



**Understanding and Managing Post-Retirement Risks**

A series of reports presenting highlights from the Society of Actuaries extensive body of research on post-retirement risks and issues.

# Shocks and the Unexpected: An Important Factor in Retirement

By Anna Rappaport, Chairperson, Society of Actuaries  
Committee on Post-Retirement Needs and Risks



# In This Report

## **BIENNIAL RISK SURVEYS**

2015 Risks and Process of Retirement Survey. This SOA report focuses on shocks, a special topic in the 2015 survey. The special topic is reported in 2015 Risks and Process of Retirement Survey: Key Findings and Issues, Shocks and Unexpected Expenses in Retirement

## **FOCUS GROUPS AND IN-DEPTH INTERVIEWS**

Post-Retirement Experiences of Individuals Retired for 15 Years or More (2015)

The Decision to Retire and Post-Retirement Financial Strategies: A Report on Eight Focus Groups (2013)

## **ESSAYS AND PAPERS**

Diverse Risk Essay Collection—Charles S. Yanikoski, “Dealing with Multiple Post-Retirement Risks in the Middle Market”

In addition, other materials are referenced in the footnotes and at the end of the report.

# Shocks and the Unexpected: An Important Factor in Retirement

Managing retirement security in the United States has been increasingly challenging for all stakeholders. Major factors contributing to these challenges include a growing older-age population, the shift from defined benefit to defined contribution plans, and significant gaps in financial literacy. These factors contribute to a growing concern about how well Americans will fare in old age, and the adequacy of their retirement security.

The Society of Actuaries' (SOA) Committee on Post-Retirement Needs and Risks (the Committee) has been working for nearly 20 years to identify and understand the way Americans manage their finances post-retirement. This research work includes a wide-ranging exploration of post-retirement risks through surveys of the public; focus groups and interviews; and collections of essays, research papers and other research reports covering related topics.

This report is part of a series that offers highlights and key findings from the 20 years of Committee research and related SOA work, together with guidance about where to find more information. This report focuses on shocks and unexpected expenses in retirement and links them to risk issues. It offers a combination of research findings, ideas for solutions and some tips. It includes the experiences of retirees and perspectives on their parents' experiences.

The intended audience for this report includes retirement experts, plan developers and service providers, and those who serve individuals, including employee benefit plan sponsors, advisors and financial services organizations.

## Shocks, Risks and Unexpected Events

How do retirees plan to handle future risks and unexpected events in retirement? A common way of

thinking is, "I will deal with it when it happens," or "I will figure it out," according to SOA Focus Group interviews with recent retirees in 2013. This was a major finding, and it prompted the SOA project team to ask, "What does that mean for the future of retirees who experience shocks?"

In particular, what problems would unplanned shocks and unexpected future events create for retirees? Such events are often referred to as "shock" events due to their powerful impact and the often-surprising nature of their arrival. Examples include death of a spouse, entry into a long-term care facility or a major repair to the home, among many others. The shocks put retirement plans at risk due to the major disruption they cause in the lives of retirees and the often costly and unplanned financial burdens that result.

The 2013 Focus Group research with individuals generally retired 10 years or less was followed up with 2015 Focus Group research with those retired 15 years or more. Together, these studies demonstrated that retirees often do not consider shocks and unexpected expenses in planning, or retirees implicitly expect to provide for such circumstances by trying to hold onto assets. The 2015 Focus Groups provided a means to understand what retirees had actually experienced over a longer retirement period and to understand how the perceptions of shorter-term retirees would play out over time.

The SOA researchers conducted both sets of focus groups with resource-constrained retirees, that is, those who had assets to manage and financial decisions to make about them that likely involved trade-offs.

## Major Research Findings and Information About Shocks

Planning generally focuses much more heavily on the expected than the unexpected. But life is a mixture of both, and how well retirees handle the unexpected is a big determinant of how well they will do overall. The SOA research found that many people are poorly prepared for unexpected expenses and people with lower incomes seemed to be more severely impacted. Key findings from the 2015 SOA Risk Survey and the 2015 Focus Groups include the following:

### PREVALENCE OF SHOCKS

- **Shocks are important and multiple shocks do occur.** About one in five retirees (19%) and one in four (24%) of retired widows experienced four or

more shocks during retirement. In contrast, 28% of retirees and 13% of retired widows had not yet experienced any shocks.

