EBRI Fast Facts
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How Much of a 401(k) Balance Should Be Used to Purchase a Deferred Income Annuity?

The prospect of outliving retirement savings is a very real risk for many Baby Boomers and Gen Xers. Yet, only a very small percentage of defined contribution (DC) and individual retirement account (IRA) balances are annuitized — and a significant percentage of defined benefit (DB) accruals have been taken as lump-sum distributions when the option was 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. Many believe that the lower cost would at least partially mitigate retirees' reluctance to give up control over a large portion of their DC and/or IRA balances at retirement age.

In its January 2019 *Issue Brief*, "Deferred Income Annuity Purchases: Optimal Levels for Retirement Income Adequacy," EBRI explored 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) combined as well as by simulated age of death. The results are also provided by age-specific wage quartiles.

We find that, at current annuity rates, purchases of a DIA at age 65 deferring 20 years with no death benefits result in an overall improvement in RRR (for all ages of death combined) for DIA purchases up to 20 percent of the 401(k) balance (Figure 3). However, there is an overall decrease in RRR for DIA purchases starting at 25 percent — due in part to the interaction with long-term care costs. If a pre-commencement death benefit is added to the DIA (Figure 5), there is an overall improvement in RRR for DIA purchases equal to 5, 10, and 15 percent of the 401(k) balance.

When the results are broken out by age at simulated death, we find overall decreases in RRR for those dying before benefits begin (ages 65–84) as well as for those dying soon after benefits begin (ages 85–89). For each of the groups living beyond age 89 we find an increase in RRR, and, as expected, the larger the percentage of 401(k) balance used to purchase a DIA, the larger the percentage increase in RRR. The results are significantly improved by adding a pre-commencement death benefit for those who die before benefits begin, but this is offset by larger decreases in RRR for those dying between ages 85 and 89 and smaller increases in RRR for those living beyond age 89.

The EBRI report, "Deferred Income Annuity Purchases: Optimal Levels for Retirement Income Adequacy," is published as the January 3, 2019, *EBRI Issue Brief* and is available online here.

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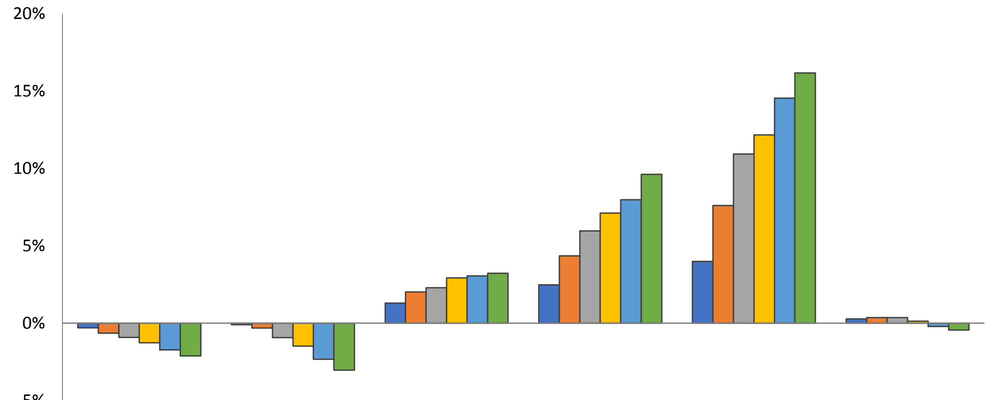
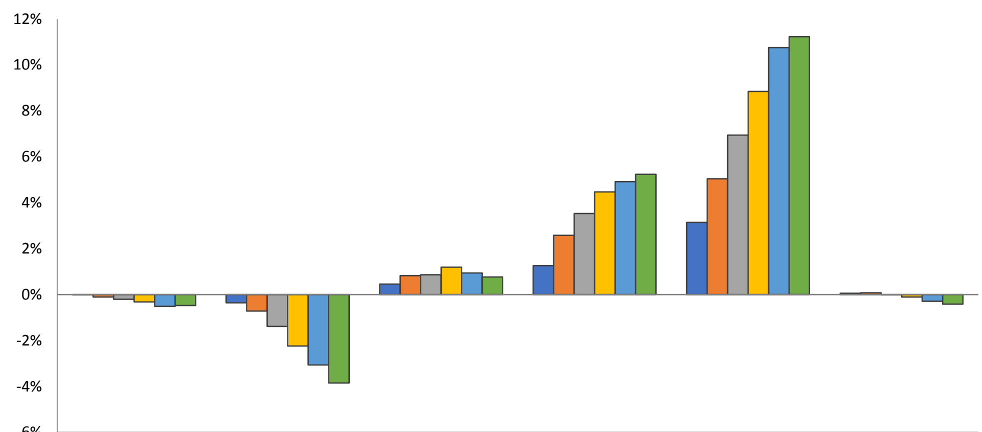
Figure 3
Percentage Change in EBRI Retirement Readiness Ratings From Various Deferred Income Annuity (DIA) Purchases at Retirement, by Age at Death*



Percentage of 401(k) Balance at Age 65 Used to Purchase a DIA Deferring 20 Years	65–84	85–89	90–94	95–99	> 99	All
5%	-0.3%	-0.1%	1.3%	2.5%	4.0%	0.3%
10%	-0.6%	-0.3%	2.0%	4.4%	7.6%	0.4%
15%	-0.9%	-0.9%	2.3%	6.0%	10.9%	0.4%
20%	-1.3%	-1.5%	2.9%	7.1%	12.2%	0.1%
25%	-1.7%	-2.3%	3.1%	8.0%	14.6%	-0.2%
30%	-2.1%	-3.0%	3.2%	9.6%	16.2%	-0.4%

For households currently ages 35–64 who have a 401(k) balance at retirement age (65).
* Second death for couples
Source: EBRI Retirement Security Projection Model® Version 3427

Figure 5
Percentage Change in EBRI Retirement Readiness Ratings From Various Deferred Income Annuity (DIA) Purchases at Retirement, by Age at Death*:
Includes Pre-Commencement Death Benefit



Percentage of 401(k) Balance at Age 65 Used to Purchase a DIA Deferring 20 Years	65–84	85–89	90–94	95–99	> 99	All
5%	0.0%	-0.4%	0.5%	1.3%	3.1%	0.1%
10%	-0.1%	-0.7%	0.8%	2.6%	5.0%	0.1%
15%	-0.2%	-1.4%	0.9%	3.5%	6.9%	0.0%
20%	-0.3%	-2.2%	1.2%	4.5%	8.8%	-0.1%
25%	-0.5%	-3.1%	0.9%	4.9%	10.8%	-0.3%
30%	-0.5%	-3.9%	0.8%	5.2%	11.2%	-0.4%

For households currently ages 35–64 who have a 401(k) balance at retirement age (65).
* Second death for couples
Source: EBRI Retirement Security Projection Model® Version 3427