Improving Retirement Outcomes: Timing, Phasing, and Benefit Claiming Choices

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This research report is authored by Vickie Bajtelsmit, Anna Rappaport, and LeAndra Foster, and is a follow-up to their December 2012 study entitled *Measures of Retirement Benefit Adequacy: Which, Why, for Whom, and How Much?*. In preparing the original study, the researchers developed a Monte Carlo simulation model of retirement cash flows incorporating a wide variety of risks and uncertainties faced by retirees, including longevity, inflation, investment, health, and long-term care. By varying assumptions, they compared the impact on outcomes of decisions such as expense reduction, mortgage payoff, purchase of annuities and long-term care insurance, and delayed versus early retirement.

Both of these studies will be of interest to multiple audiences such as –

- Consulting actuaries in advising their clients on how to maximize the utilization and effectiveness of their retirement programs through not only plan design but also targeted communication;
- Employers (both public and private sector) on how to integrate their retirement programs with their workforce management initiatives;
- Individuals who are planning for their own retirement to get an idea of what their needs might be and which strategies may work best for them;
- Public policymakers on where government efforts to encourage such things as financial education, phased retirement or later Social Security claiming can be most effective;
- Financial advisors in helping their clients plan for retirement, including working to later ages; and
- Software developers who are designing tools to be used in retirement planning.

In this study, the authors begin by providing useful background information and data, including other SOA research, as well as call-out boxes highlighting practical issues and key findings on the following topics:

- Labor force participation trends,
- Social Security claiming behaviors,
- Phased retirement choices, including some real-life examples, and
- Changes in employer retirement plan offerings.

The authors then analyze the following combinations of timing, phasing and claiming strategies and their impact on retirement outcomes:

- Both husband and wife phase to 50% part time and claim Social Security (SS) at age 66, then fully retire at age 70.
- Both husband and wife phase to 80% at age 62, phase to 20% and claim SS at age 66, then fully retire at age 70.
- Husband has $5,000 frozen defined benefit (DB) from previous employment - Retire and claim everything at age 62, 66 or 70
- Husband has DB at primary employer (18 years of service (YOS) at age 62) - Retire and claim everything at age 62; Retire and claim DB at age 62; 50% part time to age 66, claim SS at age 66
- Retire at age 66 from primary employer with 22 YOS - Retire and claim everything at age 66; Retire and claim DB at age 66; 50% part time to age 70, claim SS at age70
- Both spouses retire and claim at same age (62, 66 or 70)
- Husband retires at age 70, wife at age 62
- Retire at age 66 & claim SS at age 62
- Retire at age 66 & claim SS at age 70

- Retire and claim DB and SS at age 66, take single life annuity
- Retire and claim DB and SS at age 66, take 100% joint & survivor annuity
- Retire and claim SS at age 66, cut discretionary spending 20% or 30%
- Retire and claim SS at age 70, cut discretionary spending 20% or 30%
- Retire and Claim SS at age 66, cut discretionary & housing 20% or 30%
- Retire and Claim SS at age 70, cut discretionary & housing 20% or 30%

The base case that was presented in the original study included three levels of pre-retirement income and two levels of non-housing wealth for a married couple. Other variables in the simulation include the following:

- Pre-retirement standard of living
- Percent of wealth annuitized
- Time until mortgage payoff
- Retirement age
- Purchase of long-term care (LTC) insurance

See Table 16 in the study for a summary of the base case simulation assumptions. The results include the probability of having and the expected amount of wealth left at death, as well as the number of years income is insufficient and the amount of wealth that would have been sufficient to meet needs. Additional results are included in charts in the Appendix.

Table 18 illustrates the wide variation in results for the base case of retirement at age 62. For example, at the $60,000 pre-retirement level of income, the amount of wealth needed at retirement to be sufficient ranges from approximately $383,000 to be 50% confident of having enough to approximately $520,000 for a 90% confidence level. There is more than a 30% difference between the 50^{th} and 90^{th} percentile forecast, as well as a large additional difference between the 90^{th} and 95^{th}. These differences are largely "shock" driven, and the specific amounts of the differences are highly sensitive to model assumptions and construction. In this context, "shocks" refer to expenditures that are significantly higher than expected from the perspective of the household, such as an extended long term care stay, which may be surprising and for which they are not financially prepared, and not just events that occur suddenly.

Here are some of the key findings:

- The typical household has insufficient wealth to maintain its standard of living in retirement if the couple retire and claim Social Security at age 62 (see Table 18)

- While delayed Social Security claiming reduces the risk of retirement wealth shortfall, households are still exposed to substantial risk from health, LTC and investments (see Table 19).

- While phased retirement strategies reduce the risk of retirement shortfall, the wealth needed at retirement may still exceed the amount that typical retirees have accumulated (see Table 20).

- Expense reduction in retirement, combined with delayed retirement and increased saving, will improve the chances that retirement wealth lasts a lifetime but does not mitigate the impact of shock risks such as LTC (see Table 21).

- Although a DB plan will help retirees meet regular cash flow needs, it will not insulate them from shortfalls driven by investment, health and LTC risks. The choice of annuity option has minimal impact other than providing income to a surviving spouse (see Figure 6 and Table 22).

A major conclusion from both this and the previous study is that strategies that affect regular cash flows can improve outcomes to a degree, but do little to mitigate the impact of shocks. To be 90% or 95% confident of a successful retirement, households need significantly more wealth at retirement to hedge against the tail risk of higher than expected longevity or extended periods of long-term care. While risk management strategies such as buying annuities and long term care insurance can have a significant influence for those who live long or who need the benefit, such insurance may not be affordable for the base case families explored in this study. Typical households have far too little wealth to be confident of meeting their needs. The strategies illustrated in this study generally require some amount of behavioral change on the part of retirees which may be starting to occur, but more saving is still necessary to improve retirement outcomes in the near and long terms. The prospect for a poor retirement outcome can be very difficult to alter if action is delayed until the end of an individual's career which implies a clear policy case for more early education and government support through appropriate and well-reasoned (but not over-burdensome) legislation, rules and regulations. Plan sponsors can also help by providing access to and information on financial and other planning tools to help individuals understand the implications of various strategies as well as offering options to make it easier for individuals to work longer.

This study provides insights that should be helpful in thinking about planning approaches and tools. It should be of interest to financial planners, individuals, employers, financial service companies, software developers and those building products as well as public policy professionals. However, the results suggest that those relying on planning that does not incorporate a focus on multiple risks, including those "tail risks" that may be considered unlikely but may develop over time, should be provided information on what is considered and what is excluded from the plan. In addition, they should be provided information on the implications of excluding some risks.