- **Difficulties tend to increase with the number of shock events.** Shocks and unexpected expenses affect the majority of retirees. Families that deal well with one or two shocks may find the situation becomes increasingly difficult when faced with additional shocks.
- **The most common shocks reported were home repairs and dental expenses.** The two most frequently mentioned financial shock and unexpected expense items are home repairs and upgrades (28%) and major dental expenses (24%).
- **Lower income retirees face much greater problems.** Almost three in 10 (29%) of retirees with annual incomes of less than \$35,000 had experienced four or more shocks compared to 10% of retirees with income of \$75,000 or more.
- **Widowhood is a shock.** Sometimes the death of a spouse is totally unexpected. Many retirees indicated household income did drop as a result, but most said they were able to adjust and manage. For some, household assets also dropped.

#### GENERAL REACTION TO SHOCKS

- **Retirees are willing to adjust.** The retirees are resilient, and they are willing to make substantial adjustments in spending to manage. Many are managing very well, and overall, they are doing better than some on the project team had expected.

#### IMPACT OF SHOCKS ON RETIREES

- **Assets decline.** More than one in three who experienced shocks had their assets reduced by 25% or more because of those shocks.
- **Spending reductions.** More than one in 10 who experienced shocks had to reduce spending by 50% or more because of those shocks.
- **But most manage.** About three in four retirees felt they were able to manage within their new financial constraints at least somewhat well.
- **Long-term care, divorce and long-term help to children were the most troublesome.** Retirees felt they could make adjustments and deal with unexpected expenses in a number of areas, but not with major long-term care events requiring paid long-term care, or divorce after retirement. Adult children receiving longer term support was also a major issue.
- **Devastating shocks were low in frequency.** The survey included some shocks that could easily be devastating, including fraud, foreclosure of

home and bankruptcy. All these shocks had low frequency.

- **Comment on health care.** Those who purchased a Medicare supplement in addition to Medicare usually had their health care bills well covered so health care costs were usually not an issue. Their premiums can be substantial, however, in view of the combined costs for Medicare Parts B and D and supplemental insurance. In addition, dental and long-term care expenses are not covered by Medicare or Medicare supplements, so people must pay the cost directly or purchase dental and long-term care insurance in the private market to help pay some of these costs. People with Medicare supplements reported that large dental expenses were often unexpected and surprising.

## The Voices of Retirees: Focus Group/Interview Quotes

The focus groups provided insights into issues faced by individuals and how people think about those issues.

The 2015 SOA Focus Group research sampled views of long-term retirees (retired 15 years or more) who were in the broad middle range of financial assets: those with investable assets between \$50,000 and \$350,000 in the United States and Canada. By interviewing people who have been retired for 15 years or more, the SOA was able to learn how these people are experiencing the financial challenges they face and how they have responded to these experiences. The researchers supplemented the focus groups by conducting in-depth interviews with children of individuals who needed long-term care, but who were otherwise similar.

The SOA report includes both the focus groups and interview results. Here are some of the participants' comments:

- *In 2013 I got colon cancer. . . . The medical cost and stuff like that was unreal. I've had to spend . . . \$3,900 had to come out right off the top.—Male, Dallas, TX*
- *Dental . . . I mean, you start to get into thousands of dollars sometimes and no insurance.—Female, Chicago, IL*
- *We just separated. I had my own money and investments and he had his. We had one account and that was the house account. Yeah, so he took what he had and we split the house.—Female, Kitchener, ON*

- *I've had—our house upkeep, furnace, driveway. In the last month, I have spent \$2,500 on one expense, \$3,600 on another expense. That's in one month. A couple of years ago, my roof went and my furnace went. Everything.—Female, Chicago, IL*
- *My daughter lives alone. . . . She was on her way to a teacher's meeting, and she crossed the street and was hit by a car. Since then she has MS and they did not pay anything. We got nothing and now she has no job . . . it's very expensive.—Female, Baltimore, MD*
- *So if you take a generic your prescription is \$25, but he takes seven and one of them is not generic, because there isn't a generic one, and his doctor would probably want him to take it anyway, so it adds up.—Female, Edmonton, AB*
- *The biggest thing, about 18 years ago, I had a lot of shares of Citigroup, and they were paying like \$17,000 a year dividends. That went down to \$30.—Male, Baltimore, MD*

