The Financial Crisis and the New Retirement

How Research Provides Insight to Help People Cope Better and to Guide Policy

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Our Goals for Today's Briefing

The challenge: There is no coherent national retirement policy in the United States today. Congress is currently facing difficult challenges in helping people deal with retirement and must take action. Retirement policy is important.

Our goal is to help Congress deal better with these challenges by:

- Focusing on key questions,
- Providing information,
- Relating the research to the policy challenges,

and to help YOU identify resources from the actuarial profession that can help.

Key Questions

- How has the 2008 economic crisis affected how retirees feel about retirement?
- When and how do people expect to retire and when and how do they actually retire?
- How are retirement and retirement security changing?
- What are the risks people face *after* they retire?
- What do we know about the planning horizon and what should it be?
- How does housing wealth fit into retirement security?

Agenda

- The Current Financial Crisis and Retirement Security
- A Review of the Research
  - The new retirement
  - Insights on planning for retirement
  - What changes during retirement?
  - Research Conclusions
- Policy Considerations
- Questions?

Sponsoring Organizations

- **American Academy of Actuaries**
  - 16,000-member professional association whose mission is to serve the public on behalf of the U.S. actuarial profession.
  - Assists public policymakers on all levels by providing leadership, objective expertise, and actuarial advice on risk and financial security issues.
  - Actuaries have extensive experience in dealing with risk management and solvency issues within the financial services industry and have unique qualifications that can aid the discussion of the economic crisis.
- **Society of Actuaries**
  - 20,000-member professional association whose vision is for actuaries to be the leading professionals in the measurement and management of risk.

Resources from the Actuarial Profession

- Surveys of Post-Retirement Needs and Risks (2001, 2003, 2005, 2007) (Society of Actuaries)
- *Managing Post-Retirement Risks: A Guide to Retirement Planning* (2008) (Society of Actuaries)
- *Spending and Investing in Retirement: Is There a Strategy* (focus group report) (2005) (Society of Actuaries)
- *Will Assets Last a Lifetime?* (2008 and 2009 follow-up) (Society of Actuaries)
- *Longevity and Retirement Policy: Modernizing America's Retirement Programs to Keep Pace with Longevity* (2006) (American Academy of Actuaries)

What are the SOA's Surveys of Post-Retirement Needs and Risks?

- Survey series is every two years since 2001; 2009 version coming later this year.
- Surveys focus on public concerns about post-retirement risk, their priorities, how people retire and how they manage risk.
- Biggest concerns in 2007 were inflation, health care costs and long-term care.
- Survey results demonstrate gaps in understanding of risk, short-term thinking and minimal use of financial products.
- Results also show that the public is not well prepared for financial crisis.

The Current Financial Crisis and Retirement Security

The Economic Crisis and Retirement

- The 2008 market downturn and current fiscal crisis have created new challenges for those nearing retirement as well as those who have already retired:
  - Reduced 401(k) balances;
  - Decline in general assets;
  - Job losses;
  - Decline in housing values.
- Many people need to work longer, but will have a hard time doing so because of physical productivity and a declining job market.

Defined Benefit (DB) Pensions in the Economic Crisis

- Large private DB plans
  - Have gone from surplus position pre-crisis to substantial deficit
  - Concern about strain of contribution increases on corporate budgets
  - Pension Protection Act (PPA) challenges
    - Stricter funding rules
    - Under 80 percent funded – limits on lump-sum payments
    - Under 60 percent – law requires freeze and benefit limits
  - Did PPA intensify the problems?
    - Partial relief granted; further relief requested
    - Has relief been enough? Has it been well targeted?
    - If no further relief, will there be more freezes?
- Public sector (not subject to PPA)
  - Even bigger deficits
  - Concern about strain on current and future government budgets

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Defined Contribution (DC) Pensions in the Economic Crisis

- Little change in participation
- Some employers have dropped or cut their match.
- Creates challenges for more affluent near-retirees and those already retired
  - Reduced 401(k) balances – average loss of 25 percent or more from 1/1/2008 to 1/20/2009 – accounts of $200,000+ and 56 to 65 year old with 20+ years of service
  - Many people need to work longer, but hard to do so
    - Pre-retirees say they will need to postpone retirement by 4.2 years
    - But 4 out of 10 people retire earlier than planned
- Trend toward DC plans compounds issues for individuals

Sources: EBRI Issue Brief 326; Harris Interactive, "Retirement at the Tipping Point"

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The DB/DC Evolution

For private sector workers with pension coverage, type of plan:

Year	DB only	DC only	Both
1983	62%	12%	26%
1995	29%	56%	15%
2007	17%	63%	19%

Source: Center for Retirement Research, An Update on 401(k) plans: Insights from the 2007 SCF, March 2009. Last row doesn't add to 100% due to rounding.

Notes:

- 55% of private sector full-time employees have pension coverage.
- DB plans are widely used in public sector and for multi-employer plans (union/management sponsored).

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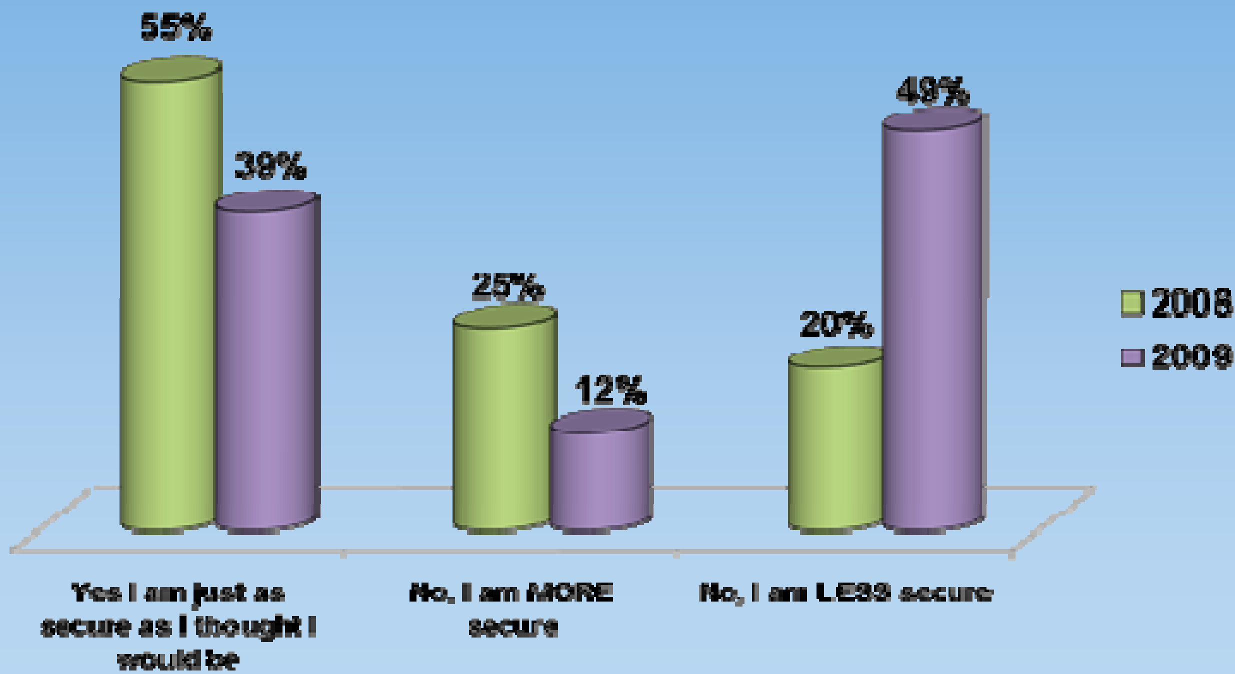
Trends in the Retirement System

