2021 PROTECTED RETIREMENT INCOME & PLANNING STUDY

Expert Viewpoints

A collection of short essays offering unique perspectives by Fellows from the Alliance for Lifetime Income's Retirement Income Institute.

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PROTECTED RETIREMENT INCOME & PLANNING STUDY

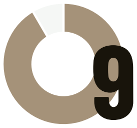
ANNUITY EDUCATION MUST TAKE CENTER STAGE FOR ADVISORS TO MEET THE DEMAND FOR PROTECTION IN RETIREMENT

By Michael Finke, PhD, fellow at the Alliance for Lifetime Income 's Retirement Income Institute, and professor and Frank M. Engle chair of economic security research at The American College of Financial Services

AMONG THE 491 INVESTOR RESPONDENTS WHO HAVE PURCHASED ANNUITIES...

75%

INDICATED ABOVE AVERAGE SATISFACTION WITH THEIR PURCHASE (ONLY 2% WERE DISSATISFIED) AND



92%

FELT THAT THEIR ANNUITY WAS SOMEWHAT OR EXTREMELY IMPORTANT TO THEIR FINANCIAL SECURITY.

Americans want the lifetime income security that only annuities can provide. Ninety-one percent (91%) of investors in the 2021 Protected Retirement Income and Planning Study rate protected retirement income as very or moderately important, and 95% feel that it is somewhat or extremely valuable to have guaranteed lifetime income to supplement Social Security income. The ability to provide an income stream that lasts a lifetime is far more important to consumers than other characteristics that financial advisors often value the most, such as asset optimization. A lifetime income stream is the most important attribute of protected income among respondents of all ages, incomes, education levels, and race. Clearly, Americans want the reliability and security of lifetime income.

But the study also reveals a disconnect between what people want and what people know about annuities. Fewer than half (46%) of investors associate annuities with creating a lifetime income stream. The inability to correctly associate annuities with one of their key benefits was even more pronounced among middle-aged (39%) than among retirement-age (49%) investors, and among those with lower levels of education. Women, those with fewer years of education, and lower-income respondents were also less likely to know much about annuities. Only 17% indicate that they are extremely familiar with annuities. Paradoxically, those who placed the highest value on lifetime income are often the groups who say they know the least about the product.

It is not surprising that, despite placing a high value on protected lifetime income, only 1 in 7 investors indicate that they are extremely interested in buying an annuity. They simply do not know enough about the product. The top reasons listed for not buying an annuity include the perception that they can get a better return on other investments, high fees, and lack of awareness.

Among the 491 investor respondents who have purchased annuities, 75% indicated above average satisfaction with their purchase (only 2% were dissatisfied) and 92% felt that their annuity was somewhat or extremely important to their financial security.

Financial advisors can bridge this knowledge gap by providing objective information about the benefits and costs of various annuity products. Among the respondents who work with a financial advisor, more than half (57%) say their advisors has discussed annuities with them. There are also clear differences between advisor channels when it comes to the perceived importance of creating a lifetime income stream. While only 40% of Registered Investment Advisers (RIAs) use a retirement income approach developed to provide a lifetime income stream, between 51% and 62% of advisors in other distribution channels employ this approach. The differences are even more dramatic when advisors are asked about the importance of asset protection. While only 58% of RIAs feel that protection is very important, between 78% and 92% of the other five advisor channels included in the study consider protection a very important aspect of retirement planning.

It is not necessarily surprising that investors value what high-quality annuities can provide in retirement. Advisors and the industry can do more to help investors both understand the value annuities provide and navigate complex products to select the right solution which provides the protection investors demand.

A GENERATIONAL LENS PROVIDES NEW INSIGHT INTO THE ANNUITY PUZZLE

By David Blanchett, fellow at Alliance for Lifetime Income's Retirement Income Institute, and Managing Director and Head of Retirement Research at QMA

Annuities provide a valuable form of insurance against longevity risk that is effectively impossible to replicate in a traditional portfolio of stocks and bonds.

There are few financial products where perceptions differ as significantly between academics and consumers as annuities. Academics generally have positive views of annuities, which I define as products that provide guaranteed, or protected, income for life. Annuities provide a valuable form of insurance against longevity risk that is effectively impossible to replicate in a traditional portfolio of stocks and bonds.

Consumer perceptions of annuities vary and are not always as positive as those of academics. Despite the nearly 50 years of research on the potential value of annuities, and annuitization in general, demand for annuities is well below suggested levels, an effect often referred to as the "annuity puzzle."