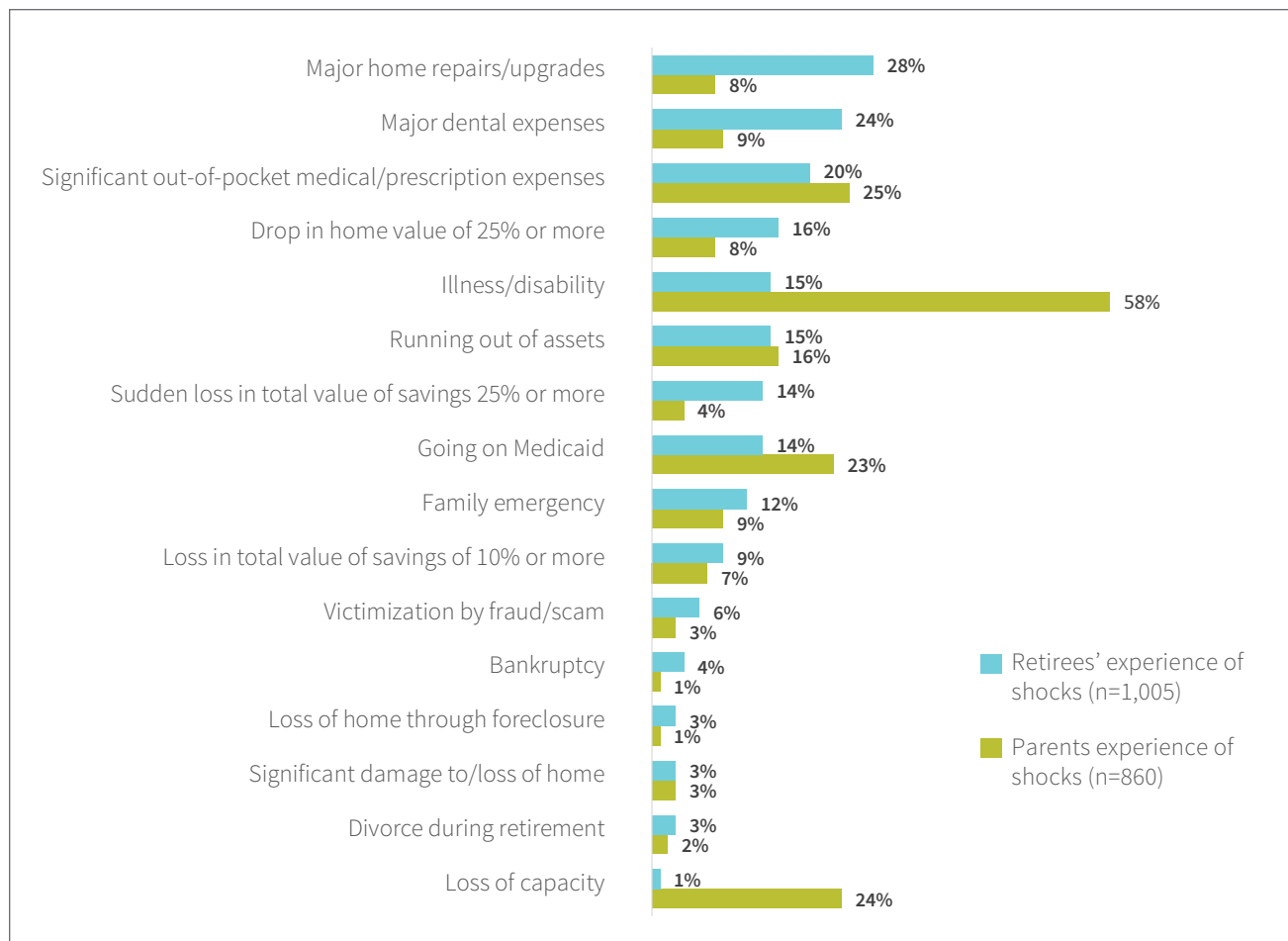
### ANOTHER VIEW: PARENTS' EXPERIENCES WITH SHOCKS

The researchers asked retirees about their parents' experiences with shocks and how their parents' experiences influenced them. Parents' experiences are indicative of what people may expect in their 80s and 90s. The study found several major differences:

