RETIREMENT INCOME INSTITUTE
Alliance for Lifetime Income

Who Should Read This Insight:
Retirement investors, financial professionals, annuity manufacturers, policymakers, researchers

Institute Research Agenda Topic:
New takes on the annuity puzzle, optimizing annuities in a retirement portfolio, understanding differences in consumer behavior and decision-making.

Insight: INFORMATION AND ENGAGEMENT IN CHOOSING ANNUITIES: A SURVEY OF PRE-RETIREES

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

LINDA S. JAMISON
is an author, public speaker, and consultant who has served in senior executive positions in the US government, including in the White House. She has worked at the United Nations and was a senior leader with the Center for Strategic and International Studies, where she was the founding dean of an international leadership academy. Jamison has trained and advised policymakers and political leaders in the art and practice of leadership both in the United States and abroad. She has a master's degree from American University in Washington, DC, and a bachelor's degree from the University of Denver.

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

Hazel Bateman, Jennifer Alonso Garcia, Eduard Ponds, and Ralph Stevens. 2019. "Learning to Value Annuities: The Role of Information and Engagement." Working paper, Institut sur la retraite et l'épargne, HEC Montréal, PQ, Canada. http://ire.hec.ca/wp-content/uploads/2019/11/Bateman-et-al_Learning-to-value-annuities_2019.pdf.

Hazel Bateman is Professor at the School of Risk and Actuarial Studies, University of New South Wales (UNSW) Sydney, Australia.

Jennifer Alonso Garcia is Professor of Actuarial Science at the Department of Mathematics of the Université Libre de Bruxelles in Belgium; and Associate Investigator @ARC Center of Excellence in Population Ageing Research at the UNSW Business School.

Eduard Ponds holds the chair of Economics of Pensions at Tilburg University in the Netherlands and is employed at the Dutch pension service provider APG (www.apg.nl).

Ralph Stevens is Researcher at the CPB Netherlands Bureau for Economic Policy Analysis.

IDEAS IN THE INSIGHT YOU CAN PUT INTO ACTION

Current trends show that most economically developed countries have seen public and private pension programs move away from defined-benefit plans and toward defined-contribution plans. This shift gives consumers more choices as they make investment choices and plan for retirement. These choices can range from annuity investments that offer guaranteed lifetime income, to flexible accounts that require periodic drawdowns and come with more options. More variety can be an attractive incentive to retirement planning, but the details of individual products can be confusing if consumers do not know how products work or how to weigh the risks and benefits of specific plans. Hazel Batemen and colleagues conducted an online survey of Australian and Dutch pre-retirees aged 50–64 to understand how individuals plan to make retirement benefit decisions once they stop working and to determine whether partial or full annuitization would be more appealing to them. By providing repeated learning opportunities for the participants throughout the survey, the authors were able to draw important conclusions about the factors that might predict whether consumers prefer annuities over flexible pension products.

PRINCIPAL INSIGHTS

According to a 2017 study produced by the Organisation for Economic Co-operation and Development (OECD), most economically developed countries have seen a steady transition away from defined-benefit plans and toward defined-contribution plans. To understand how consumers are adapting to this transition, and to contribute to the debate on how people make retirement benefit decisions, Hazel Bateman and colleagues created an experimental online survey.

In designing the survey, the authors focused on how the perception of **lifetime annuity** investment products might differ from flexible drawdown plans in two economically developed countries—Australia and the Netherlands—where the choices between pension plans are similar yet have different methods of payment distribution. They examined the behavior of approximately 1,000 Australians and 1,000 Dutch **consumers** aged 50–64 who were either **pre-retirees** or who were part of a couple where at least one person was not retired. The authors designed the survey to reflect elements of the national pension systems from both countries. They assumed that the Australian participants were acquainted with both a lifetime annuity system from a state pension they receive and a pension structure offering flexible options and drawdowns. They further assumed that the Dutch survey participants were familiar with their country's defined-benefit retirement structure with compulsory **annuitization**. The authors thus assumed that Dutch participants had little or no experience with anything but **annuity** products. The participants from each country were randomly selected from an international database and were paid to complete the survey.

