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New Research from EBRI:

Ensuring Adequate Income in Retirement: Immediate vs. Longevity Annuities

WASHINGTON—For new retirees wanting to ensure they don't run short of money in retirement, two products offer a source of guaranteed lifetime income: immediate annuities (which immediately begin to generate lifetime income) and longevity annuities (which delay payments until the retiree hits an advanced age, such as 80 or 85).

New research by the nonpartisan Employee Benefit Research Institute (EBRI) finds that, generally, either type would be effective at reaching desired income adequacy targets—especially for lower-income retirees.

However, the EBRI analysis also shows that a key factor in planning for a high level of retirement income adequacy (90 percent) is whether the costs of long-term care are included in the calculations or not. If they are, no more than 80−90 percent of a retiree's assets should be converted to an immediate annuity, with the balance reserved to cover long-term care costs. If a longevity annuity is used, retirement wealth should be split between the annuity and equity (stock) investments to ensure long-term care costs are covered.

The technical EBRI report is published in the May 2011 *EBRI Issue Brief,* online at www.ebri.org, and updates earlier computer simulation analysis by EBRI on retirement income adequacy. It focuses on a male retiring at age 65, with specific assumptions on the long-term capital market and investment expenses, the long-term inflation rate, and the mortality table.

Specifically, the report analyzes how differently immediate and longevity annuities can affect probable income adequacy in retirement by taking into account long-term health care expenditures. It attempts to find the optimal level of annuitization and asset allocation that would provide a desired level of confidence that individuals will have sufficient retirement income, based on three different types of risk:

- Investment income (how much money retirement wealth is likely to generate in retirement).
- Longevity (how long the retiree expects to live in retirement).
- Long-term care (how much is needed to cover nursing home or home health care in retirement).

As EBRI notes, various studies on longevity annuities have found that a modest allocation of retirement wealth to a longevity annuity can deliver as large a benefit as a significant allocation to an immediate annuity. EBRI's new report compares the impact of immediate and longevity annuities on retirement income adequacy, assuming that a retiree would face long-term health care risk as well as investment income and longevity risk.

The Employee Benefit Research Institute is a private, nonprofit research institute based in Washington, DC, that focuses on health, savings, retirement, and economic security issues. EBRI does not lobby and does not take policy positions.

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