- 58% of parents had experienced illness/disability compared to 15% of respondents
- 24% of parents had experienced a loss of capacity as compared to 1% of respondents
- 23% of parents had gone on Medicaid as compared to 14% of respondents
- 8% of parents were reported to have experienced major home repairs/upgrades as compared to 28% of respondents

The differences in these experiences provide some indication of what the retirees may experience in the future and of how society may need to deal with an aging population. The following graph summarizes

### Comparison of Retirees' and Parents' Experience



Source: 2015 Society of Actuaries' Survey of Post-Retirement Risk and the Process of Retirement, Figure 121

what the 2015 Risk Survey respondents said about their experiences and their parents' experiences.

### THE VOICES OF CAREGIVERS: EXPERIENCE WITH PARENTS' LONG-TERM CARE NEEDS

The SOA In-Depth Interviews provided insights into issues faced by family caregivers of those retired 15 years or more who have long-term care needs. The caregivers are also involved with financial management for the family members for whom they are caring.

- *We had maybe \$60,000 or \$70,000 in Fidelity, and we had maybe \$10,000 in a savings account that was going to be fun money for us. We had to spend all that. —Female assisting husband in the United States*
- *Initially she had quite a lot of money saved. There was no problem. About \$400,000 not counting the house. [And now] Maybe \$20,000. —Female assisting mother in Canada*

## Retirement Adequacy, Planning and Shocks

Planning systems generally include a measurement for defining what resources are needed to meet expected retirement expenses. Such tools may not consider unexpected expenses, however.

For example, another SOA-sponsored research project showed that traditional measures of retirement needs may not focus on shocks or retirees' willingness to make substantial adjustments in lifestyle and spending. Yet modeling of retirement resource adequacy that considers a range of shocks, including long-term care, adverse investment experience and higher medical costs, indicates this can be risky. The modeling shows that the asset value needed to have a 90% chance of assets lasting for life is much higher than the assets needed to have a 50% chance of assets lasting for life, primarily because of shocks.

**For more information see: Measures of Retirement Benefit Adequacy, Society of Actuaries, 2013.**

## Dealing with Shocks

Retirees experience a wide range of shocks and unexpected expenses. The situation is different for people who have multiple shocks than for those who do not, and the magnitude of the problem and options for dealing with shocks vary depending on the individual situation.

An essay from the SOA Diverse Risks Essay Collection provides a process for thinking about the risks and potential shocks as a totality. The author, Charles Yanikoski, introduced three ways to deal with risks: purchasing insurance products, using self-insurance and reducing exposure to the risk. Noting that there are trade-offs in applying resources to buy insurance, he suggested a process for optimizing the strategies. The Yanikoski process involves four major steps: assessment of financial risk exposure, defining financial risk abatement capacity, assessing financial products for risk abatement, and last, a reality test.

**For more information see: Yanikoski, Charles S., Dealing with Multiple Post-Retirement Risks in the Middle Market, Society of Actuaries' Diverse Risks Essay Collection, 2016**

The 2015 SOA Risks and Process of Retirements Survey and 2015 Focus Group findings provide insights into what people do, and what resources they have, to enable them to respond to the shocks and unexpected events. Note: The focus groups do not provide statistical data but rather a look at what people say they do, and their comments do not cover all situations.

- **Spending adjustments.** People adjust their spending in response to changes in circumstances.
- **Emergency funds.** The research clearly shows that many people do not have adequate emergency funds, and most people face some unexpected expenses.
- **Other methods of dealing with shocks.** People deal with shocks and unexpected expenses by adjusting regular expenses, withdrawing funds from savings, borrowing, getting help from others, or not paying the unexpected expenses. In extreme cases, they may go into bankruptcy.
- **Long-term care insurance can help.** The research showed that increased use of long-term care insurance would help some families. However, such insurance is relatively expensive for those with modest means. Some will not be able to afford it, and others may choose to take the risk of going without it.
- **Home repairs.** Although people can accumulate reserve funds for such expenses, it is not easy to insure the potential exposures. Note: Retirees who are condo owners benefit from their share of building repairs being incorporated into their monthly maintenance fees; however, condo owners face the potential for special assessments that come unexpectedly, can be for significantly

