



Definitions of **bolded key terms** are at the end of this article.

## JASON J. FICHTNER,

PhD, is Senior Lecturer in the Department of Economics and Finance, and Associate Director of the Master of International Economics and Finance program at the Johns Hopkins University School of Advanced International Studies. He is also a Research Fellow with both the Alliance for Lifetime Income and the Retirement Income Institute.

Kaitlyn O'Neill is a student at the Johns Hopkins School of Advanced International Studies working toward a Master of Arts degree in international economics and finance. She also holds a Bachelor of Commerce degree in economics and management science.

### Authors, Titles and Publication Dates of the Articles Addressed in the Insight

Brown, Jeffrey R., Jeffrey R. Kling, Sendhil Mullainathan, and Marianne V. Wrobel. 2008. "Why Don't People Insure Late-Life Consumption? A Framing Explanation of the Under-Annuitization Puzzle." *American Economic Review* 98 (2): 304–9. <https://www.aeaweb.org/articles?id=10.1257/aer.98.2.304>

Beshears, John, James J. Choi, David Laibson, Brigitte C. Madrian, and Stephen P. Zeldes. 2014. "What Makes Annuitization More Appealing?" *Journal of Public Economics* 116 (C): 2–16. <https://www.sciencedirect.com/science/article/abs/pii/S004727271300114X>

Hurwitz, Abigail. 2019. "Using Behavioral Insights to Increase Annuitization Rates: The Role of Framing and Anchoring." *Brookings Institution, Washington, DC*. [https://www.brookings.edu/wp-content/uploads/2019/06/ES\\_201906\\_HurwitzAnnuitities.pdf](https://www.brookings.edu/wp-content/uploads/2019/06/ES_201906_HurwitzAnnuitities.pdf)

**Who Should Read This Insight:**  
Financial professionals, insurance companies, and annuity manufacturers.

**Institute Research Agenda Topic:**  
New takes on the annuity puzzle.

# Insight: THE ANNUITIZATION DECISION AND FRAMING

## IDEAS IN THE INSIGHT YOU CAN PUT INTO ACTION

The authors' research findings suggest the following insights and ideas: (1) Annuity demand could be increased if finance professionals were to use different framing techniques—that is, ways of structuring their conversations with retirement savers about annuities. Specifically, they should adopt a frame that focuses on how money from an annuity will ultimately be spent (consumption), rather than using a frame that focuses on the risk and return characteristics of an annuity (investment). (2) Annuity demand could be increased by presenting consumers with more partial annuitization options, instead of forcing them to choose between receiving 0% or 100% of their retirement benefit in the form of an annuity. (3) Annuity demand could be increased by testing further customization of annuities, such as by offering an annual bonus payment, which would be financed by lowering the payment made in the other months throughout the year. Finally, (4) some frames have no impact on annuity demand, such as explaining that the annuity being offered is a better deal than what could be purchased on the open market.

## PRINCIPAL INSIGHTS

These three articles focus on the annuity puzzle—that is, the divergence between economic theory, which suggests that annuities improve the welfare of individuals longevity risk (i.e., the risk of outliving their assets); and economic data, which show that relatively few consumers opt to receive their retirement benefit in the form of an annuity (i.e., a retirement benefit in the form of a series of regular payments). The first two articles, "Why Don't People Insure Late-Life Consumption? A Framing Explanation of the Under-Annuitization Puzzle," and "What Makes Annuitization More Appealing?," use an experimental approach, and are based on online surveys conducted with Americans approaching retirement age. The third article, "Using Behavioral Insights to Increase Annuitization Rates: The Role of Framing and Anchoring," builds on existing economic literature and focuses on the role of framing and anchoring in increasing annuitization rates. The commonality among the three articles is that the authors believe a possible explanation for the annuity puzzle involves behavioral factors (i.e., how people respond emotionally), and does not involve only pure economic factors, and, in particular, how the annuitization decision is framed (i.e., presented) to retirees.

Financial professionals can better design annuity products and increase annuitization by understanding the reasons for the annuity puzzle. In their article "Why Don't People Insure Late-Life Consumption? A Framing Explanation of the Under-Annuitization Puzzle," Jeffrey Brown and colleagues suggest that the manner in which the annuity decision is framed, or presented, to a retirement saver can explain the annuity puzzle. They hypothesize that many consumers view the annuitization decision in an investment frame

(narrowly focusing on the risk and return features of the annuity) rather than in a consumption frame (focusing on how the money from the annuity will ultimately be spent over time). The authors also argue that, under the consumption frame, consumers view an annuity as an attractive investment and a form of insurance, whereas under the investment frame, they view an annuity as an unattractive investment that is riskier than a bond, since its return ultimately depends on the time of death, which is unknown at the time of purchase.

