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Highlights

Highlights of GAO-11-400, a report to the Chairman, Special Committee on Aging, U.S. Senate

June 2011

RETIREMENT INCOME

Ensuring Income throughout Retirement Requires Difficult Choices

Why GAO Did This Study

As life expectancy increases, the risk that retirees will outlive their assets is a growing challenge. The shift from defined benefit (DB) pension plans to defined contribution (DC) plans also increases the responsibility for workers and retirees to make difficult decisions and manage their pension and other financial assets so that they have income throughout retirement. GAO was asked to review (1) strategies that experts recommend retirees employ to ensure income throughout retirement, (2) choices retirees have made for managing their pension and financial assets for generating income, and (3) policy options available to ensure income throughout retirement and their advantages and disadvantages. GAO interviewed experts about strategies retirees should take, including strategies for five households from different quintiles of net wealth (assets less debt); analyzed nationally representative data and studies about retirees' decisions; and interviewed experts and reviewed documents about related policy options.

GAO received comments on a draft of this report from the Department of the Treasury and technical comments from the Department of Labor, Internal Revenue Service, Securities and Exchange Commission, Social Security Administration, and the National Association of Insurance Commissioners, and incorporated them, as appropriate.

View GAO-11-400 or key components.
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What GAO Found

Financial experts GAO interviewed typically recommended that retirees systematically draw down their savings and convert a portion of their savings into an income annuity to cover necessary expenses, or opt for the annuity provided by an employer-sponsored DB pension instead of a lump sum withdrawal. Experts also recommended that individuals delay receipt of Social Security benefits until reaching at least full retirement age and, in some cases, continue to work and save, if possible. For example, for the two middle net-wealth households GAO profiled with about $350,000 to $375,000 in net wealth, experts recommended purchase of annuities with a portion of savings, drawdown of savings at an annual rate, such as 4 percent of the initial balance, use of lifetime income from the DB plan, if applicable, and delay of Social Security. To navigate the difficult choices on income throughout retirement, they noted strategies depend on an individual's circumstances, such as anticipated expenses, income level, health, and each household's tolerance for risks, such as investment and longevity risk.

Regarding the choices retirees have made, GAO found that most retirees rely primarily on Social Security and pass up opportunities for additional lifetime retirement income. Taking Social Security benefits when they turned 62, many retirees born in 1943, for example, passed up increases of at least 33 percent in their monthly inflation-adjusted Social Security benefit levels available at full retirement age of 66. Most retirees who left jobs with a DB pension received or deferred lifetime benefits, but only 6 percent of those with a DC plan chose or purchased an annuity at retirement. Those in the middle income group who had savings typically drew down those savings gradually. Nonetheless, an estimated 3.4 million people (9 percent) aged 65 or older in 2009 had incomes (excluding any noncash assistance) below the poverty level. Among people of all ages the poverty rate was 14.3 percent.

To help people make these often difficult choices, policy options proposed by various groups concerning income throughout retirement include encouraging the availability of annuities in DC plans and promoting financial literacy. Certain proposed policies seek to increase access to annuities in DC plans, which may be able to provide them at lower cost for some individuals. However, some pension plan sponsors are reluctant to offer annuities for fear that their choice of annuity provider could make them vulnerable to litigation should problems occur. Other proposed options aim to improve individuals' financial literacy, especially to better understand risks and available choices for managing income throughout retirement in addition to the current emphasis on saving for retirement. Proposed options include additional federal publications and interactive tools, sponsor notices to plan participants on financial risks and choices they face during retirement, and estimates on lifetime annuity income on participants' benefit statements.