- The move to defined contribution plans compounds the current challenges brought on by the fiscal crisis
  - More pressure on personal savings as a form of retirement income
  - Low savings rates
  - Most people who can take lump sums do so; highly risky
- Move to more gradual retirement and later retirement
- Heavy reliance on default options
  - Growth of auto-enrollment and life cycle funds in DC plans

A Review of the Research: The New Retirement

What a Difference a Year Makes: Survey of Retirees in 2008 and 2009

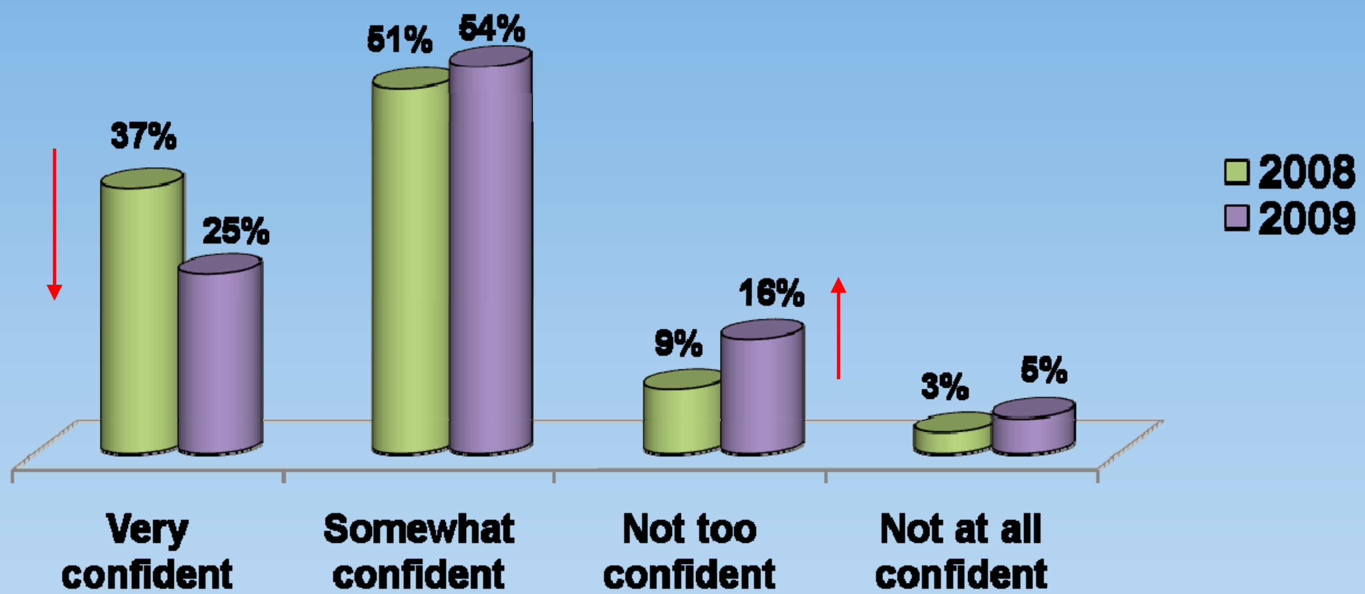
- Are you as financially secure now as you thought you would be when you first retired?



Source: Will Retirement Assets Last a Lifetime – 2008 and 2009 supplement, Society of Actuaries, LIMRA and INFRE

What a Difference a Year Makes: Survey of Retirees in 2008 and 2009

- How confident are you that you saved enough money to live comfortably throughout your retirement years?



Source: Will Retirement Assets Last a Lifetime – 2008 and 2009 supplement, Society of Actuaries, LIMRA and INFRE

The New Retirement

- New ways to think about life cycle
  - Third age: period between full time work and total retirement
  - A transitional period
    - Some work and more leisure
    - Supplement earnings with retirement resources
  - More focus on engagement during retirement
  - People planning to work longer, but maybe differently

The New Retirement

- Retirement ages are increasing
  - Labor force participation rates, age 65-69:
    - Men: 27% in 1994, 34% in 2007
    - Women: 18% in 1994, 26% in 2007
  - May increase further because of economic crisis
- Healthier longer…but not forever
- Living longer – women are still living to higher ages
- Women still earn less and work fewer years than men
  - 2000 retirees, median years worked: 44 for men, 32 for women

The New Retirement Demographics

Probability of Living to 80, 90, 100: Projected to 2025

Projection to 2025				
Survival Age	**Female 65**	**Male 65**	**Both Survive**	**Either Survive**
Survive to 80	78%	72%	56%	94%
Survive to 90	41%	30%	12%	59%
Survive to 100	5%	2%	0.1%	6%

When do people retire/expect to retire?

- Big difference between when people retire and when pre-retirees expect to retire.
  - Many people forced to retire before they wanted to.
  - People wanting/needing to work longer may have a difficult time.
  - Post-crisis, even fewer resources to rely on.
- Timing of when you claim Social Security is a very important issue, but not well understood.

Sources: Society of Actuaries Surveys of Post-Retirement Risk EBRI/Greenwald Retirement Confidence Surveys, and Anna Rappaport Consulting

Disconnect Between Expectations and Reality

How old were you when you retired or began to retire from your primary occupation?/At what age do you expect to retire from your primary occupation?

Age category	Retirees (%) (n=400)	Pre-retirees (%) (n=401)
Under age 55	31	1
55 to 61	30	16
62 to 64	16	12
65 to 69	13	27
70 or older	4	6
Will not retire	1	1
Doesn’t apply	3	32
Don’t know	2	6

