

# TRENDS AND ISSUES

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## CONVERTING ASSETS TO INCOME IN RETIREMENT: WHAT NEAR-RETIREEES ARE THINKING

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### EXECUTIVE SUMMARY

The primary objective of an employment-based retirement plan is to provide a secure and adequate income for workers throughout retirement. In the defined contribution framework, accumulating account balances is a means to the end, but not the end. An annuitization payout option allows retiring plan participants to readily convert savings into an income stream guaranteed to last their lifetime. Such payout options, while rare among private sector 401(k) plans, are generally available in the defined contribution plans sponsored by colleges and universities. This report examines the thinking of savers approaching retirement age in the higher education sector regarding managing that savings in retirement and their plans for converting it into income.

Two-thirds of higher education near-retirees (currently age 50-70) are concerned about outliving their savings and about choosing the best way to draw income from their savings. Forty percent report that they do not have a good understanding of the various options available for converting retirement savings into retirement income, 46% understand the options somewhat and 14% feel that they understand available options very well.

Thirty-seven percent of near-retirees intend to draw income from their retirement savings through regular periodic withdrawals of a fixed percentage of savings. Withdrawing only the minimum amount required by law and annuitizing some or all of their retirement savings were chosen by 29% and 25%, respectively. Among those planning to annuitize some or all of their retirement savings, the security of a guaranteed lifetime stream of income was by far the greatest motivation.

Near-retirees who have consulted with a financial advisor specifically about drawing income from savings in retirement appear better prepared for making such decisions. Not surprisingly, these individuals have devoted more thought to managing their savings in retirement and drawing income from it, and they are more confident in their understanding of the options for converting savings



to income. Twenty-nine percent of those who have consulted with an advisor on drawing income from savings plan to annuitize some or all of their retirement savings compared with 24% of those who have not consulted an advisor on the topic.

## INTRODUCTION

The primary objective of an employment-based retirement plan is to provide (in concert with Social Security) a secure and adequate income for workers throughout retirement. In the defined contribution framework, accumulating account balances is a means to the end, but not the end. The end is a lifetime stream of income, but this end is generally ignored in the design of private sector defined contribution plans, especially 401(k) plans, where the emphasis is on wealth accumulation as opposed to retirement income. Annuitization is the only means to guarantee a stream of income that will last the lifetime of a retiree (and his or her spouse in the case of a joint and survivor annuity). The typical 401(k) plan does not offer an annuitization option;<sup>1</sup> the 401(k) norm is to provide participants with a lump-sum distribution option. Not all defined contribution plans are designed in this manner, however. In the higher education sector, an annuitization option is generally available to plan participants.<sup>2</sup>

Even if the option is not offered through the sponsored retirement plan, a plan participant can always choose to buy an immediate annuity at retirement from an insurance company with his or her retirement savings. But data over time is clear—individuals do not annuitize despite the benefits of annuitization and the fact that partial annuitization of a fraction of assets is always an option.<sup>3</sup> To gain a deeper understanding of these phenomena, college and university employees aged 50 to 70 (thus nearing what are viewed as typical retirement ages) and saving for retirement were surveyed regarding their plans for managing that savings and converting it into income once they enter retirement.<sup>4</sup> This report presents data for different classes of employees in higher education (faculty, staff and administration) and those who are relatively young (age 50 to 64) versus those who are relatively old (age 65 to 70) among “near-retirees.”<sup>5</sup>

## MANAGING SAVINGS FOR RETIREMENT INCOME

Most (77%) near-retirees in higher education intend to maintain their current standard of living once they move into retirement, with an additional 5% planning to enjoy a higher standard of living. At the same time, 65% are concerned about outliving their savings (22% very concerned and 43% somewhat concerned) and an essentially identical 67% are concerned about choosing the best way to draw income to live on from their savings (20% very concerned and 47%

1 Twenty-one percent of plans offer annuities as a retirement distribution option according to The Profit Sharing/401(k) Council of America's *51st Annual Survey of Profit Sharing and 401(k) Plans (Reflecting 2007 Plan Year Experience)*.

