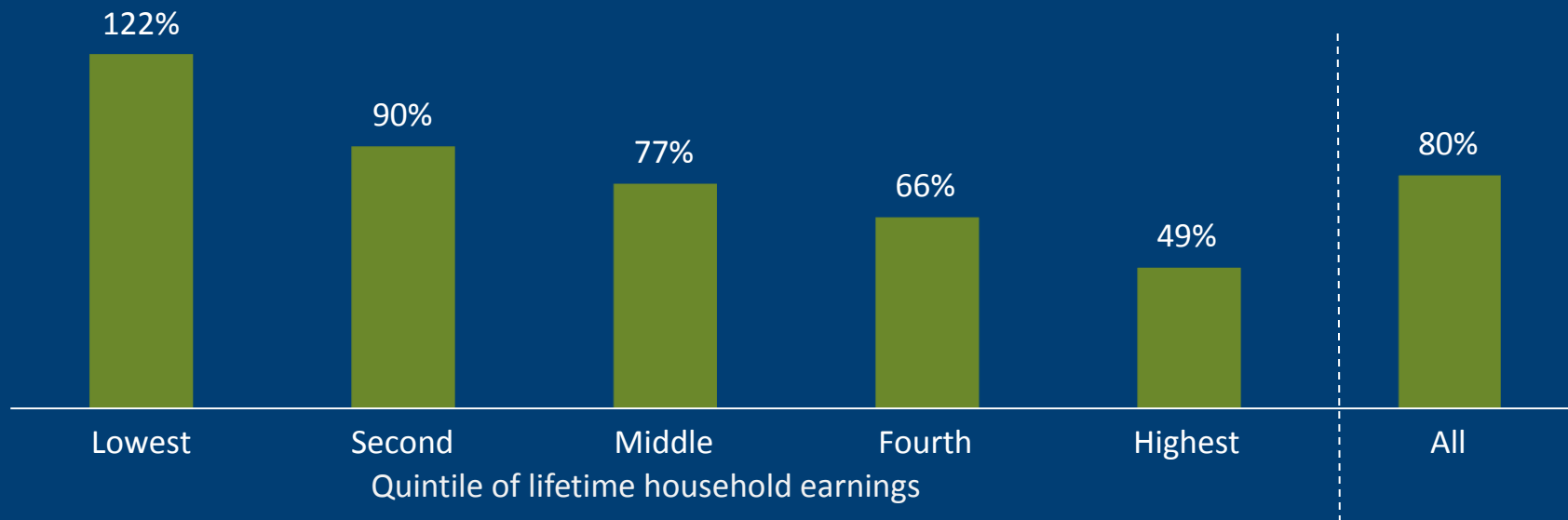
Sources: Congressional Budget Office and Investment Company Institute

No One Who Claims Social Security Before Age 70 Should Purchase a Market-Priced Annuity

- » Delayed claiming produces more “bang-for-the-buck”
 - » Benefit adjustments designed to be actuarially fair
 - » Better than actuarially fair at current interest rates/mortality
- » Those contemplating purchasing a market-priced annuity should
 - » Delay claiming Social Security benefits
 - » Spend down funds earmarked for annuity purchase

Note: Does Not Mean *All Should* Delay Claiming

Average projected Social Security replacement rate* for workers in 1960s birth cohort who claim at age 70



*Scheduled benefits net of income tax as percentage of average inflation-indexed earnings
Sources: Congressional Budget Office and Investment Company Institute

Need for Retirement Income Is a Market Opportunity, Not a Public Policy Concern

Public Policy

- » Retirees want both annuities and investments
- » Most Americans already highly annuitized
- » Most lower-income household should not purchase a market-priced annuity (delay claiming Social Security instead)

Market Opportunity

- » Many higher-income households likely desire additional regular income, especially given the shift from DB to DC