Is there a Strategy?

Society of Actuaries

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SPENDING AND INVESTING IN RETIREMENT

IS THERE A STRATEGY?

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EXECUTIVE SUMMARY

The approaching retirement of the baby boom generation has focused increasing attention on retirement income and asset management. And as the number of people retiring each year increases, the proportion of workers covered by defined benefit plans declines, resulting in a smaller proportion of retirees receiving significant guaranteed income streams throughout their retirements. Defined contribution plans are now a popular retirement vehicle among employers offering some type of retirement plan. But often these plans provide lower value benefits at retirement age than defined benefit plans, making decisions about when to retire and how to manage income more important.

As a result, future retirees will have more responsibility for their financial security than previous generations of retirees. This makes their level of knowledge, skill, and judgment in making financial decisions related to retirement more crucial to their financial well-being throughout retirement than ever before. With this increased level of responsibility, it is of particular importance to understand the current "state of the art" — how well retirees who now have to manage significant parts of their own assets make key decisions, including 1) when they can afford to retire, 2) what they should do with retirement plan and savings accumulations at retirement, 3) how much they can afford to spend each year, and 4) whether they should protect themselves against uncertainties, such as the need for long-term care and the uncertain timing of death, through insurance mechanisms.

Exploring the thought process and actions of current retirees helps provide insight into the approaches future retirees might take regarding their retirement income. Focusing on those who are not getting the majority of their money in the form of guaranteed income streams will give an indication of how most future retirees will manage their money.

To gain insight into these issues, LIMRA and the Society of Actuaries conducted six focus groups with retirees who have considerable retirement income management responsibilities; that is, they have at least $100,000 of investable assets and must depend on that money to maintain their lifestyles because they do not have sufficient amounts of annuitized income from Social Security and defined benefit plans to meet all of their expenses. Most of the focus group participants had either no defined benefit plan or only limited income from defined benefit plans.

The purpose of this research is to gain an understanding of how current retirees approach key financial decisions about managing their money in retirement. The benefits of this qualitative study are multidisciplinary. It can help 1) actuaries design better retirement financial systems, 2) the financial services industry understand areas of misperception and causes of poor management, and 3) provide policy-makers an understanding of how to drive public policy goals. Furthermore, this initial phase of research will guide the direction of the next intended phase of research, a broader survey of retirees, to provide extensive quantitative data.

This report presents the key findings from these focus groups, with verbatim comments from the participants, and interpretative comments and conclusions by the researchers.

Key Findings

The researchers believe that this research adds substantially to the understanding of the processes people use to make key financial decisions in retirement. Unfortunately, what we observed is that a number of the financial decisions people make tend to be somewhat shortsighted. The focus group participants were generally, with some exceptions, optimistic about their financial chances in retirement. Their rationale is primarily that they lead moderate lifestyles and can cut back significantly if they run into financial difficulties. Although there is awareness of the risks of needing expensive medical care or long-term care, few prepare for these risks. Most of the participants prefer not to think about these risks. It seems clear that a number of the focus group participants are not well protected against major financial risks; many will probably face financial difficulties as they age. Following are the researchers' views of the most important findings.

The Decision of When to Retire Is Most Often Not Carefully Planned

It can be argued that the decision of whether and when to retire is one of the most important financial decisions a person makes. It can easily impact a retiree's financial security for a period of 25 years or more. But relatively few focus group participants retired with the benefit of having undertaken a careful analysis to determine whether their funds would sustain them throughout the retirement period. And none reported that they retired *after* achieving a calculated (dollar) target level indicating that they could afford to retire. A number of participants retired because they had reached the ages their parents retired, had unpleasant experiences at work, were offered generous packages, or thought they had attained preconceived socially appropriate ages to retire. Age rather than attained assets is the meter by which they gauged when it was time to retire.

Other research has shown that poverty and near-poverty rates are considerably higher for those who live past age 85. Of course the incidence of widowhood rises after age 85, compounding financial problems for many. A significant percentage of retirees will live beyond age 85. Without doing a better job of determining when they can afford to retire, it is likely that a considerable portion of them will not have sufficient financial resources to maintain their standards of living.