The authors tested their hypothesis using an experiment that consisted of an online survey of American adults age 50 and older in December 2007. The authors developed scenarios that involved a retiree deciding whether to access a retirement benefit in the form of a life annuity (i.e., an annuity that makes payments for the rest of its owner's life) as opposed to either a non-life annuity product (i.e., annuities that make payments for 20 or 35 years, rather than until the retiree's death) or a non-annuity product (i.e., savings account bond). Some of the survey participants in each group were told of the scenarios using a consumption frame, whereas others were told of the scenarios using an investment frame.

Based on the survey responses, the authors concluded that framing is important to the annuitization decision. The majority of survey participants who were presented with the scenarios in an investment frame chose non-life annuity products and non-annuity products over the life annuity product. In contrast, the majority of survey participants presented with the scenarios in a consumption frame chose the life annuity over non-life annuity products and non-annuity products.

The authors find that individuals prefer life annuities over non-life annuity products and non-annuity products, both when consumers have a strong bequest motive, and plan to leave assets to their heirs, and when consumers have a weak bequest motive, and plan to leave money to charity. In addition, the authors studied how bequest motives (i.e., a desire to leave money after death to family or others) affect survey participants' decisions to choose a life annuity over other products, for example by examining the impact of telling participants that any remaining payments after death will go to charity instead of to the retiree's children. When told in the consumption frame that any remaining payments after the death of the retiree will go to charity, most participants preferred a monthly life annuity over a comparable consumption stream from a savings account. In one example, 72% of participants preferred a \$650 per month life annuity over a comparable consumption stream. For those presented with the scenarios in an investment frame and told that any remaining payments would go to charity, 21% of participants preferred a \$650 per month life annuity over the consumption stream from a savings account of comparable actuarial value.

When the survey participants were told that any remaining payments from the investment products would go to the retiree's children rather than to charity, the percentage of participants preferring the life annuity under the consumption frame declined. Under the consumption frame with this strong bequest motive, 59% of participants preferred the \$650 per month life annuity over the consumption stream from a savings account of comparable actuarial value. Furthermore, 65% of participants preferred the life annuity to an annuity paying \$650 per month for 20 years; 53% of participants preferred the life annuity to an annuity paying \$500 per month for 35 years; and 49% of participants preferred the life annuity to a bond paying \$400 per month forever. Among the participants who were presented with the scenarios in an investment frame, however, the percentage choosing the life annuity over other investment products also declined.

Similar to the first article, this article, “What Makes Annuitization More Appealing?,” from John Beshears and colleagues uses surveys of American adults who are approaching retirement age. Moreover, the surveys outlined in this article focus on several factors besides the role of framing in the annuitization decision. The surveys focused on understanding what factors are important to individuals in the annuitization decision, how partial annuitization could influence overall annuitization rates, the real income path desired by consumers in their retirement (i.e., how much money after inflation people want on a monthly or annual basis over the course of their retirement years), and whether consumers are interested in an annuity that offers an annual bonus payment.

The survey asked consumers what factors are most important to them in their annuitization decision. The considerations that received the highest average ratings by the respondents were (1) a desire to ensure they have enough income later in life, (2) a desire for flexibility in when they spend their assets, and (3) worry about the company’s ability to pay them the benefit in the future. Of intermediate concern were inflation, consumers’ desires to invest their money on their own, and their desire to prevent overspending. Finally, the desire to leave money to their children and concern over dying early were low-level concerns for the respondents.

In terms of partial annuitization, the authors compared annuitization choices under two options: (1) the all-or-nothing option, under which survey respondents had to choose between receiving 0% or 100% of their retirement benefit in the form of an annuity; and (2) the partial annuitization option, under which there were five incremental annuitization options, in increments of 25% between 0% to 100% of one’s retirement benefit. The authors found that 59% of survey participants chose partial annuitization when they were given such an option. Also, the fraction of participants who chose to fully annuitize fell from 50% to 21%, and the fraction of participants who chose a lump sum with no annuity fell from 50% to 20%. Furthermore, allowing for partial annuitization raised the average percent of pension wealth annuitized from 50% to 57%.

The authors found that people tend to prefer an income stream during retirement that increases every year, presumably because people expect their consumption to increase every year. For example, 50% of survey participants preferred an increasing consumption path, while only 32% preferred a flat consumption path. The authors acknowledge that this is inconsistent with the actual consumption path that consumers exhibit during retirement, since empirical evidence has shown that, holding household composition fixed, the path of consumption for retirees is a 2% decrease in real (after adjusting for inflation) consumption per year.

