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PARTICIPANT PERCEPTIONS AND DECISION-MAKING CONCERNING RETIREMENT BENEFITS

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From 1964 until 2002, the State of Nebraska sponsored a defined contribution plan (the "State Employees Plan") for most employees of state government. During this period, the State Employees Plan was unique among state government-sponsored public pension plans because it was an individual account-type plan that offered participants the choice of a present value sum or an annuity form of distribution for their vested account balances.

Such a choice presents the opportunity to learn more about how individuals perceive various types of financial risks and weigh various motivational factors when deciding whether to choose a present value sum or an annuity for the distribution of their retirement benefits (the "distribution decision"). This study focuses on participants in the State Employees Plan who either retired or terminated employment in 1997 and who were eligible at that time to receive a distribution of their retirement benefits (collectively, the "1997 Population"). The study was conducted as a mail survey to collect individual-level data concerning how members of the 1997 Population assessed longevity, inflation, investment and health shock risks and the factors that motivated their distribution decisions in 1997. The survey further collected individual-level demographic data, including data on financial literacy and efforts at retirement planning, and data concerning the investment and consumption experiences of the members of the 1997 Population for the ten-year period following the distribution decision.

In reviewing the preliminary data results, three general themes emerge. First, in making distribution decisions, plan participants may need more and better information to assess the financial risks presented by uninsured medical care expenses in retirement. Although medical care expense risk was perceived as high by most retirees at the time of the distribution decision, subsequent self-evaluation indicated that many retirees had underestimated the financial risk associated with uninsured medical care expenses. In fact, more than one-third of retirees reported actually spending a portion of their retirement benefits on medical care expenses not covered by insurance.

The second theme that emerges from the preliminary data is the important role that federal tax and social welfare policies may play in an individual's distribution decision. Survey respondents indicated that federal tax policy penalizing lump sum distributions and the lifetime annuity payments provided by Social Security were the most prevalent major factors considered in making the distribution decision.

Further individual-level research on the distribution decision-making process could prove valuable to policymakers in assessing the potential impact of proposals to amend federal tax and social welfare policies.

The third theme is cautious optimism that, in the future, financially literate individuals as retirees will be able to successfully manage a present value sum distribution during retirement. The survey respondents evidenced a relatively high level of financial literacy. Slightly more than ninety percent (90.9%) of retirees who responded to the survey indicated that, in the tenth year following their distribution decision, they had a sufficient household income to pay for their daily living expenses, including the costs of premiums for health care-related insurance coverage. More than 90% (91.67%) of retirees indicated that they were satisfied with their distribution decision, and none of the retirees who responded to the survey were dissatisfied with their distribution decision.

Perhaps the most important conclusion to be drawn from the survey is that, although there are methodological challenges to be overcome, it is possible to collect individual-level data on the perceptions and decision-making processes used by retirement plan participants in making distribution decisions. Such individual-level data is a potentially valuable resource for state and local government officials as they evaluate public pension systems in light of future fiscal challenges. Individual-level data also is likely to provide valuable insights as researchers seek to understand the annuity puzzle. In particular, individual-level data can be used to create financial products that combine annuity features with other features, such as an ability to have some measure of control over investments, that will appeal to the motivations of workers who are entering the retirement phase. Finally, individual-level data can be used to improve the content of both public financial literacy programs and private efforts by employers to provide workers with retirement financial education.

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