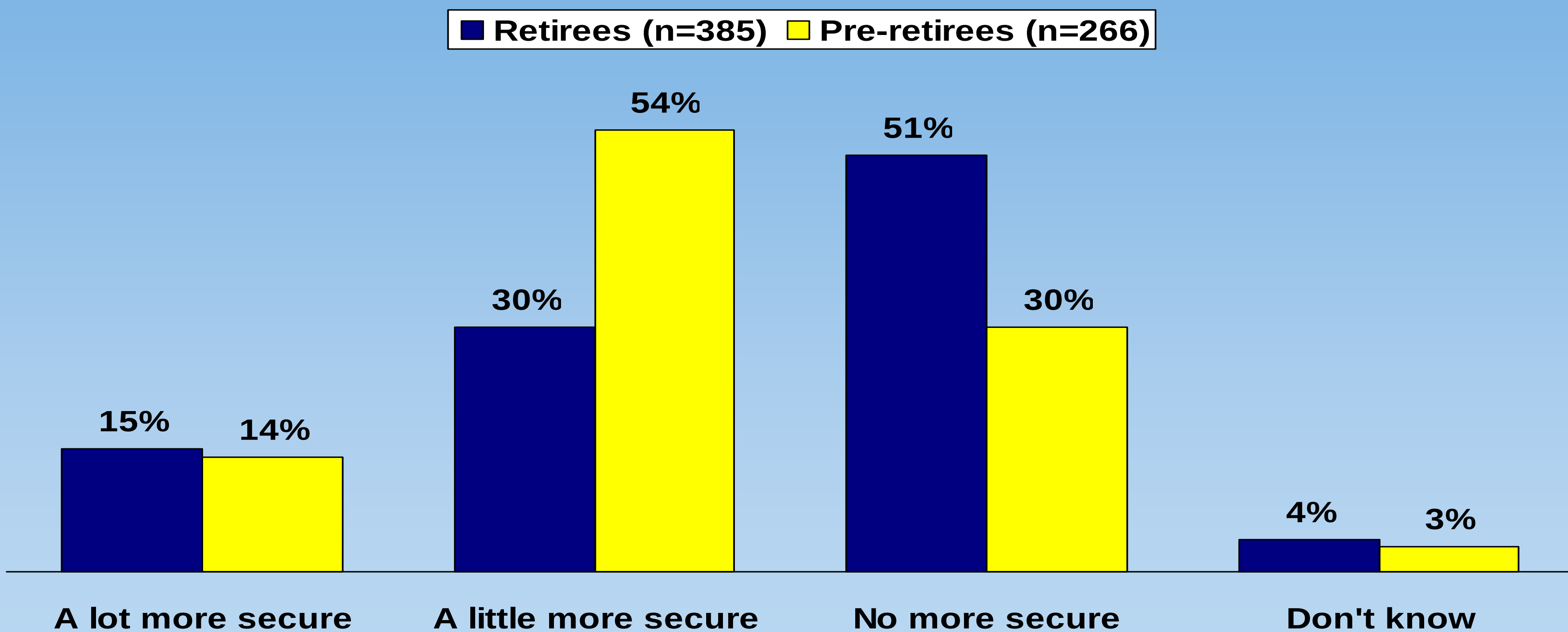
Source: Society of Actuaries, 2007 Risks and Process of Retirement Survey

How People Retire

- People expect to retire later, but will they?
- Phased retirement already exists without formal programs – studies show 30-40 percent of retirees worked for pay in last year.
- Phased retirement will likely increase in the future.
- 2005 survey looked at working retirees and their work:
  - One in three continued to work for same company as before retirement,
  - Majority used skills from primary occupation.
- Few retire at same time as their spouses.

Pre-retirees think delaying retirement would increase their security

Suppose you had retired three years later than you actually did/Suppose you were to retire three years later than you are currently planning. Do you think this would make your retirement financially…? (Among those providing retirement age from primary occupation)



Source: Society of Actuaries, 2007 Risks and Process of Retirement Survey

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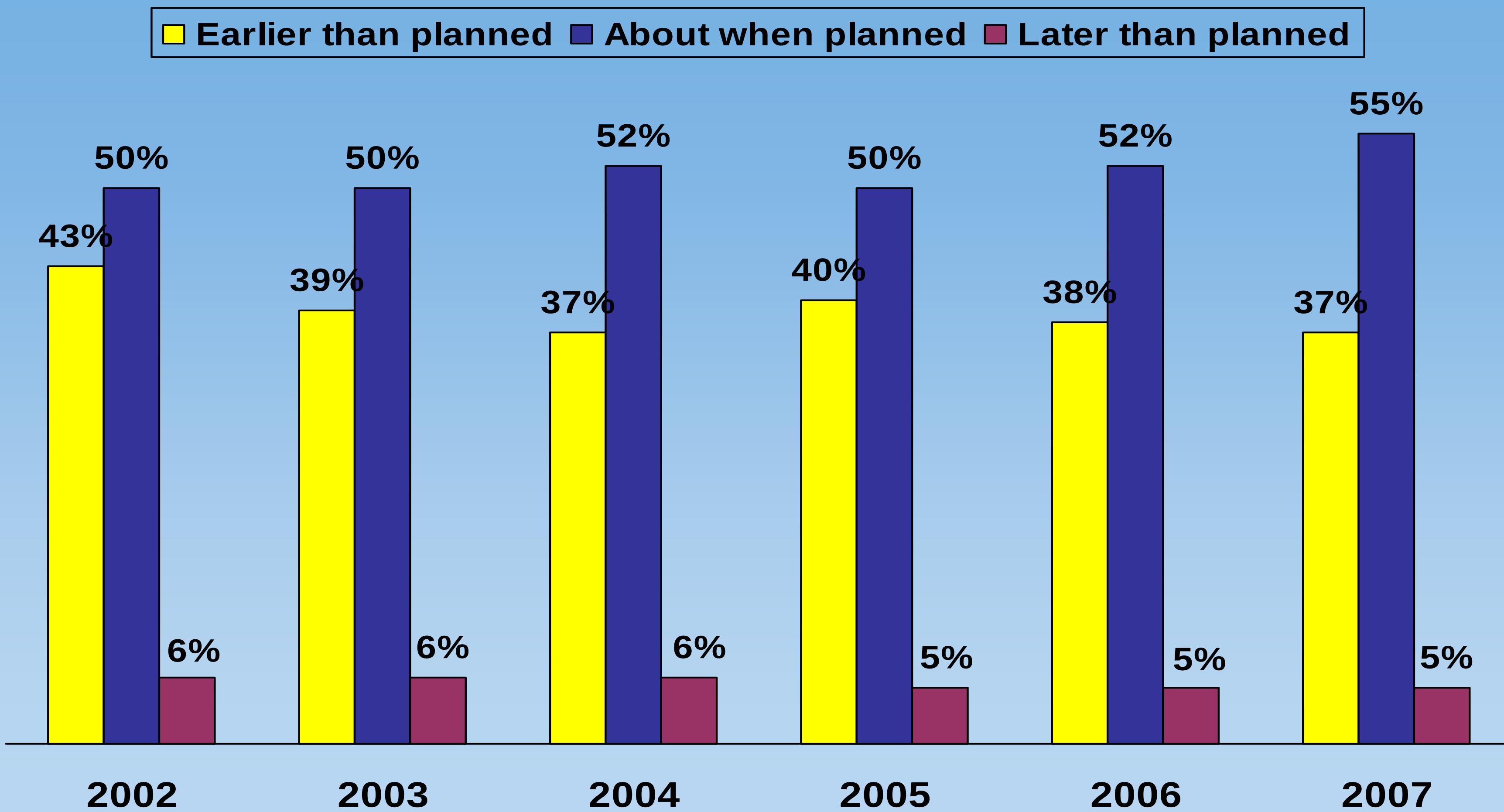
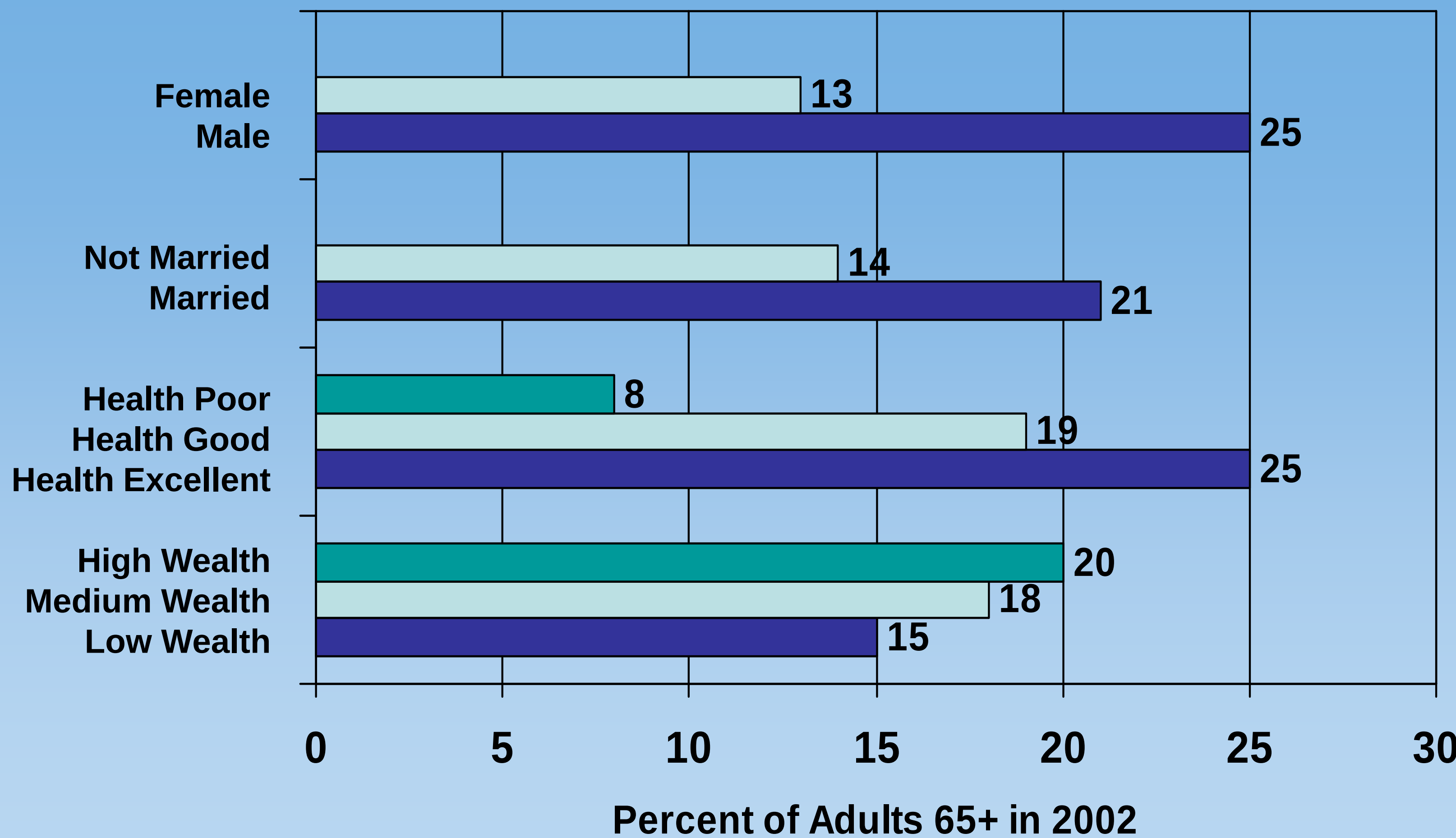
Many may be ignoring the possibility of involuntary early retirement



