Research suggests financial literacy, debt and liquidity drive annuity purchases

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New research from experts at the George Washington University and funded by the Alliance for Lifetime Income's Retirement Income Institute shows a close link between the decision of older Americans to purchase annuities and four factors—financial knowledge, leveraged assets, debt obligations, and liquidity constraints.

Shared for the first time in a new paper, Examining the Barriers to Annuity Ownership for Older Americans, these findings provide significant new insights for helping solve what economists have termed "the annuity puzzle"—the financially irrational under-utilization of annuities that could provide greater retirement security to millions of Americans.

"Simple economic models argue that annuities are beneficial for almost all retirees," says Annamaria Lusardi, academic director of the Global Financial Literacy Excellence Center at the GW School of Business and University Professor of Economics and Accountancy at GW. "But what our latest research shows is that higher levels of debt, less access to liquidity and a lack of basic financial knowledge can lead to poor decision making when it comes to retirement income planning. For the retirement industry, solving the annuity puzzle must start with financial education."

Lusardi authored the paper along with Andrea Hasler, an assistant research professor in financial literacy at GFLEC, and Hallie Davis, a senior research associate at GFLEC.

The findings—which examined data from pre-retirees (ages 40-61) and retirees (62 and over) in the FINRA Foundation's 2018 National Financial Capability Study—suggest that financial literacy may also lead to improved annuity take-up rates by improving individuals' money management practices which may result in increased access to liquidity.

Low levels of personal financial literacy indicates that some individuals may lack the necessary knowledge to comprehend the benefits annuities can provide as part of a holistic retirement plan. And although financial literacy increases with age, literacy rates have remained considerably low across age groups. Less than half of those surveyed were able to correctly answer basic financial questions concerning interest rates, inflation and risk diversification. On top of that, individuals across both groups struggled the most with comprehending risk, which is a critical factor when considering the benefits of annuities.

Understanding financial strategies is key to developing a successful retirement plan. Policy makers, financial professionals, employers and academic institutions need to prioritize and invest in financial education so consumers can fully grasp these fundamental financial concepts and can make better informed retirement planning and saving decisions. Additionally, since many employers no longer offer traditional pensions plans, it's even more important that employers take on a bigger role in helping educate their employees by offering more financial education information on topics like debt and liquidity, demand for which was observed in this research.

"The bottom line is that smart advisors use and recommend annuities to protect retirement for their clients," says Jason Fichtner, senior fellow for the Alliance for Lifetime Income's Retirement Income Institute. "Though the research suggests you should be prepared to provide people with things like debt and liquidity education, if you want to have a successful conversation about optimal and holistic retirement income planning, it needs to involve annuities."

More information: Report: www.protectedincome.org/wp-con … P-03-Davis-et-al.pdf

Provided by George Washington University