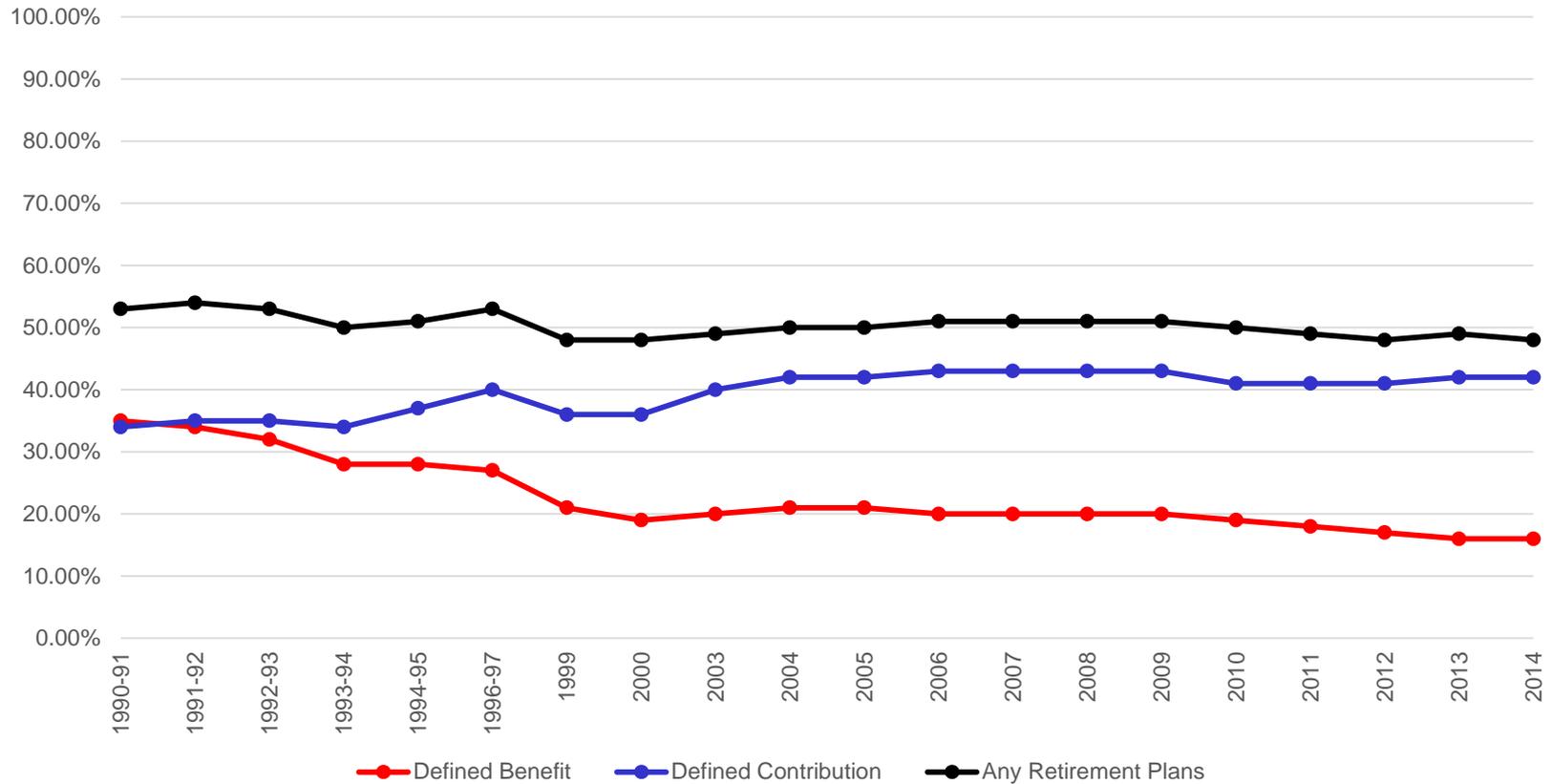


The Annuity Puzzle

Prof. Elizabeth F. Brown
Georgia State University

Percentage of U.S. Private Sector Workers with Pension Plans, 1990-2014



The Annuity Puzzle

Defined Benefit Plan

- Median Income in Virginia: About \$75,000
- Works for the same employer for 20 years.
- Annual pension equals about \$30,000 ($\$75,000 \times 2\% \times 20$)
- Monthly income: \$2500

Defined Contribution Plan

- Median Income in Virginia: About \$75,000
- Recommended Savings: \$600,000 (Income x 8)
- If withdraws 4% annually, annual income about \$24,000
- Monthly income: \$2000
- Use \$500,000 to buy a single life annuity, est. monthly payment: \$2500



Reasons People Might Not Purchase an Annuity:

1. Failed to save sufficient funds to buy one
2. Motivated to leave a bequest to their heirs
3. Need to deal with health shocks – illiquid
4. Concerns about whether an annuity is a good investment
5. Concerns about the financial viability of the firm offering the annuity
6. Overestimating their ability to manage their funds in retirement

Reasons People Might Not Purchase an Annuity (cont.):

7. Too much choice which causes inertia:
 - Fixed annuities
 - Variable annuities
 - Equity-indexed annuities
 - Guaranteed annuity contracts
 - Two-tiered annuities
 - Annuities with death benefit options
 - Deferred vs. immediate annuities
 - Qualified vs. non-qualified annuities



Growing Alternatives or Substitutes for Annuities:

1. Reverse Mortgages
2. Managed payout funds or income replacement funds offered by mutual fund companies