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# *News* from EBRI

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***New Research from EBRI:***

## Annuity Choice Driven by Pension Plan Rules

WASHINGTON—Why do some retiring workers with a pension choose to take a stream of lifetime income, while others cash out their entire benefit in a lump-sum distribution?

Amidst growing concerns about workers outliving their retirement savings, this has emerged as a key issue—and it depends to a large extent on whether the individual pension plan allows or restricts lump-sum distributions (LSDs), according to new research by the nonpartisan Employee Benefit Research Institute (EBRI). A better understanding of these decisions stands to shed light not only on the outcomes for traditional pensions, but also for defined contribution plans, where LSDs are the rule rather than the exception.

EBRI's research, the first time this level of analysis has been done on this scale, reveals that differences in defined benefit (DB) plan rules or features result in very different annuitization rates. In fact, the results show that the rate of annuitization—the rate at which workers choose to take their benefit as an annuity—varies directly with the degree to which plan rules restrict the ability to choose a partial or lump-sum distribution. In choosing an LSD, the individual takes on the investment risk and responsibility for managing the distribution, and, ultimately, arranging his or her own income flow in retirement from those funds.

Analyzing data from more than 80 different pension plans, EBRI compares the "annuitization rate" among individuals at various age, tenure, and account balances, along with the rules and distribution choices within individual pension plans. EBRI found that between 2005 and 2010, pension plans with no LSD distribution options had annuitization rates very close to 100 percent. In contrast, the annuitization rate for defined benefit and cash balance plans with no restrictions on LSDs was only 27.3 percent.

"Whether people annuitize depends to a large extent on whether or not they are allowed to choose some other option," said Sudipto Banerjee, EBRI research associate and author of the study. "Any study of annuitization that fails to take into account the impact of plan design on participant choice will likely lead to misinterpretations."

The report notes that through the 1960s DB pension plans offered mainly one distribution choice: a fixed-payment annuity. That changed beginning in the 1970s, as some DB plans began to offer the option of full or partial single-sum distributions, and as "hybrid" pension plans expanded in the 1980s, so did distribution options. Today, most DB pension plans offer some type of single/lump-sum option, in addition to the traditional annuity choice.

The full report is published in the January 2013 *EBRI Issue Brief* no. 381, "Annuity and Lump-Sum Decisions in Defined Benefit Plans: The Role of Plan Rules," online at www.ebri.org

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