It is important to understand why these differences exist. The inaugural Protected Retirement Income and Planning Study, conducted for the Alliance for Lifetime Income and CANNEX by Artemis Strategy Group, surveyed people between the ages of 45 and 75 with $100,000 in investable assets about their perceptions of annuities.

The more fascinating results of the survey center on the varied interest in owning an annuity and the reasons an individual chooses to pass on that option. There are also some interesting responses across ages. Here are some highlights.

Firstly, it is important to note that interest in annuities or lack thereof varied significantly by respondent. In short, there does not appear to be a common denominator explaining why households choose not to annuitize. There is no simple answer.

Secondly, there was a notable decline in interest in purchasing an annuity as investors got older. At first this may seem counterintuitive since one would think interest in a product that provides guaranteed lifetime income would rise as someone approaches retirement. In reality, what happens is that annuity ownership rises by age and households end up joining the pool who already own an annuity (and are not purchasing more annuities) or those who are not interested in purchasing one. In other words, people who want to buy an annuity do, and those that have yet to purchase one become increasingly less likely to do so as they get older.

Thirdly, there are also differences by age in why individuals choose not to own an annuity. For example, younger investors (ages 45-55) are not being adequately informed about annuities, much less having the product recommended to them. Older investors (ages 65-75) cite having sufficient perceived savings or existing sources of guaranteed income as well as being warned against purchasing annuities as reasons for their reluctance. In other words, there is no one reason consumers eschew annuities.

The results of the survey suggest that younger consumers have potential interest in annuities but need more education. In older households, investors may not think they need annuities, but if they are properly educated on the risks of retirement, especially longevity risk, their thinking may change. The annuity puzzle is, in some sense, a series of puzzles but the missing piece is most likely consumer education.

AMERICANS ARE TURNING TO ANNUITIES, AND THEIR EMPLOYERS, IN SEARCH OF PROTECTION

By Jason J. Fichtner, PhD, senior fellow and head of the Alliance for Lifetime Income's Retirement Income Institute

The effective elimination of private-sector pensions has not absolved employers of the responsibility to innovate new approaches to workplace benefits.

In the early 1980s, 60% of private sector workers in the U.S. relied on a pension as their only retirement account. That number had winnowed down to a mere 3% in 2020. Alas, the metaphor of a three-legged stool for retirement planning—employer pensions, personal savings and Social Security—that once represented a financially secure retirement for generations of Americans is now a precarious construct consisting of just two legs.

To their credit, Americans recognize that a new structure is needed—one that provides guaranteed income in retirement. According to a joint research study by the Alliance for Lifetime Income and CANNEX, a near-unanimous majority of investors (91%) say it is important that their retirement income plan is designed to provide a guaranteed income payment or principal protection, while more than half of investors (56%) who have an employer-sponsored retirement savings plan are at least moderately interested in investing in an annuity through that plan.

Lawmakers are also taking steps to help Americans do just that. Congress passed the Setting Every Community Up for Retirement Enhancement Act of 2019, also known as the Secure Act, which makes it easier for a retirement plan sponsor to offer an annuity option in a defined-contribution plan. This provision enables employers to offer an annuity option (traditionally associated with defined-benefit pensions) within a defined-contribution retirement plan. A bipartisan effort is also underway to pass "Secure Act 2.0," which might offer additional measures to compensate for the increasing absence of pension plans.

Employers have always been fundamental to our nation's retirement readiness—as evidenced by the fact that more Americans have an employer-sponsored plan than any other retirement account other than Social Security. According to a 2020 study by the Department of Labor's Bureau of Economic Statistics, 67% of private sector workers had access to private retirement accounts. Fifty-two percent of them only had access to defined-contribution plans and 12% had access to both a defined-contribution plan and a defined-benefit plan. Only 3% of private industry workers have access only to a pension—a number that continues to fall.

For many decades, Americans have relied on their employers to help them prepare for a financially secure retirement, initially in the form of a pension, and now in the form of 401(k)s and, increasingly, annuities. The popular narrative in retirement security circles today is that the shift from pensions to defined-contribution plans has moved the burden of providing for retirement security from the employer to the individual. And while this may be true in a technical sense, the Alliance-CANNEX study (among others) contributes to the growing body of evidence that suggest employees are still looking to their employers for retirement planning guidance and assistance. The demand in the workforce for employers to provide the tools needed to guarantee lifetime income in retirement is irrefutable.

The effective elimination of private-sector pensions has not absolved employers of the responsibility to innovate new approaches to workplace benefits. For those that accept this responsibility, the good news is that there is an increasingly robust toolbox to create the financial protection their workers are asking for.