Source: EBRI/Greenwald, 2002-2007 Retirement Confidence Surveys

Who works past age 65?



Source: Butrica, Barbara, How Do Older Americans Spend Their Time, Urban Institute

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A Review of the Research: Insights on Planning for Retirement

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What insights can we offer about planning and what concerns do we have?

- Most important decisions for many middle class Americans
  - When to retire and claim Social Security
  - Housing assets are key: for those aged 55 to 64 in 25th percentile to 85th percentile (based on wealth)
    - Non-financial assets are about 70 percent of total assets (not counting Social Security and DB pensions)
- Thorough discussion of housing often neglected in planning
- Time horizons are often far too short
- Software research provides insights

Source of housing data: Society of Actuaries Segmenting the Middle Market Retirement Risks and Solutions (2009)

Planning for Retirement: Voices of retirees

"I traveled about 70 percent of my time when I was working. I got up one morning and said, 'I've had it.' and walked in and quit."

"I never sat down and thought, I am 59, and in 30 years I'll be 89. Have I allocated enough for 30 years? I never did that. Theoretically, I should have. But it doesn't seem to make any difference."

Source: *Spending and Investing in Retirement: Is There a Strategy?,* Society of Actuaries and LIMRA (2006)

Findings from Focus Groups

- Retirees tend to plan on a short-term and not a long-term basis.
- It is common for retirees to take 6 percent of assets and compare to expenses (less income from other sources) and use this as a measure of affordability of retirement.
- Most of the retirees did not have an organized comprehensive risk management program. Rather they took each day at a time and dealt with things as they occurred.

Source: *Spending and Investing in Retirement: Is There a Strategy?,* Society of Actuaries and LIMRA (2006)

Findings from Focus Groups (cont.)

- Many of the retirees did not do formal retirement planning.
- There was a lot of awareness of long-term care insurance, but few bought it, and a number thought it was too expensive.
- There was very limited awareness of annuities.
- A lot of what people think they know is often misguided or false.

Source: *Spending and Investing in Retirement: Is There a Strategy?,* Society of Actuaries and LIMRA (2006)

Where does housing fit into the retirement financial picture?

- Biggest item of expense and biggest asset item for many
- Fraud and predatory lending are problems
- Planning software does not treat it well and many programs ignore housing asset
- Several choices for use of housing equity to help finance retirement
- No agreement on process to evaluate and most software does not handle

How does software fit in: results of two studies

- There is much room for improvement: programs are tools and there is no <u>right</u> answer.
- Programs are generally not developed to address retirement risk. <u>They mainly mask risk.</u>
- Not much has changed from 2003-2009.
- Programs varied greatly in inputs and treatment of different situations. Example: housing.
- There is a wide range of results and direct comparison is very difficult, if not impossible.
- (Case 1 – all consumer programs ran out of assets and 7 out of 10 professional programs ran out of assets – Earliest date 2006 and latest date 2034)

Life Expectancy and Planning Period

- Programs generally do a poor job of dealing with life expectancy.
- Some programs permit users to enter their life expectancy. Studies have shown that people tend to underestimate life expectancy.
- Some use a planning period to a specified age.

