

RETIREES SPEND MORE WITH LIFETIME INCOME

BY DAVID BLANCHETT AND MICHAEL FINKE

The shift from defined benefit to defined contribution savings plans means that retirees must decide how much to spend each year from savings. Estimating how much income can be withdrawn from investments in retirement is far more complex than receiving a monthly pension payment. This complexity may lead retirees to spend less than life cycle theory would predict, resulting in reduced well-being and higher unintended bequests.

In our recent paper¹ “Retirees Spend Lifetime Income, Not Savings” we provide an expanded analysis of our original research² “Guaranteed Income: A License to Spend,” exploring how retirees use various sources of wealth to fund spending in retirement. We confirm our previous finding that retirees spend significantly more from wealth held in the form of lifetime income and find evidence that required minimum distributions (RMDs) from qualified accounts allow retirees to frame savings as income.

Our analyses support a concept known as mental accounting. Households tend to bracket accounts such as traditional IRAs, brokerage accounts, and wealth held in the form of lifetime income differently. For example, retirees may try to preserve or grow investment assets while spending lifetime income. This is consistent with prior research on the value of reframing assets as income rather than as a lump sum. Our findings suggest that distribution techniques such as annuitization or RMDs can reduce underspending if retirees ignore the reality that wealth must be either spent or passed on after death.

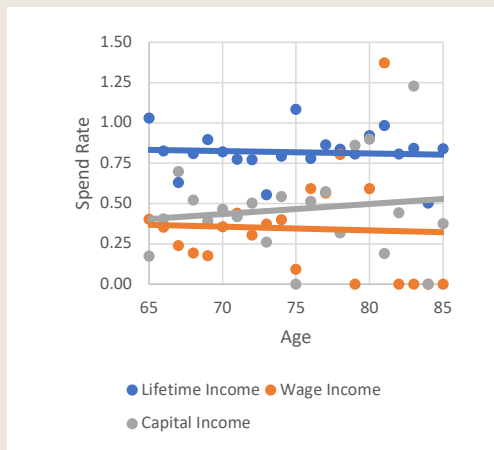
We use data from the Health and Retirement Study (HRS) to better understand how households use qualified savings, nonqualified savings, wage income, capital income, and lifetime income to fund consumption in retirement. We find compelling evidence that retirees spend less from investment assets than from wealth held in the form of lifetime income. For example, while approximately 80% of lifetime income is spent by retirees, only about half of wages and capital income are spent by retirees and spending levels decline as household financial assets increase.

Spending from savings is also significantly lower than would be considered optimal. For example, spending (i.e., withdrawal) rates from savings were only approximately 2.1% for 65-year-old married households and 1.9% for single households. This is significantly less than general guidance on portfolio withdrawal rates (such as the “4% Rule”) or income that could be generated from an annuity. We also find evidence that retirees spend more from qualified savings when RMDs begin. This suggests that automatic liquidation rules can help retirees in-

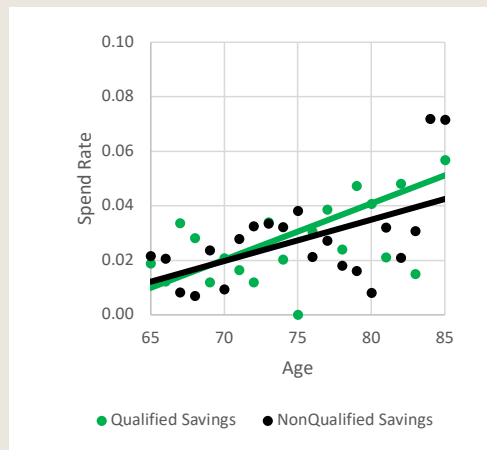
1. https://www.protectedincome.org/wp-content/uploads/2025/03/RP-30_BlanchettFinke_v3.pdf
2. <https://www.protectedincome.org/license-to-spend/>

Exhibit 1: Spend Rates for Married Households

PANEL A: INCOME SOURCES



PANEL B: ASSET SOURCES



Source: 2020 Health and Retirement Study, Accessed March 22, 2024, Authors' Calculations.

crease spending by allowing them to frame financial assets as income.