Calculations Used Reveal a Lack of Consideration of Inflation Risk, Market Volatility, or Longevity Risk

Participants were given several scenarios of individuals at age 65 and asked in each case whether the person could afford to retire. Their answers reveal how people calculate how much money is needed to maintain a lifestyle in retirement. The basic approach appears to be 1) calculate average monthly expenses, 2) add up expected monthly income from Social Security and any defined benefit stream of income, 3) subtract the monthly income from the monthly expense to determine the "gap" that would need to be funded, 4) add up financial assets and multiply the total by .06 to signify a 6 percent expected return (while there are differences of opinion on this, 6 percent appears to be the typical response) and then divide by 12 to derive a monthly investment return, and 5) if the expected return fills the gap, the person can afford to retire.

This approach has several problems. First, even if investment returns average 6 percent, which may be difficult because many of the retirees have significant investments in fixed investments, a poor market in the early years of retirement could permanently impair the ability to provide the funding needed for daily living. When investment income is relied upon for everyday expenses, fluctuations in returns may be disruptive. Second, this approach does not take inflation into account. Third, there is no method of dealing with changing needs during retirement, including a likely increase in health care costs, a possible need for long-term care, and costs linked to other risks that are fairly prevalent in retirement. It also does not take into account the wish to spend more to fulfill retirement dreams, such as travel and hobbies.

Very few of the focus group participants feel positive about annuitizing portions of their assets. Of course monies that are annuitized can provide higher returns than monies individually managed, because the annuitant can take advantage of the pooling of mortality (as others in the pool die, the annuitant draws their income). Thus, with the effective use of annuitization people can extract more financial security out of a specific level of accumulation. As more middle-class people enter retirement with Social Security and large single sums, annuitization should be considered as an option. But these focus group participants do not think highly of annuitization and do not take this option into account when thinking about how retired people should invest.

Most of the Retirees Take an Intuitive Approach to Long-Term Planning

Few participants have developed goals for sufficient asset levels in future years. Nor have many assessed when they should change their asset allocations (e.g., when they retire or as they age) or whether they should change their spending levels at retirement to meet evolving conditions. When asked how they expect to adjust to inevitable changes in costs, health, and market conditions, the typical response was, "I'll just know." These participants appear to have relied on intuitive reasoning their entire adult lives and have faith in their ability to sense when change is necessary.

The retirees do not seem to realize that retirement is different from the working years. While workers can accommodate financial setbacks by working longer, delaying retirement or postponing expenses, retirees have less control. They have less opportunity to return to work, less ability to weather down markets because of the need for income from investments, and less control over certain expenses. Therefore, it is questionable how reliable the intuitive approach can be — but it is an approach that the retirees believe in. Many also do not believe you can plan for the "unexpected", although some did mention the use of insurance for this purpose. Although many agree with the statement one participant made that "if you fail to plan, you plan to fail" when asked questions about planning, they see planning as fairly short-term and based on intuition. They do not understand the type of long-range planning retirement requires.

Resistance to Advice

Very few participants had financial advisors *prior* to their retirements. Currently, a minority have financial advisors whom they trust and rely on. Most of the retirees appear to be planning their investments and spending on their own. One reason that many plan on their own may be a distrust of advisors. A number of the retirees believe that they can plan their finances better than professionals can.

As retirement becomes more complex, and the financial management responsibilities of individuals grow, professional advice will become more important, particularly for middle-class retirees. Yet, the viewpoints expressed in the focus groups show the difficulty the financial services industry faces in helping retirees through the complexities of managing money amid the financial uncertainties that mark the retirement period.

Investing in Retirement

In regard to becoming more or less aggressive in their investments after retirement, focus group participants exhibit a variety of approaches. Some have invested more conservatively after they retired (usually because of concern about a market downturn), some did not change their investments, and others invested more aggressively.[1] Having their investing strategies come under the influence of new advisors *after* retirement seems to be the main reason retirees become more aggressive in their investing after retiring. Most of the retirees who did not change their investment strategies saw no need to do so. They were satisfied with the returns, did not need to increase returns, or did not feel they could afford to become more conservative or aggressive, and therefore did not make changes.