2009 Study: Social Security Poorly Measured

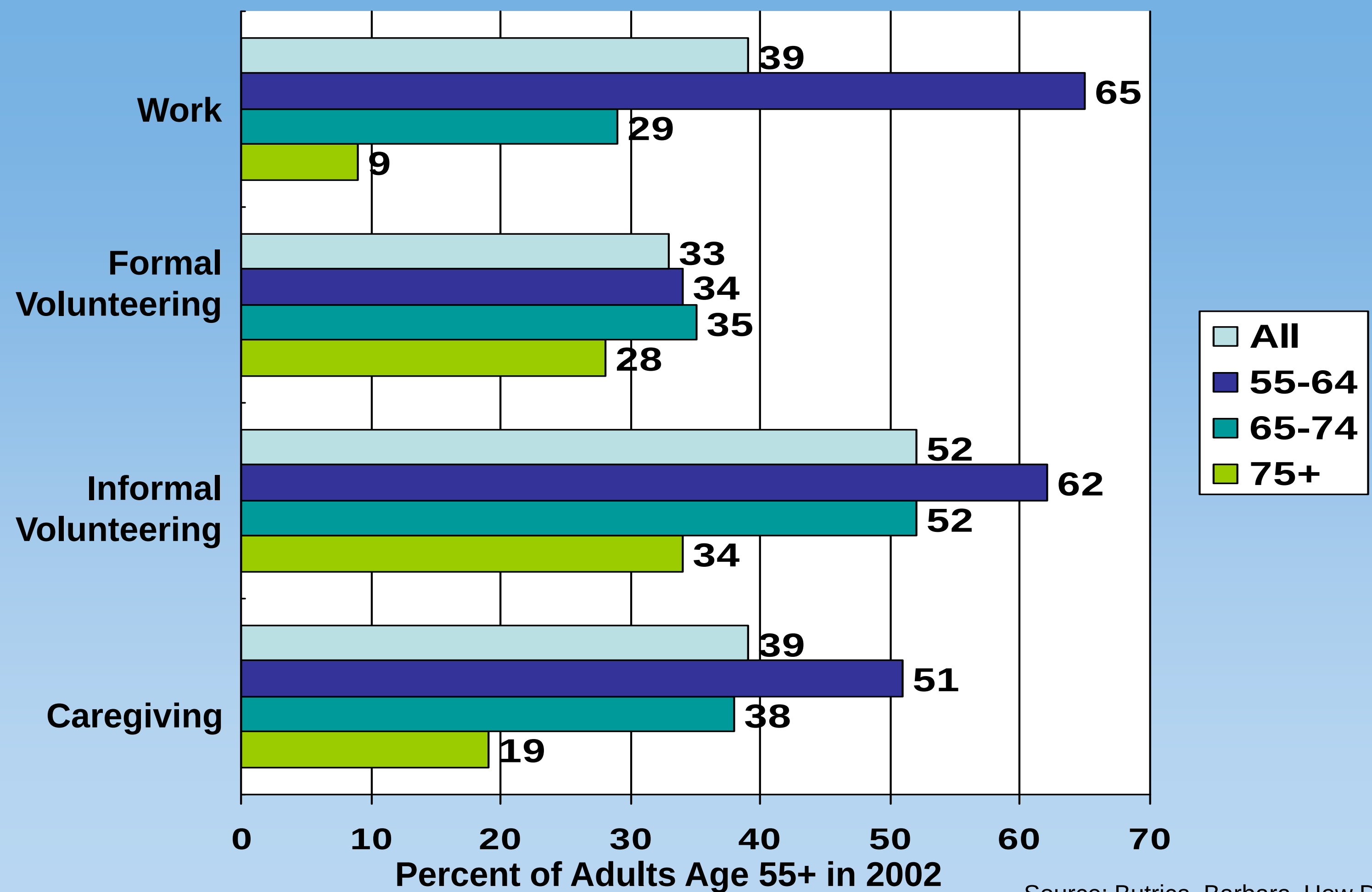
- Financial planning software examined in this study generally does a poor job of obtaining information on Social Security benefits.
- Some programs estimate benefits based on a single year of earnings.
- Some programs allow or require the user to provide an estimate, but studies have shown that many people do not know within a reasonable range what their benefits will be.
- One program uses a flat amount.

A Review of the Research: What Changes During Retirement?

What changes during retirement and what does this mean for retirement planning?

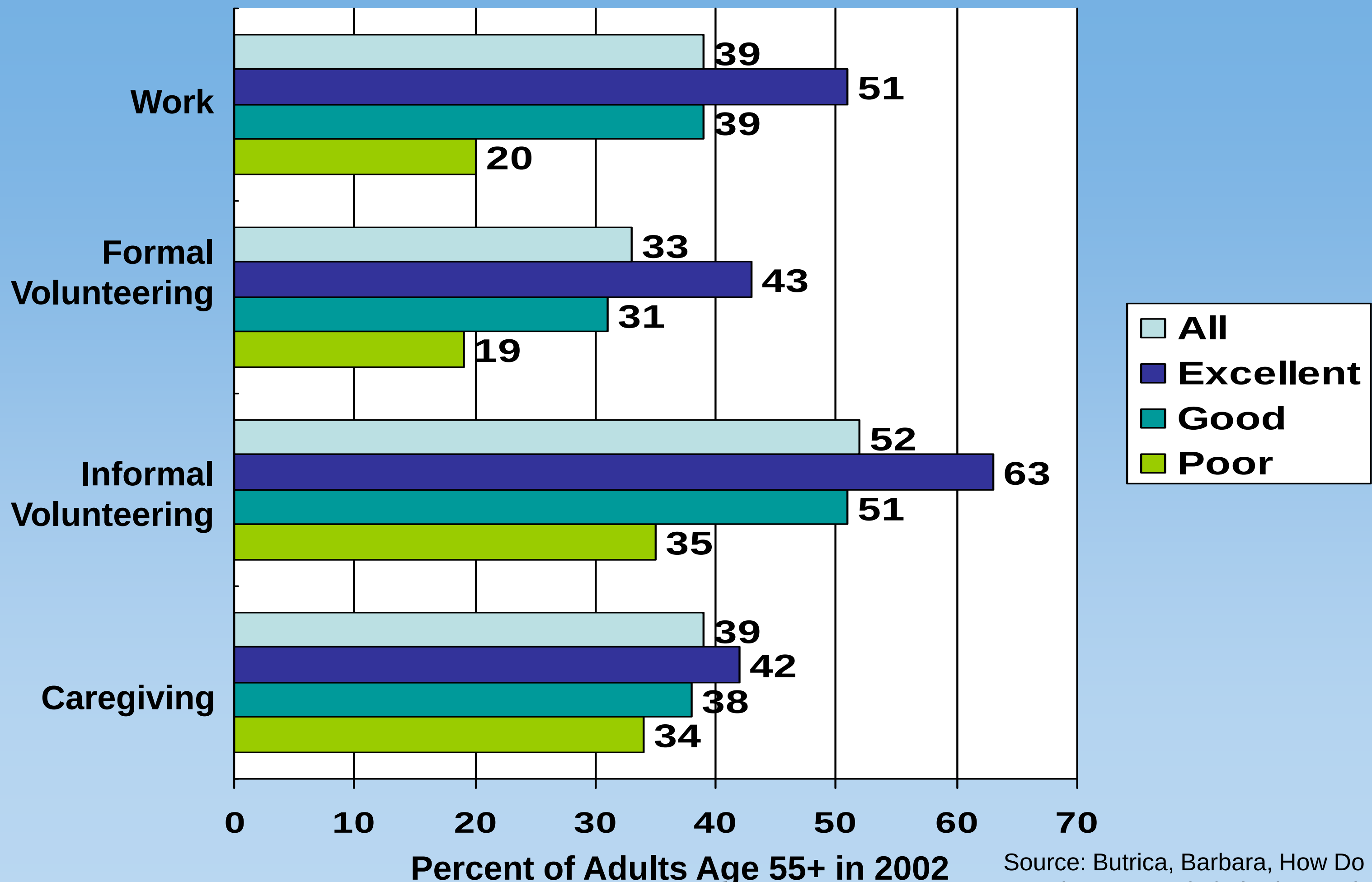
- Age 60 to 100+
- Thinking about
  - Financial resources for the rest of life
  - Health and long-term care
  - Getting help
  - Staying engaged and maybe working
  - Meeting our dreams
  - Limitations on our activities
  - Needs of family members
  - Where and how to live

What older Americans do with their time varies by age...