Our analyses demonstrate that the composition of household assets is likely to have a material effect on how much retirees spend and perhaps most notably that allocating savings to lifetime income, either through delayed claiming of Social Security or buying a lifetime income annuity, is likely to give retirees a “license to spend” that is well beyond what they would be comfortable spending from savings.

SPENDING IN RETIREMENT

The objective of our research is to investigate how households consume from different household financial resources in retirement. We hypothesize that retirees will frame wealth held in investments differently than wealth held as annuitized income, resulting in higher rates of spending from annuitized assets.

In order to investigate differences in spending rates from assets, two broad categories of available financial resources are considered: income and savings. Income is separated into three groups: lifetime income (Social Security retirement benefits, pension benefits, and annuity income benefits), earnings (wages and salaries), and capital income (which includes income from businesses, rental property, dividends and interest, and trust funds or royalties), while savings are broken out

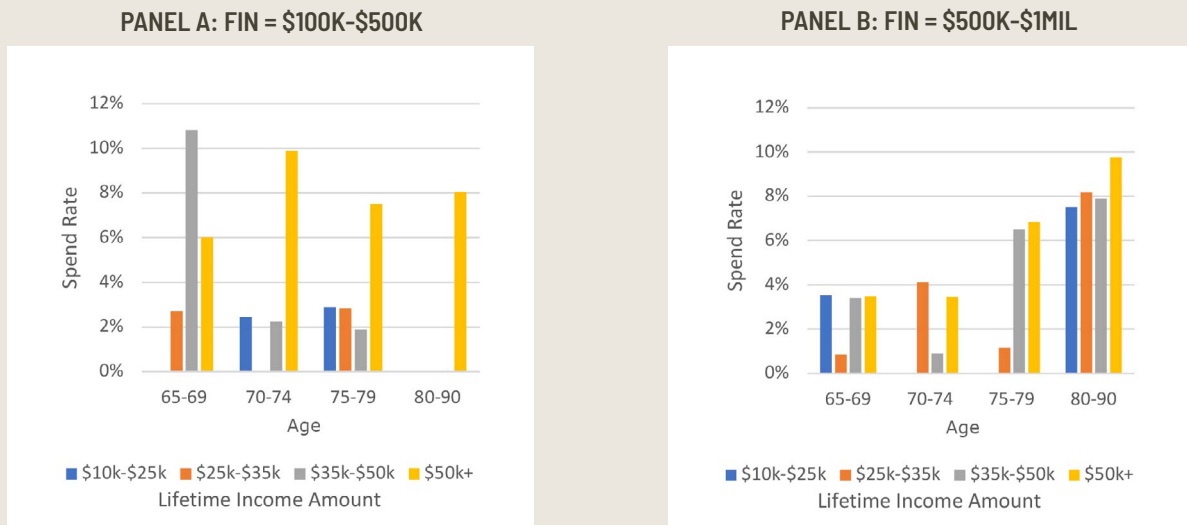
into qualified (defined contribution balances, IRAs, etc.) and nonqualified monies held in taxable accounts. We only include households with at least \$100,000 in total financial assets (in 2019 dollars) in the analysis. After applying a number of additional filters, a total of 2,500 households are included in the analysis resulting in a total of 7,498 observations (since some households could be included more than once).

The analysis largely relies on a series of ordinary least squares (OLS) regressions where the dependent variable is consumption, which we use as a proxy for total spending. While there is a separate total spending variable available in the HRS, we use the consumption variable because it amortizes the potential utility from spending on consumer durables, where the purchase occurs in a single period but the benefits are also realized in future periods. The independent variables for the regressions are the respective resources available to fund spending, which are income and savings either pooled or considered separately depending on the model.