2 An annuitization option is also typically offered to participants in public sector defined contribution plans that are the primary retirement vehicle sponsored by a state. See Crane, Roderick B., Michael Heller and Paul J. Yakoboski, “Best-Practice Benchmarks for Public-Sector Core Defined Contribution Plans,” TIAA-CREF Institute *Trends and Issues* (July 2008).

3 Forty-five percent of TIAA-CREF participants beginning an income stream in 2001 chose an annuity. See Ameriks, John, “Recent Trends in the Selection of Retirement Income Streams among TIAA-CREF Participants,” TIAA-CREF Institute *Trends and Issues*, Issue #74 (December 2002). According to Hewitt Associates data, annuitization is chosen by 3% of participants in 401(k) plans that offer an annuity as a payout option.

4 1,002 individuals were surveyed by telephone during April and May, 2009 regarding their financial preparations for retirement and their views regarding those preparations. PublicMind of Fairleigh Dickinson University fielded the survey and collaborated with the TIAA-CREF Institute and TIAA-CREF on development of the questionnaire. The survey was restricted to individuals whose primary retirement plan is a defined contribution plan. Survey results were weighted to be representative of the population of interest. Individuals who did not envision themselves as ever retiring or leaving the workforce for any reason were excluded from the survey.

5 The survey sample included 500 individuals age 50 to 64, 502 individuals age 65 to 70, 584 individuals employed as faculty, 230 employed as staff, and 188 in administration positions.

somewhat concerned) (table 1). Older near-retirees appear less concerned on both issues, possibly due to greater attention they have focused on the issue (see discussion below). Faculty are less likely to be very concerned about outliving their retirement savings; this may be explained by a tendency among faculty to remain in their college or university position and retire at later ages.

**TABLE 1  
CONCERNS ABOUT GENERATING RETIREMENT INCOME FROM RETIREMENT SAVINGS AMONG  
HIGHER EDUCATION EMPLOYEES (AGE 50-70)**

	ALL	AGE 50-64	AGE 65-70	FACULTY	STAFF	ADMINISTRATION
Outliving retirement savings						
Very concerned	22%	23%	18%	13%	29%	29%
Somewhat concerned	43	44	37	47	44	34
Not too concerned	22	21	26	27	16	23
Not at all concerned	13	12	19	13	11	14
Choosing the best way to draw income from retirement savings						
Very concerned	20%	20%	17%	17%	24%	16%
Somewhat concerned	47	48	44	46	53	40
Not too concerned	24	24	25	25	20	31
Not at all concerned	9	8	13	12	3	12

Note: Only those with a defined contribution plan as their primary retirement plan were surveyed.  
Source: TIAA-CREF Institute (2009)

**ADVANCE PLANNING?**

Forty percent of near-retirees report that they do not have a good understanding of the various options available for converting retirement savings into retirement income; 46% understand the options somewhat and 14% feel that they understand available options very well (table 2). Not surprisingly, understanding appears related to the level of thought that has been given to the issue—36% have really not considered it, 46% have thought about it some and 17% have thought about it a great deal. Older near-retirees have given more thought to managing their retirement savings for income and report a greater level of understanding regarding available options. Staff report the lowest level of understanding even though they are just as likely to have thought about the issue.

**TABLE 2  
GENERATING RETIREMENT INCOME FROM RETIREMENT SAVINGS AMONG HIGHER EDUCATION  
EMPLOYEES (AGE 50-70)**

	ALL	AGE 50-64	AGE 65-70	FACULTY	STAFF	ADMINISTRATION
How well do you understand options available to draw retirement income from savings?						
Very well	14%	13%	23%	16%	9%	18%
Somewhat well	46	46	47	46	45	49
Not too well	29	30	23	28	33	25
Not at all	11	11	7	10	13	8
Have you thought about managing your savings once retired and drawing income from it?						
A great deal	17%	15%	32%	15%	21%	17%
Some	46	46	49	46	47	46
Hardly at all	25	27	14	26	23	28
Not at all	11	12	5	13	9	10

Note: Only those with a defined contribution plan as their primary retirement plan were surveyed.  
Source: TIAA-CREF Institute (2009)

When asked about current intentions for drawing income from their retirement savings, regular periodic withdrawals of a fixed percentage of savings was the most common option chosen (37%) (table 3). Withdrawing only the minimum amount required by law and annuitizing some or all of their retirement savings were chosen by 29% and 25%, respectively. Nine percent did not know what they will likely do. The challenge from a retirement income security perspective is encouraging follow through in retirement on the intent to annuitize and creating similar intent and follow-through among the others.