Source: Butrica, Barbara, How Do Older Americans Spend Their Time, Urban Institute

…and health status



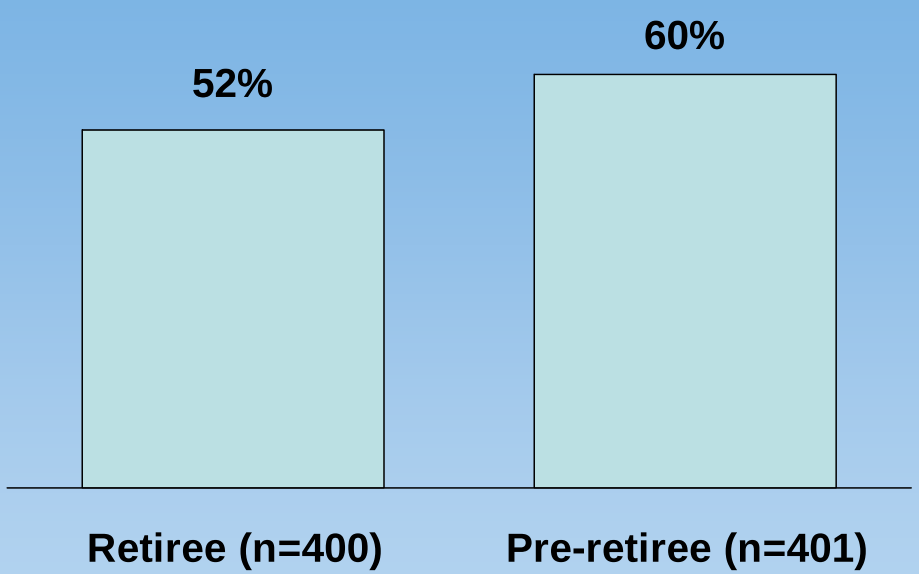
Source: Butrica, Barbara, How Do Older Americans Spend Their Time, Urban Institute

Phases of retirement: a different way to think about retirement

- Can be defined by activity level, employment status, age, health status
- Post-Retirement Risk Survey defines phases based on abilities and associated needs
  - Active, somewhat limited, severely limited
- Planning often focused on first phase
- Issues for couples
  - Timing of retirement
  - Changes at death of spouse

Only half of retirees have or expect an active phase of retirement

Do you think you will have a time in retirement when your abilities and needs are about the same as before you retired?

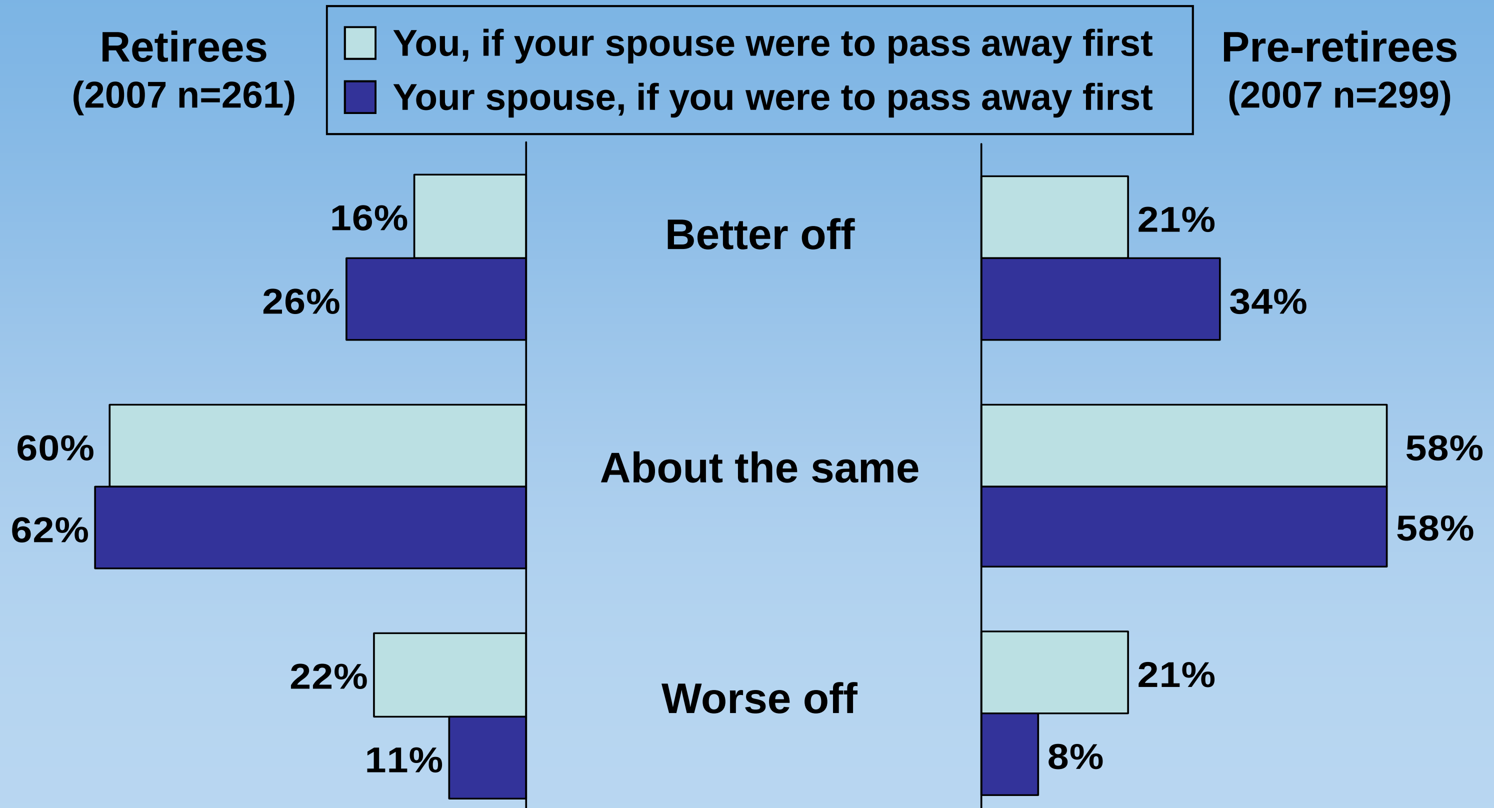


By the time they retire, about half have limitations.

