GRI Product Allocations in a QDIA Framework

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The margin of safety retirement savers need for peace of mind.

Most retirement savers both under-save for retirement and potentially face a serious return drag from sub-optimal, market chasing behavior—Guaranteed Retirement Income (GRI) products can help.

Employer education, automatic enrollment, investment defaults, and automatic contribution escalation have greatly helped to improve the retirement savings situation in years since their widespread adoption.

Mounting empirical evidence, however, indicates that the serious behavioral problems persist. Our paper examines one of the more serious issues for the retirement savers—namely the pernicious, tactical investor behavior of “chasing returns.”

The tendency of investors to market time by “chasing returns” has been well documented and the evidence is clear that it results in a serious portfolio return drag of 1.5%-2.0%. This behavior can have a meaningful impact on subsequent retirement savings. Unfortunately, the tendency to react is higher for those participants with shorter time horizons and higher financial balances.

We use empirical Target Date Fund (TDF) fund flow data from the recent market downturn in 2020 to examine this phenomenon. Our research indicates that, as the time horizon shortens and financial balances grow, retirement savers start to definitively change their investing behavior and loss aversion grows.

The provision of appropriate downside protection products, such as GRI products, has the ability to meaningfully address this issue for retirement savers by providing the peace of mind to ride out market downturns. Moreover, it has the potential to help with the under-saving problem by enabling larger equity allocations for a given risk/volatility tolerance profile.

We review the benefits and features of various GRI products in the market from generic DFAs to GLWBs, along with various analyses that elucidate the impact on retirement income and bequest goals, as well as potential downside risk mitigation.

Most GRI products have the ability to provide for meaningful positive impact not only in retirement income security, but in bequest goals (ending terminal wealth), as well. They provide the key benefit of a hedge against longevity risk, which can drain assets.

The downside risk protection benefits vary by GRI product-type (accumulation vs decumulation), but this ‘peace of mind’ element offers potential positive impacts on investor return behavior, as well as portfolio construction in terms of appropriate risk level.

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