**TABLE 3  
CURRENT PLANS FOR DRAWING INCOME FROM RETIREMENT SAVINGS AMONG HIGHER EDUCATION  
EMPLOYEES (AGE 50-70)**

	<b>ALL</b>	<b>AGE 50-64</b>	<b>AGE 65-70</b>	<b>FACULTY</b>	<b>STAFF</b>	<b>ADMINISTRATION</b>
Withdraw fixed percentage each month or year to cover expenses	37%	38%	28%	38%	39%	29%
Convert some or all into a payout annuity	25	26	22	24	26	27
Withdraw only the minimum amount required by law each year	29	27	41	28	28	32
Don't know	9	9	9	10	6	12

Note: Only those with a defined contribution plan as their primary retirement plan were surveyed.  
Source: TIAA-CREF Institute (2009)

Among those planning to annuitize some or all of their retirement savings, the security of a guaranteed lifetime stream of income was by far the greatest motivation, cited by 40%. In addition, 13% cited the safety, stability and security of the annuitization option and 11% feel that it will maximize their retirement income.

A lack of understanding and information appears to be a key driver among those who do not intend to annuitize their retirement savings—31% of these report that they do not understand annuitization and 11% say that they need more information and to think about it more. In addition, 9% fear that the payments will not continue to be made over time.

**ADVICE AND ANNUITIZATION**

Thirty percent of near retirees in higher education have consulted with a financial advisor or other financial professional within the past two years specifically about drawing income from savings during retirement.<sup>6</sup> These individuals appear to be better prepared to address the issue than those who have not had such an interaction with an advisor (table 4).

<sup>6</sup> Sixty percent report consulting with a financial advisor regarding their retirement preparations in general and 50% of these covered how to draw income from savings in retirement.

**TABLE 4**  
**PROFESSIONAL ADVICE ON DRAWING INCOME FROM SAVINGS IN RETIREMENT AMONG HIGHER EDUCATION EMPLOYEES (AGE 50-70)**

	<b>CONSULTED ADVISOR ON DRAWING INCOME</b>	<b>NOT CONSULTED ADVISOR ON DRAWING INCOME</b>
Have you thought about managing your savings once retired and drawing income from it?		
A great deal	24%	14%
Some	51	44
Hardly at all/Not at all	25	42
Concern regarding outliving retirement savings		
Very concerned	18%	24%
Somewhat concerned	43	44
Not too/Not at all concerned	40	32
Concern regarding choosing the best way to draw income from retirement savings		
Very concerned	18%	20%
Somewhat concerned	48	47
Not too/Not at all concerned	34	33
How well do you understand options available to draw retirement income from savings?		
Very well	22%	11%
Somewhat well	57	41
Not too/Not at all well	21	48
Current plans for drawing income from retirement saving		
Withdraw fixed percentage each month or year to cover expenses	32%	39%
Convert some or all into a payout annuity	29	24
Withdraw only the minimum amount required by law each year	30	28
Don't know	9	9

Note: Only those with a defined contribution plan as their primary retirement plan were surveyed.

Source: TIAA-CREF Institute (2009)

Not surprisingly, these individuals have devoted more thought to managing their savings in retirement and drawing income from it (24% a great deal of thought; 51% some thought) compared with those who have not consulted an advisor on the subject (14% a great deal of thought; 44% some thought). This likely reflects two dynamics. Those focused on the issue initially are more likely to engage an advisor regarding it, and the act of working with an advisor leads to further thinking and planning regarding generating retirement income from savings.

