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Retirees Make Prudent Decisions with 401(k) Assets, October 2008

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Few Spend Funds Immediately; Most Roll Over to IRAs; Many Rely on Advisers

Washington, DC, October 21, 2008 - Retirees do not spend their defined contribution (DC) balances immediately at retirement, but instead make thoughtful choices and use the proceeds prudently, according to a new study released today by the Investment Company Institute.

Only about 3 percent of accumulated DC account assets were spent immediately at retirement, the study, based on a 2007 survey of more than 600 recent retirees, found. The few retirees who spent their entire DC plan lump sums generally had received small distributions and, on average, derived a sizable portion of their household incomes from defined benefit (DB) plan and Social Security payments. Even of those who spent their entire lump sum, most used the proceeds sensibly, for example, to buy a primary residence, make home repairs, repay debt, or pay for healthcare.

“This research dispels the myth that DC participants spend their retirement assets immediately upon leaving the workforce,” says Brian Reid, chief economist of the Investment Company Institute. “More generally, retirees’ careful decisions about distributing their account balances reaffirm the main premise of the DC retirement system: Americans tend to act responsibly to build their own retirement security.”

The study, Defined Contribution Plan Distribution Choices at Retirement, was written by ICI senior economist John Sabelhaus, ICI associate economist Michael Bogdan, and ICI senior director of retirement and investor research Sarah Holden. The research takes a detailed look at how retirees handled their DC balances at retirement--whether through lump sums, installment payments, annuity payments, or deferrals.

The study found that more than half of DC plan participants received their distribution as a lump sum. Of these, 86 percent reinvested all or some of the proceeds, usually in rollover Individual Retirement Accounts; 62 percent reinvested the entire amount. The greater the value of the lump-sum distribution at retirement, the more likely recipients were to reinvest the proceeds.

For the most part, retirees were guided by professional financial advisers. The survey found that when DC plan participants had more than one option for their plan balances, they typically consulted multiple sources of information, appeared to have carefully considered their options, and generally selected a mode of distribution consistent with their personal financial circumstances. For example:

- Retirees with sizable household financial assets and income typically postponed use of their plan balances, either by reinvesting the assets in IRAs or deferring their distributions.
- Retirees seeking a steady income stream typically annuitized plan assets. Retirees with strong needs for current income started to withdraw their balances in installment payments.
- Large account balances were much more likely to be distributed through annuities or as lump sums that are rolled over into other investments.

The new study is based on a survey in late 2007 of more than 600 primary or co-decisionmakers for household saving and investing who retired between 2002 and the time the survey began.