While working, many of these focus group participants invested mainly through defined contribution plans at work. This investing was most likely shielded to some extent from input from others. After retiring, some retirees turned to financial advisors for advice on how to invest these accumulations.

Overall, based on the observations gathered during the focus groups, these retirees seem somewhat resistant to change; indeed, they could be fairly labeled as gradualists. They want to maintain their current lifestyles (although many wind up spending more), they tend to live in the same homes, they do not change their investments much, nor their financial planning or financial management. This lack of change is interesting: While the end of earning money through work is an enormous financial and social change, these retirees seem committed to balancing this by keeping their financial situations fairly unchanged.

[1] One cannot impute proportions of the population that moved in each direction based on qualitative research.

Spending Money in Retirement

Many focus group participants are spending more money now than they did while working. There are two reasons for this. First, retirement tends to mean having more time for socializing and hobbies. Many retirees have fairly expensive hobbies, such as fishing and golf. Socializing often takes the form of eating out and other entertainment. While there are costs associated with work, such as commuting, that are eliminated in retirement, for a number of participants these savings are more than offset by the cost of retirement. The other reason is the relative increase in expenses caused by inflation. A number of retirees commented that they have been surprised by the increased cost of energy, prescription drugs, and other expenses. While many of the retirees find they spend more money in retirement, others are spending less. They are happy to stay home (rather than travel) and use coupons at restaurants when eating out. Participants also point out that they know how to cut back on expenses if necessary, something they do not feel their baby boomer offspring will be able to do.

In this time of historically mild inflation, the rising cost of living is an unwelcome surprise to many retirees. It is interesting that retirees should be surprised by inflation, because it is a fact of life for all Americans. It is likely that the impact of inflation, while having always been there, is now felt more acutely because of the relatively greater role of fixed income sources in retirement.

REPORT ON FOCUS GROUP RESEARCH

FINANCIAL CHARACTERISTICS OF THE PARTICIPANTS

Retirement came fairly early for the majority of the focus group participants — almost two in three participants retired earlier than they had planned. This proportion is considerably higher than reported by retirees in national surveys.[2] The focus group finding may reflect the participants' higher-than-average economic status (they are in the upper half of their age cohort by assets) and the local economies, which may have led more firms than average to push older employees into retirement. The average retirement age of focus group participants was in the late 50s.

Almost half of the participants state that their current annual incomes are in the $25,000 to $49,999 range. Only one in five has income of at least $75,000 per year. The participants express a good deal of contentment with the lifestyles they live on their income. Most have lived in their homes for a long time, and few have moved because of retirement. It is easy to presume that their homes are paid for. Indeed, two in five have no debt whatsoever, including mortgage debt and home equity loans, and only one third have debt in excess of $20,000 (again including mortgage debt and home equity loans). On the asset side, one third have assets of under $250,000 while one quarter have assets of $250,000 to $499,999 and one third have assets of $500,000 to $999,999.

A questionnaire submitted to participants prior to the focus groups asked which of 10 expenses had major impact on their income. The two cited most often are medical expenses and taxes; yet each is indicated as a major expense by only one in four.

The focus group participants have a wide diversity of investments: About half have invested in stocks, two in five have savings accounts, almost two in five have mutual funds, little over one third have CDs, 3 in 10 have annuities (although only a few have immediate annuities). Further, majorities have life insurance and Medigap or other private health insurance. About half have prescription drug coverage[3] and two in five have dental insurance. A little under one quarter have long-term care insurance.

Thus, overall, the participants are maintaining comfortable but not overly affluent lifestyles, supported by somewhat conservative investing and little or no debt. Many of them stated that they feel financially secure, and these background data provide some evidence of this.

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[2] LIMRA International's 2005 Retirement Income Preferences survey found that 52 percent of retirees had retired earlier than planned. EBRI/Greenwald Associates' 2006 *Retirement Confidence Survey* reports that 38 percent of retirees left the work force earlier than planned.