Annuities provide people with guaranteed income later in life. How annuities are framed or presented to consumers matters. In terms of how annuities are framed, the authors found that two frames significantly reduced demand for annuities, relative to a neutral frame. These two frames that reduce demand for annuities are (1) a focus on flexibility in the timing of spending and control over investments, and (2) a focus on investment attributes. A frame that focuses on partial annuitization could increase the demand for annuities. Furthermore, the authors found that there were four frames that did not have an impact on annuity demand. These four frames are (1) explaining that the annuity being offered is a better deal than what could be purchased on the open market, (2) presenting the total expected undiscounted lifetime payments from the annuity, (3) explaining that the annuity provides insurance against outliving one’s assets, and (4) explaining that the annuity transfers money from a time where one is dead and the value of money is low to a time where one is alive and the value of money is high.

Finally, the authors investigated the demand for an annuity that offers a higher payment one month of the year, known as a bonus payment, that is financed by lower payments during the other months of the year. An annuity making a bonus payment was well received by the survey participants; 60% of participants preferred an annuity with a bonus payment over a traditional annuity. This suggests that increased customization of annuity products by retirees could result in increased demand for annuities.

In this article, “Using Behavioral Insights to Increase Annuitization Rates: The Role of Framing and Anchoring,” Abigail Hurwitz builds on the results of previous economic studies and suggests a behavioral approach to the annuity puzzle. The author believes that behavioral biases (a tendency to take an action based on emotion, or cognitive shortcuts, rather than on fact) prevent individuals from choosing to receive their retirement benefit in the form of an annuity. Specifically, the author focuses on the role of framing and anchoring in the annuitization decision. Anchoring is a behavioral economic term that suggests people tend to rely too heavily on the first piece of information offered when subsequently making decisions after receiving additional information. For example, if a person shopping for a car first sees one that costs \$50,000, then sees a second car that costs \$25,000, the person is either likely to view the second car as either a good deal or as of lesser value, because the comparison is anchored to the first price irrespective of the actual quality or value of the second car.

In terms of framing, the author argues that focusing on a consumption frame, by describing an annuity as a future stream of income, could increase the annuitization rate, as shown in other studies, including those mentioned above. The author believes that one way this could be achieved is by reporting the level of the expected annuity (i.e., the percentage of assets that are annuitized upon retirement) in the annual reports that are sent out to survey participants in defined-contribution pension plans. The author also believes that a consumption frame should be accompanied by a minimum target level for annuitization (i.e., a suggestion for the minimum percentage of assets at retirement that should be annuitized), since this type of anchoring toward the target level could increase demand for annuities.

## Conclusion

The authors of these three articles suggest that a potential explanation of the annuity puzzle is the framing, or presentation, of the annuitization decision. The first article, “Why Don’t People Insure Late-Life Consumption? A Framing Explanation of the Under-Annuitization Puzzle,” displays evidence of higher annuitization rates when a consumption frame is used rather than an investment frame, even when the bequest motive is strong.

In the second article, “What Makes Annuitization More Appealing?,” the authors focus on understanding the role of framing and what factors are important to individuals in the annuitization decision. The authors also discuss the positive impact that partial annuitization options and an annual bonus payment might have on increasing the demand for annuities. They further focus on understanding what factors are important to individuals in the annuitization decision, the positive impact partial annuitization can have on overall annuitization rates, the income path desired by consumers during their retirement, and whether or not consumers are interested in an annuity that offers an annual bonus payment. In terms of framing, the authors find that the frames that have a significant negative impact on annuity demand are a focus on flexibility and control, and a focus on investment attributes.

Finally, in the third article, “Using Behavioral Insights to Increase Annuitization Rates:

The Role of Framing and Anchoring,” the author argues that presenting the annuitization decision in a consumption frame, with a minimum target level for annuitization, could increase demand for annuities.

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To learn more, visit the Retirement Income Institute at [www.allianceforlifetimeincome.org/retirement-income-institute](http://www.allianceforlifetimeincome.org/retirement-income-institute)

**KEY TERMS ARE SOURCED FROM THE ALLIANCE FOR LIFETIME INCOME'S ANNUITIES LANGUAGE GLOSSARY AND INVESTOPEDIA**

**annuitization:** *The process of converting an investment into a series of periodic income payments by buying an annuity or beginning an income flow from an annuity.*

**annuitize:** *When you turn your current account balance into a series of periodic income payments, either for a specific period of time or for your whole life.*

**annuity:** *A financial product that can offer protected lifetime income and even potentially grow your money.*

**annuity products:** *The types of annuities available.*

**annuity products:** *The types of annuities available.*

**annuity puzzle:** *The annuity puzzle refers to the fact that few people choose to annuitize even a portion of their accumulated savings even though they have many good and rational reasons to do so.*

**financial professional:** *A qualified person who can help you understand your options and make financial decisions to work toward your financial goals.*

**frame, framing:** *Framing is how financial products are presented to consumers.*

**life annuity:** *An annuity that makes payments for the rest of its owner's life.*

**longevity risk:** *The chance that you will live longer than your income will last.*

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