Source: Society of Actuaries, 2007 Risks and Process of Retirement Survey

Few believe they will suffer financially by their spouse's death

If your spouse were to pass away before you/if you were to pass away before your spouse, do you think it would leave you/your spouse financially…? (Among married retirees and pre-retirees)



Source: Society of Actuaries, 2007 Risks and Process of Retirement Survey

Insurance plays only a small role in preparing for increased need

What, if anything, have you done or will you do to prepare for your changing needs in retirement? (Among those expecting less active phases)

Top Mentions (multiple responses accepted)	Retirees (%) (n=330)	Pre-retirees (%) (n=353)
Save (more) money	16	37
Invest to make assets last	15	19
Buy long-term care insurance	11	8
Make home modifications	6	4
Cut back on spending	6	4
Stay healthy/improve health	4	4
Pay off debts	2	5
Nothing	28	15
Don't know	7	7

Source: Society of Actuaries, 2007 Risks and Process of Retirement Survey

Conclusions From Research

- The economic crisis has affected retirement plans.
- Work is part of the new retirement.
- Housing wealth is important for retirement.
- People are assuming more responsibility, but major gaps remain in understanding risk.
  - Longer-term risk management is very difficult for individuals.
- Widows and the very old will continue to be vulnerable.
- There is a need for more effective financial products or programs.

Policy Considerations

Policy Considerations – Agenda

- Sources of retirement *risk*
- Sources of retirement *security*

- Fundamental policy questions
- Current policy directions
- "Retirement 20/20"

Sources of Retirement Risk

1. Economic forces

   - Investment losses
   - Inflation
   - Timing (market cycles)

   - Housing losses
   - Labor market demand for older workers

Sources of Retirement Risk

2. Biological

   - Longevity (your own)
   - Mortality (of your spouse, or others you depend on)
   - Morbidity / disability / catastrophic medical costs

Sources of Retirement Risk

3. Educational / human nature

- Lack of financial literacy
- Lack of "longevity literacy"
- From behavioral finance: Failure to mitigate risk or plan for change even by those who are highly financially literate
- Fraud

Sources of Retirement *Security*

The Traditional 3-Legged Stool

1. Social Security
2. Traditional pension plans (Defined Benefit)
3. Personal savings (including Defined Contribution plans)

The *New* Retirement: A 7-Legged Stool

1. Social Security
2. Defined Benefit
3. Defined Contribution / Personal Savings

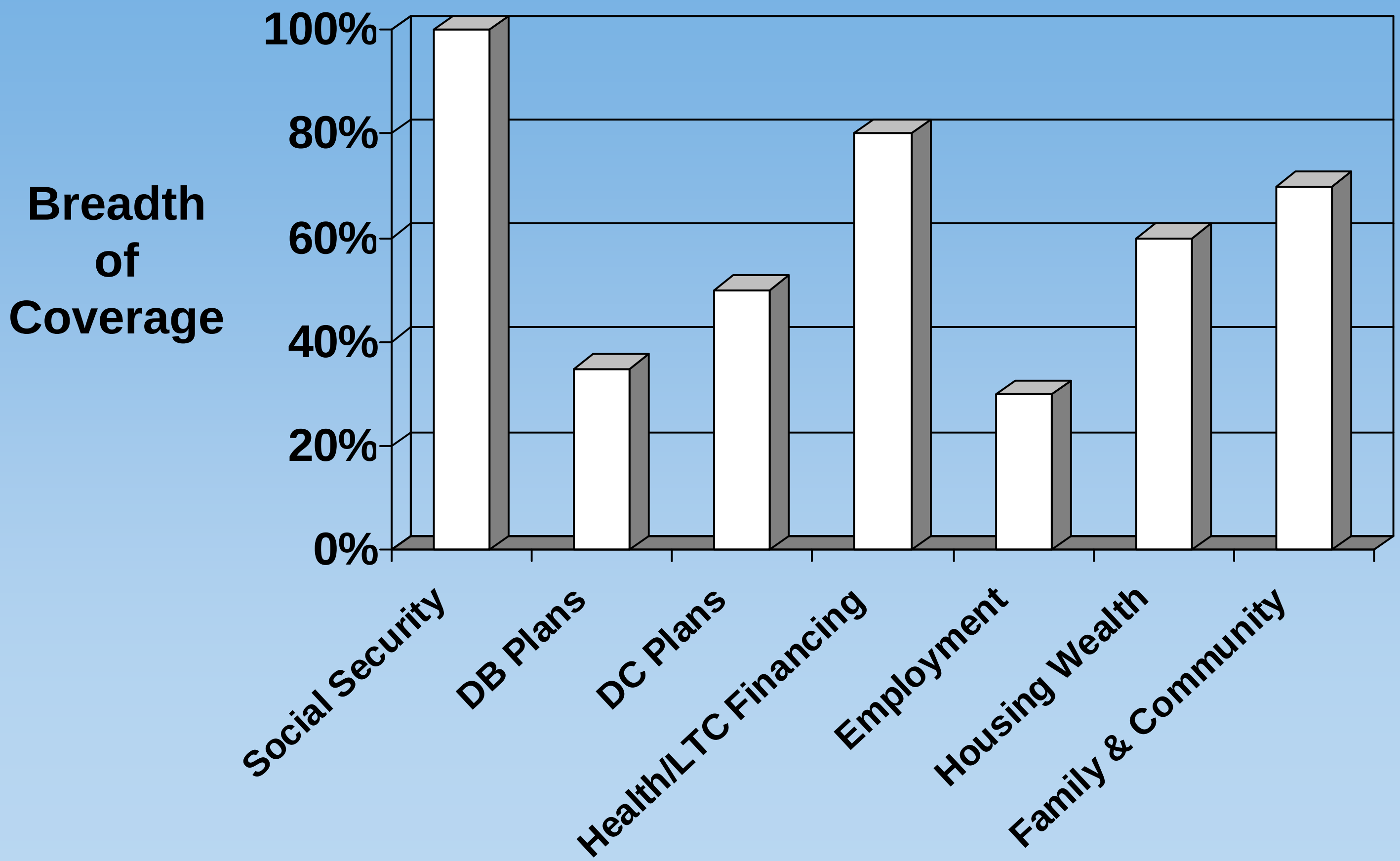
4. Health and Long-Term Care Financing
5. Employment
6. Housing Wealth
7. Family and Community