Exhibit 1 includes the spending rates for lifetime income, wage income, and capital income for married households in Panels A and B, respectively, by individual ages. We only include respondents 65 and older since these individuals are most likely to be retired.

Lifetime income sources have a much higher spend rate than wage income or capital income, as documented in Panel A. For example, roughly 80% of lifetime

Exhibit 2: Spend Rates for Qualified Savings by Level of Lifetime Income and Age Group



Source: 2020 Health and Retirement Study, Accessed March 22, 2024, Authors' Calculations.

income is spent (or consumed), while less than half of wage income and capital income are spent. The lower utilization of wage income could be related to things like withholdings, or even saving for retirement, while the lower utilization for capital income could be due to its uncertainty.

With respect to assets, utilization of either money-type (qualified and nonqualified) is well below what would generally be considered optimal. For example, the spend rate from either qualified and nonqualified savings is only about 2% for a 65-year-old couple (Exhibit 9, Panel B), which is roughly half of the commonly cited “4% Rule,” and even lower than most recent estimates, suggesting 5% is a more reasonable starting place.³ The fact spend rates increase by age does suggest required minimum distributions (RMDs) may have a role with respect to spending.

Next, we explore how lifetime income levels could be related to portfolio spending. In other words, a retiree with a higher base of lifetime income may be more comfortable spending down from savings given the assurance of income for life versus a retiree with less lifetime income.

For the analysis, we group households based on age, the amount of lifetime income benefits, and total level of financial assets. We focus on two asset levels: households with \$100,000 to \$500,000 in financial assets and those with between \$500,000 and \$1 million in financial assets. Only married respondents are included because the sample pool is larger. Spend rates are included in Exhibit 2, we only include spend rates for those groups with at least 30 households in the respective combination.

It is clear that households with more lifetime income tend to have higher spend rates, although there is some variation in individual group values. For example, the average spend (withdrawal) rate for households from the ages of 65-69 with between \$100,000 and \$500,000 in total financial assets with lifetime income levels between \$25,000 and \$35,000 had a spend rate of 2.7% versus 6.0% for those with lifetime income exceeding \$50,000 per year. While a 6.0% spend rate may sound high, assuming a median asset level of \$300,000 (halfway between \$100,000 and \$500,000), this would only represent a withdrawal amount of \$18,000, which is likely to be less than a third of lifetime income. In other words, retirees with higher levels of lifetime

3. Guided Spending Rates: <https://www.pgim.com/dc-solutions/article/guided-spending-rates-rethinking-safe-initial-withdrawal-rates>

income typically have a greater capacity to withdraw from their portfolio than they appear to be doing.

CONCLUSIONS

Our analysis clearly demonstrates that households spend differently across sources of wealth. Retirees spend a much higher percentage of their lifetime income and spend about half the amount that they could safely spend from other sources. However, after the government requires distributions from retirement savings accounts, individuals increase their rates of spending from qualified investments.

Retirees appear to bracket wealth held in investments differently than wealth held as income and consequently spend less than would be optimal in a life-cycle model. Differences in retirement spending by assets after retirees must withdraw savings from qualified investment accounts suggests that policy can counteract the tendency to underspend from savings.

Financial institutions that are aware of the tendency to bracket investment decisions differently than lifetime income can focus on reframing wealth as income or automatically liquidate investments to create the appearance of income. For example, managed payout funds designed to distribute a percentage of wealth each year can help retirees frame saving as income. Likewise, policies designed to provide lifetime income illustrations of wealth in retirement savings statements can alter perceptions that result in suboptimal narrow bracketing.

Overall, these findings have important implications for the current and future state of retirement in the United States given the rise of defined contribution (DC) plans as a more prevalent funding source for retirement. DC plans are principally focused on growing assets and typically are not explicitly focused on generating/funding income. Therefore, unless steps are proactively taken to ensure retirees effectively use savings to fund spending, this analysis suggests households are likely to continue underconsuming in retirement, potentially at even greater levels noted in this analysis (and past research) as the importance of personal savings for retirement increases.

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