- large amounts, and provide little or no control over timing for payment.
- **Dental.** Dental expenses are frequently unexpected and uninsured. They can be quite large when compared to retirees' resources available for unplanned expenses. Dental insurance is available to retirees on a limited basis, and benefits may be limited for certain procedures.
- **Borrowing money.** Some people borrow money to help deal with shocks. Caution is needed as some debt, for example, credit cards and payday loans, can have very high interest rates and can be very expensive. Debt can spiral and create an ever-worsening problem if not managed well.
- **Improved budgeting and planning can help.** Different methods of budgeting and financial planning can probably reduce the impact of unexpected expenses. This will not reduce the expenses, but it might spread them over time and provide the ability for a much more realistic assessment of, and adjustment to, expenses.
- **Family may be a source of help or hindrance.** Some people get help from others, including family, in case of emergency. Retirees are more likely to financially help younger family members than vice versa. Cultures differ regarding the extent that family members provide help to each other.
- **Emergency funds.** It is important to maintain liquidity and have emergency funds. Financial assets are a prime source for emergency funds. An alternative source for emergency funds is a line of credit or reverse mortgage. Consider setting up such an arrangement so it can be used as needed.
- **Dental expenses.** Be prepared for dental expenses. Medicare does not cover dental expenses, but limited insurance coverage may be purchased. Even for households that have insurance, larger expenses may not be covered. Shopping around for dental care may help get better results for the money.
- **Planning for long-term care.** Long-term care insurance can often help. Households without long-term care insurance may need a significant amount of assets to pay for long-term care. Households without adequate assets who need major care may be forced to spend down assets and hope to get coverage through Medicaid (note there are special rules and timing for how this must be done). For couples, be sure to consider the consequences for both partners.
- **Avoiding traps and difficult issues.** There are several areas where unexpected expenses are common or difficult to deal with. Here are ideas for managing those risks:
  - Avoid the use of high cost debt. Examples of high cost debt are credit cards and payday loans. Be careful in the use of borrowing and meet repayment plans. Consider a plan to eliminate debt.
  - Evaluate whether current housing is affordable based on anticipated finances. Be sure to consider cost of repairs, special assessments for condos, future increases in taxes, and so on.
  - In the event of divorce, retirement assets need to be factored into the financial agreements. For married couples, consider structuring a plan that works for the couple as well as for each person alone. Having a plan that works for each spouse should help reduce the impact of divorce.
  - Use caution in providing financial help to family. There is a danger that funds needed later in retirement will be given to family before that need arises.

**For more information see: The 2015 SOA Risk and Process of Retirement Survey and the 2015 Focus Groups. Additional survey results come from the How Americans Manage Their Finances Study, Center for Economic and Social Research, University of Southern California, 2015. This study was supported by the SOA.**

## Tips Based on This Research

This research offers important information for individuals, advisors, organizations sponsoring employee benefits and companies that offer risk management products. Tips reflect the concern that many planning packages do not focus on shocks, and many people have emergency funds that are very small. The following are general tips for different stakeholders.

### TIPS FOR RETIREES AND NEAR RETIREES

- **Planning for the unexpected.** Planning is important, and be sure to consider the longer term and the unexpected. Make a list of potential unexpected expenses and risks, and expectations for dealing with them should they occur. The assessment process in the essay described earlier is helpful in making this list.

### TIPS FOR EMPLOYEE BENEFIT PLAN SPONSORS AND SERVICE ORGANIZATIONS

Benefit plans have an opportunity to fill in the gaps in tools, benefits and information to help employees get better results. Here are a few ideas:

- Many planning tools ignore shocks. They can provide misleading results. Employers can provide tools or offer information about the use of publicly available tools. Many tools exist, but users often find it challenging to identify which are reliable without help from a trusted resource.
- Many individuals do not have access to any professional advice. Employer-sponsored programs can help meet this need by offering advice and guidance options.
- Explore financial wellness programs and methods of helping employees deal with debt.
- Voluntary products offered through the employer can help fill in some risk areas where there is not adequate coverage. Examples of protection that may be offered on a voluntary basis include long-term care and disability coverage.