The experimental survey was divided into six stages. Each stage was designed to take the participants through a series of steps that would expose them to the differences, critical trade-offs, risks, and flexibility of two types of retirement investment products: an annuity that they termed lifetime guaranteed income and a phased withdrawal scheme that they termed a **flexible account product**. As participants progressed at their own pace through the six stages, the survey presented them with general information about each product, quizzed them on their knowledge about the products, asked them about their attitudes toward each product, exposed them to price lists for the products, asked them to complete a set of tasks, and, finally, asked them to choose a product based on what they had learned. Each participant completed the survey in about 35 minutes.

The first stage of the survey provided general information about each product with details, and then quizzed the participants on the specific features of each of the two products. The results showed that most participants got four out of the five questions correct, but that only 43 percent of the Dutch and 45 percent of the Australians made no mistakes. The most mistakes they made were on the questions about whether remaining wealth can be inherited, and whether financial markets impact the retirement product. Interestingly, despite the Netherlands having a predominantly defined-benefit pension system, slightly more of the Dutch participants did not know that payments from the annuity product were not dependent on financial market fluctuations. The authors speculated that this is an ordinary mistake made when people confuse the adjustments made to the value of an annuity. All of the participants were given feedback on their incorrect answers so they could learn about the product features.

After the authors had provided participants with general information about each product and after the participants had completed the quiz, Bateman and colleagues assigned each participant at random to one of the **framed** explanations of each product. These explanations were divided into four framing treatments (consumption gain, consumption loss, investment gain, investment loss) for each retirement investment product, and the general product features for the two retirement benefit products were presented on the screen as a reminder of the general details as the participant worked through the survey. Informing participants of the gain/loss of each product served, according to the authors, as a creative way to emphasize the trade-offs between consuming and investing where particular words (e.g., income, return, standard of living, and portfolio) appeared in bold. With this tactic the authors prompted the participants to associate the trade-offs of certainty and risk with either the guaranteed lifetime income product or the flexible account product.

The authors intended from the start to help the participants learn as they progressed through the six stages of the survey. A major reason for providing chances to learn was a critical component of the experiment. The authors contend that helping participants make educated choices about retirement benefit products with which they are unfamiliar will reduce the confusion and uncertainty about the products when it comes time for them to make decisions. For example, in addition to providing feedback on the incorrect answers to the quiz, each participant was given an online calculator to help them with mathematical formulas when choosing options about the amount of retirement income and investments they preferred. Another learning opportunity was the appearance of frequent onscreen reminders of the product details, such as whether it provides flexibility in the event the **retiree** has unexpected expenditures, and whether the product guarantees income for life.

Some of the trends and themes identified by the authors as a result of the survey evaluated how the participants perceived the pension products as a function of their willingness to pay or their willingness to accept a full or partial annuity product as the choice in a retirement benefit program. First, the authors concluded that the participants who were more financially knowledgeable and who engaged in the survey were better able to understand the finer points of each pension product regardless of which country they were from. Next, those who have spent more time considering their retirement needs, including the income they will need during retirement, showed a better understanding of the annuity product. The Australian participants showed a preference for the flexible account product compared to the annuity product, possibly because they do not have any real-world experience with the latter; the authors explain that the flexible account product has been a favored product in that country. The authors state that, although the participants did not generally prefer one product over the other based solely on its financial value, they did prefer one over the other based on the product's perceived usefulness.

Finally, the authors provide three suggestions for policymakers and product developers based on the survey findings: First, people tend to prefer the products that they are familiar with instead of products that require them to learn new details and rules. Second, when presenting consumers with basic information about retirement products, it is critical to keep explanations simple. And third, financial advice that explains the financial implications of products in real time, such as having use of the interactive calculator, leads to informed choices.

To learn more, visit the Retirement Income Institute at
www.allianceforlifetimeincome.org/retirement-income-institute

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

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

consumer: *Someone who invests in annuities.*

defined-benefit plan: *A defined-benefit plan is an employer-sponsored retirement plan where employee benefits are computed using a formula that considers several factors, such as length of employment and salary history.*

defined-contribution plan: A *defined-contribution plan is a retirement plan that is typically tax deferred, like a 401(k) or a 403(b), in which employees contribute a fixed amount or a percentage of their paychecks to an account that is intended to fund their retirements.*

flexible account product: *A product that allows flexible withdrawals from a pension account.*

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

lifetime annuity: *A lifetime annuity is an investment vehicle that functions as a personal pension plan.*

pre-retiree: *Adults age 45 and up who have not retired.*

retiree: *Someone who has retired, regardless of age or investments.*

For industry use only.