Family and Community

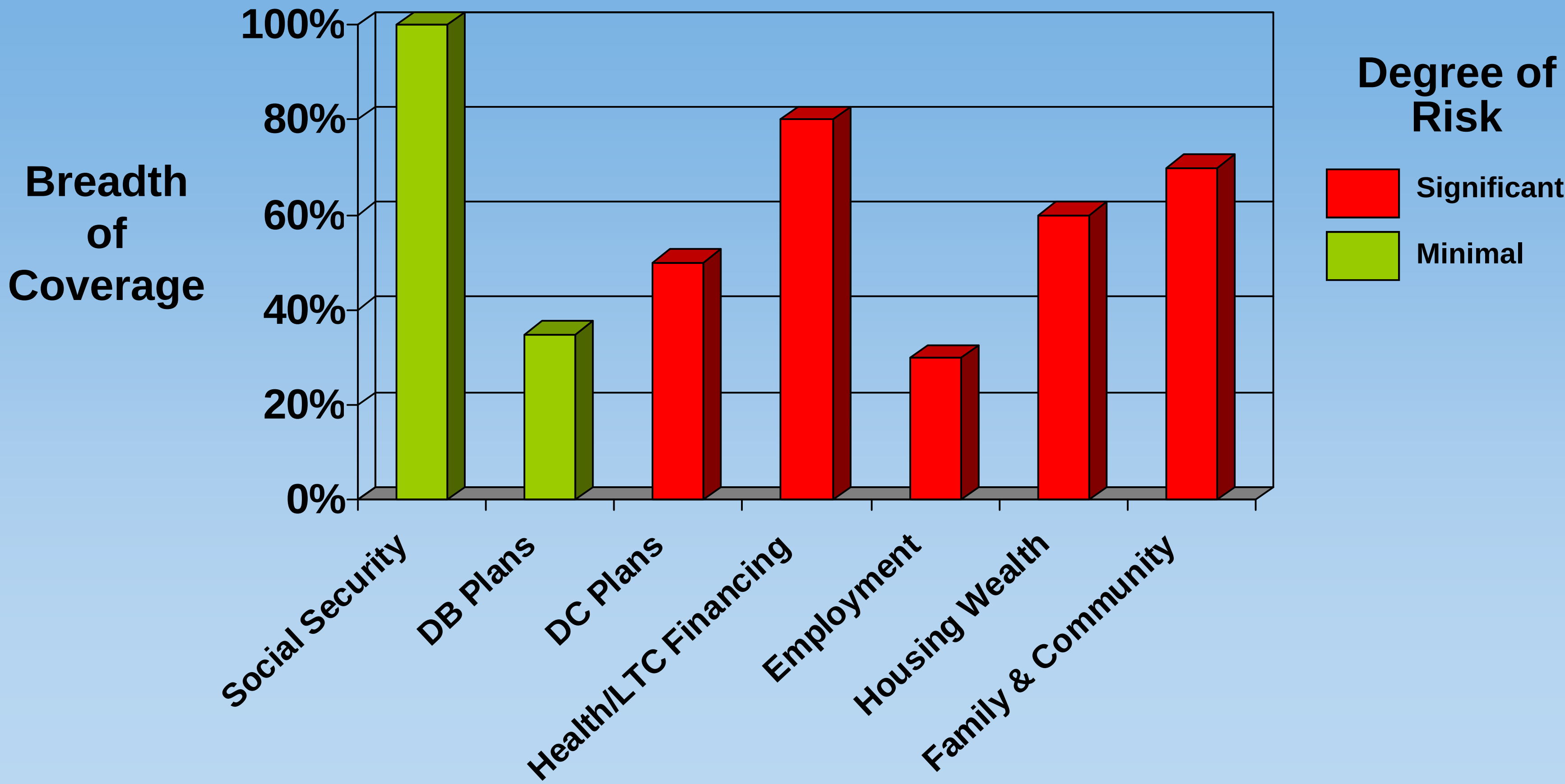
- Receiving care or assistance from a spouse, children, or friends/community
- Economies of scale of living with a spouse or other person(s)
  - Cost of living for elder *person* is approx. 70-75% that for elder *couple*[1]
  - Result: 40%-50% more expensive to live alone than to share costs
- Can be significant source of retirement security, but with high risk of loss

[1]Source: Wider Opportunities for Women, The Elder Economic Security Initiative

The 7-Legged Stool:
Breadth of Coverage



The 7-Legged Stool:
Breadth of Coverage & Degree of Risk (Retirees)



Policy Considerations

- Should we have a National Retirement Policy???
  - Beyond tax policy
- Should it encompass all 7 legs (or more) of the stool?
  - What do we want to do with each? Alter? Expand?
  - Does it include labor market policy?
  - Does it include financial policy related to housing?
  - Does it include retiree health care / long-term care policy?

Policy Considerations

- Should we / can we shift more emphasis to the less wobbly legs of the stool?

- Can we make some of the legs of the stool less wobbly?

Policy Considerations

- Do we try to change *people* to fit *programs*?
  - e.g., make people more financially literate so that defined contribution programs are more effective.
- Or do we change *programs* to fit *people*?
  - e.g., change default options in defined contribution plans.

Policy Considerations

- Two policy design issues:
  - Investment vs. insurance (pooling)
    - Example: DC vs. DB
  - Choice vs. defaults / mandates
    - Examples:
      - Employee options within DC
      - Employer options on what to offer
- Philosophical issues with retirement security implications

Policy directions currently being proposed by stakeholders (policy discussants)

- Social Security – preserve/reform, but don't expand
- Defined benefit plans – stop the bleeding of what's left, but little emphasis on expanding
- Defined contribution and savings plans
  - Expand (e.g., auto enrollment, auto IRA)
  - Reduce risk (e.g., target date funds, defaults, fees, annuities)
- Health insurance – control costs
- Housing – Reforms to avoid another bubble
- Labor market opportunities for older workers?

Policy Evolution??

- Retirement policy of the future could include new types of programs that don't look like those we have today. We are not limited to today's DB/DC menu. Other combinations of risk allocation, risk sharing, and financing are possible.

- Retirement 20/20 project.

http://retirement2020.soa.org

Questions?

SOA Recently Published Retirement Research

RETIREMENT RISK REPORTS

The Society of Actuaries (SOA) recently published several new retirement risk research reports. All reports are available at http://www.soa.org/research/pension/research-post-retirement-needs-and-risks.aspx

The ***2007 Risk and Process of Retirement Survey,*** in cooperation with Mathew Greenwald & Associates and EBRI, reports the results of this 2007 survey of retirees and pre-retirees. The survey explored retirees' and pre-retirees' awareness of retirement risk issues and strategies for dealing with them. The report is the fourth in a series. Previous reports in the series can also be found on the same Web page.

Spending and Investing in Retirement—Is There a Strategy? presents the results of six focus groups composed of retirees ages 60-72 on their experiences of managing assets in retirement. The focus groups examined how individual retirees make decisions about financial management of assets.

SHORT REPORTS FOCUSING ON SPECIFIC RETIREMENT RISK ISSUES

A set of reports highlighting key findings from the 2007 Risk and Process of Retirement Survey is now available. A set of reports highlighting the 2005 survey can also be found on the same Web page.

The Phases of Retirement and Planning for the Unexpected highlights changes that may occur during retirement and planning for them.

Understanding and Managing the Risks of Retirement explores what retirees and pre-retirees understand about various retirement risks and risk management strategies. Risks considered include investment, inflation, health care and longevity.

Health and Long-Term Care Risks in Retirement focuses on retiree knowledge about health care and long-term care risks in retirement. Issues such as affordability and access are explored.

PUBLIC MISPERCEPTIONS ABOUT RETIREMENT SECURITY

Also on the same Web page, two reports examining ***Public Misperceptions about Retirement Security*** are available for downloading. The reports explore what the public knows about retirement security and where significant gaps exist. The latest report suggests how various stakeholders can help ensure a secure retirement for future retirees.

FUTURE VISIONS OF RETIREMENT

Reenvisioning Retirement in the 21st Century Monograph is a collection of papers presented at the symposium with the same title in Washington, D.C. on May 3-4, 2006. The papers explore new visions for retirement income plans in the 21st century. The papers can be found in the retirement monographs section of the SOA Web site at http://www.soa.org/

Retirement 20/20 is a multi-year strategic project that has been undertaken by the SOA's Pension Section. The motivation for the project is to look at where we are today, determine what kind of retirement systems we need for tomorrow and help build them. More information can be found at http://retirement2020.soa.org/

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