## Final Thought

Many people do not plan, but among those who do, common planning methodologies may not consider the unexpected. Successful provision for the unexpected is critical to success in financial management during retirement. Because there are so many different unexpected events that are possible, planning can become a daunting task. Strategies to plan for the unexpected include maintaining emergency funds and liquid assets, working to reduce risks, and buying insurance. Maintaining liquid assets that are available for a variety of unexpected expenses is a very good start.



# Appendix: More About the Research

The Society of Actuaries' Committee on Post-Retirement Needs and Risks has based its insights on robust research designed to increase understanding of the way Americans manage their finances post-retirement and to help improve the management of the risks.

**The full reports from the Committee are available for download at the SOA website: <https://www.soa.org/research/topics/aging-ret-res-report-list/>**

The Committee's focus has been on exploring the perspective of the individual. This includes representation at all income levels, but with primary focus on the middle market.

The research approaches include:

- **Biennial risk surveys.** Surveys of the knowledge and attitude of Americans age 45 to 80, split between retirees and pre-retirees with respect to post-retirement risks and the process of retirement. Each report includes some common questions and several topics of emphasis selected for that survey, such as health and long-term care, women's issues, shocks, and so on. Surveys conducted since 2001.
- **Focus groups and in-depth interviews.** Periodic projects targeted to specific subgroups and issues,

to better understand retiree rationale, to supplement the surveys and also to help provide input into questions and structure of surveys. Projects conducted in 2005, 2013, 2015 and 2017.

- **Consumer Information.** Gaps in knowledge are a key finding of the research, so the Committee designed several publications that are designed to fill in gaps and provide helpful information for consumers and consumer-support services. These publications include *Managing Post-Retirement Risk: A Guide to Retirement Planning* (risk chart), *Managing Retirement Decisions* (a series of 12 shorter guides to specific decisions), and *Age Wise Infographics* on longevity-related issues. A new series starting with *Retirement Health and Happiness* provides information about Retirement Literacy.
- **Essays and papers.** These are monographs that include essays and papers on topics such as the Financial Wellness Essay Collection, Diverse Risks Essay Collection and *Managing the Impact of Long-Term Care Needs and Expense on Retirement Security*. These works reflect a range of perspectives from individual publishing authors who responded to calls for papers. Their ideas include solutions to some of the challenges raised by the research.
- **Other Research.** The Committee has conducted other projects, including a series on lifetime income, reports on financial advice, and discussions of retirement planning software. In addition to the direct work of the Committee, the SOA conducts other research related to these issues and includes work performed by related entities.

# References

## BIENNIAL RISK SURVEY SERIES

- *2015 Risks and Process of Retirement Survey: Key Findings and Issues, Shocks and Unexpected Expenses in Retirement, Society of Actuaries, 2016*

## FOCUS GROUPS

- *Post-Retirement Experiences of People Retired for 15 Years or More, Society of Actuaries, 2016*
- *The Decision to Retire and Post-Retirement Financial Strategies: A Report on Eight Focus Groups, Society of Actuaries, 2013*

## ESSAYS

- *Diverse Risks Essay Collection: Yanikoski, Charles S., Dealing with Multiple Post-Retirement Risks in the Middle Market, Society of Actuaries Diverse Risks Essay Collection, 2016*

## OTHER

- *Rappaport, Anna, Financial shocks, unexpected expenses and financial experiences of older Americans, 2017 Living to 100 monograph, Society of Actuaries (forthcoming)*
- *Carvalho, Leandro, Arie Kapteyn and Htay-Wah Saw, How Americans Manage Their Finances—Results of the Financial Management Survey, Working paper 2015-020 CESR-Schaeffer Working Paper Series from the University of Southern California with support from the Society of Actuaries, 2015*
- *Bajtelsmit, Vickie, Anna Rappaport and LeAndra Foster, Measures of Retirement Benefit Adequacy: Which, Why, for Whom and How Much?, Society of Actuaries, 2013*

*Note: The content of this research brief are a combination of the author's own ideas and ideas drawn from the research described in the brief. The tips reflect the opinion of the author. The ideas and tips are not an opinion of the Society of Actuaries or any Committee thereof.*



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