Such focus and engagement with an advisor have tangible results in that these individuals are less concerned than their peers regarding outliving their retirement savings; 40% are not concerned compared with 32% of those who have not consulted an advisor (and only 18% are very concerned compared with 24% of those who have not consulted an advisor). There is little difference, however, in the level of concern about choosing the best way to draw retirement income; two-thirds of each group are concerned in this regard. This could be explained by a higher initial likelihood of concern among those consulting with an advisor, with this interaction then subsequently lowering the level of concern.

Near-retirees who have consulted with a financial advisor feel that they have a much better understanding of their options for converting savings to income in retirement. Twenty-two percent reported that they understand the options very well and 57% somewhat well, compared with 11% and 41%, respectively, for those who have not consulted an advisor on the subject.

Twenty-nine percent of those who have consulted with an advisor on drawing income from savings plan to annuitize some or all of their retirement savings compared with 24% of those who have not consulted an advisor. It is somewhat surprising that there is not a greater differential in this regard. Given that, in general, near-retirees who work with an advisor feel that the advice they receive is always independent and objective (46%) or at least is most of the time (39%), and that 69% typically implement the recommendations of their advisor, it could be that individuals are not being advised to annuitize in some cases.

Among near-retirees intending to annuitize, 13% of those who consulted with an advisor reported that a recommendation to annuitize impacted their planning; this compares with 4% of those who plan to annuitize but have not consulted an advisor. In each group, about 40% cited the value of a lifetime income stream as a motivation. Among those who consulted with an advisor but don't plan to annuitize their retirement savings, only 4% were advised against it (this advice did not necessarily come from the advisor). So while it appears that the recommendation of an advisor matters, it does not appear as though advisors are recommending against annuitization. But it's also not clear how proactively they are promoting it relative to other options.

## **CONCLUSION**

Savings is necessary but not sufficient to generate a secure and adequate lifetime income for retirees. In retirement, savings must be managed and used to generate a stream of income. Annuitization is the only means to convert savings into an income stream guaranteed to last the lifetime of a retiree (and his or her spouse). An annuity payout option, while rare among private sector 401(k) plans, is generally available in defined contribution plans sponsored by colleges and universities. In the absence of such a plan feature, participants can still annuitize their savings through an immediate annuity contract that they purchase on their own. But the reality is that annuitization rates are low.

This report examined the concerns of savers approaching retirement age in the higher education sector regarding managing that savings in retirement and their plans for converting it into income. Two-thirds of higher education near-retirees are concerned about outliving their savings and about choosing the best way to draw income from their savings.

It is clear that consultation with a financial advisor can be of real value to individuals in this regard. Near-retirees who have consulted with a financial advisor specifically about drawing income from savings in retirement appear better prepared for making such decisions. These individuals have devoted more thought to managing their savings in retirement and drawing income from it, and they are more confident in their understanding of the options for converting savings to income. Twenty-nine percent of those who have consulted with an advisor on drawing income from savings plan to annuitize some or all of their retirement savings compared with 24% of those who have not consulted an advisor on the topic.

## ABOUT THE AUTHOR

Paul Yakoboski is a Principal Research Fellow with the TIAA-CREF Institute. He conducts, manages and communicates research on issues such as income and asset management in retirement, defined contribution plan design, the preparation of higher education faculty for retirement, managing faculty retirement patterns, options for funding retiree health care, and research on issues related to strategic management in higher education. He is also responsible for the development and execution of Institute symposiums on such issues. In addition, Yakoboski serves as director of the Institute's Fellows Program and editor of the Institute's *Trends and Issues* and *Advancing Higher Education* publication series.

Prior to joining the Institute, he held positions as Director of Research for the American Council of Life Insurers (2000 to 2004), Senior Research Associate with the Employee Benefit Research Institute (1991 to 2000) and Senior Economist with the U.S. Government Accountability Office (1989 to 1991). He is a member of the American Economic Association and serves on the editorial advisory board of *Benefits Quarterly*. He previously served as Director of Research for the American Savings Education Council (1995 to 2000). Between 1986 and 1988 he served as an adjunct faculty member at Nazareth College. Yakoboski earned his Ph.D. (1990) and M.A. (1987) in economics from the University of Rochester and his B.S. (1984) in economics from Virginia Tech.

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