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Deferred Income Annuities Enhance Retirement Readiness

Transfer of longevity risk benefits longest-living Americans most, rising interest rates could increase benefits across age groups

Washington, D.C. – January 23, 2019 — The Employee Benefit Research Institute (EBRI), a private, nonpartisan, nonprofit research group, has found that Deferred Income Annuities can provide an effective hedge against outliving retirement savings.

Many Baby Boomers and Gen Xers face the grim prospect of outliving their retirement nest eggs, yet only a small percentage of defined contribution (DC) and individual retirement account (IRA) balances are annuitized — and a significant percentage of defined benefit (DB) accruals are taken as lump-sum distributions when the option is available.

Some believe that cost is an issue: Deferred Income Annuities (DIAs) are designed to reduce the probability of outliving savings by providing monthly benefits in the later stages of retirement. Because of their delayed payments, DIAs could be offered for a small fraction of the cost for a similar monthly benefit through an annuity that starts payments immediately at retirement. This reduced cost could at least partially mitigate retirees' reluctance to give up control over a large portion of their DC and/or IRA balances at retirement age.

EBRI's study, **"Deferred Income Annuity Purchases: Optimal Levels for Retirement Income Adequacy,"** explores how the probability of a "successful" retirement, measured by the EBRI Retirement Readiness Rating (RRR), varies with the percentage of the 401(k) balance that is used to purchase a DIA. Results are provided for all households with a 401(k) balance and analyzed by simulated age of death. The results are also examined by age-specific wage quartiles.

"At current annuity rates, EBRI finds purchasing a DIA at age 65, deferring 20 years with no death benefits, results in an overall improvement in retirement readiness for all ages of death combined, when DIA purchases were up to 20 percent of the 401(k) balance," said Jack VanDerhei, Ph.D., Director of Research, Employee Benefit Research Institute, and author of the report. "However, there is an overall decrease in retirement readiness for DIA purchases starting at 25 percent — due in part to the interaction with long-term care costs."

The study finds an overall improvement in retirement readiness when DIA purchases equal to 5, 10, and 15 percent of the 401(k) balance, and a pre-commencement death benefit, are added to the DIA. When the results are broken out by age at simulated death, there is an overall decrease in retirement readiness for those dying before benefits begin, as well as for those dying soon after benefits begin.

Investors living beyond age 89 will experience a significant increase in retirement readiness, with the larger the percentage of 401(k) balances being used to purchase a DIA, resulting in a larger percentage increase in retirement readiness.

EBRI plans to release additional research addressing DIA issues in 2019.