[3] Focus groups were held prior to Medicare D prescription drug enrollment.

MARRIED VERSUS NONMARRIED

Of the six focus groups, four groups comprised married people and two comprised nonmarried people — somewhat evenly split between never married and widowed. One of the goals of this approach was to discern the differences between married and nonmarried retirees on issues of income management after the working years. A few factors make it difficult to make a clear determination of the impact of marital status on income management. First, we are working with rather small numbers — fewer than 20 nonmarried participants and fewer than 40 married participants. Second, differences are somewhat difficult to determine in qualitative research, not only because of the small sample sizes, but because each focus group takes on, to some degree, a "life of its own," examining some issues in more depth than others. This is a strength of focus groups — to be able to home in on issues that arise — but it also makes comparisons between groups of different composition more difficult. In quantitative research, each respondent is asked the very same questions — (usually) in the same order — and thus answers each question in the same context as other respondents do. In focus group research, the questions are not always asked in the same order, or in the same exact way in all groups.

Third, the nonmarried participants, not unexpectedly, had lower assets. In explaining differences between the nonmarried and the married participants, it is difficult to pinpoint which may have been caused by being single and which were caused by lower income. Also, the married participants are more likely to have children who are potential sources of support, including financial, emotional, and social support, housing, and support with the challenges of aging, such as long-term care.

Having stated this, a key difference between married and nonmarried participants is that married participants appear more optimistic and more secure and seem to feel less vulnerable. They seem, to some extent, to be more interested in insurance protection, but also more concerned about the cost of this coverage. Quantitative research will be necessary to draw these distinctions out and discern causality.

THE DECISION TO RETIRE

There is substantial diversity concerning when these focus group participants decided to retire. A rather small minority did extensive amounts of financial planning prior to deciding when to retire. Some of these people had relationships with financial advisors and sought out their advice on when they could afford to retire. A few did detailed financial projections, using assumptions for life expectancy, investment return and inflation. However, the life expectancy assumptions used may have presented some risk. One participant, who is typical, says his advisor suggested he plan to live to age 85, which the participant, who appeared in good health, thought was far too long. It appears that very few analyzed how long their retirements could last or estimated how much money would be required to fund very long retirements. The average age at retirement for this group was the late 50s.

> *I didn't consider how long retirement would be.*
>
> — Male, Hartford

A common reason for early retirement, according to the EBRI/Greenwald Associates' 2006 *Retirement Confidence Survey*, is ill health or disability. Within the focus groups, a fair proportion of retirees retired earlier than planned; some retired due to poor health or because their employers wanted them to retire. In some cases, when it was the employer's choice, a package was offered. A number of participants retired because they felt burned out, had had enough or could not physically work any more.

> *I traveled about 70 percent of my time when I was working. I got up one morning and said I had it and walked in and quit.*
>
> — Male, Hartford

> *I was forced out … none of us know about it, January 31 we walked in, an hour later I was out the door, full package in hand.*
>
> — Male, Chicago

A few participants retired when they reached specific ages. One person said he retired because he was 65. Another had a long-held goal of retiring at age 55 and did so, without any debt. He mentioned that his father had retired at age 55. Although some may have had specific ages in mind at which to retire, not one focus group participant had a targeted financial figure in mind with which he or she could retire with financial security. No one retired when he or she reached a predetermined savings goal that would have indicated they could afford to retire.

> *Sixty-two was the right age to quit working for me.*
>
> — Female, Chicago

> *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.*
>
> — Male, Chicago

> *I thought you were supposed to retire when you are about 65 and thought I would try it.*
>
> — Male, Hartford

> *I remember something my mother always said ... "What do you want to do, die at your desk?" Oh no. That's right ... go on Social Security and get your pension and then be busier than ever.*
>
> — Female, Chicago

Some looked forward to retirement.

> *I was looking forward to retirement because there were so many things that I wanted to do and work seemed to interrupt all of them.*
>
> — Female, Chicago

How People Know They Can Afford to Retire

The decision that one can afford to retire is most often made based on a feeling that current monthly expenses can be met without income earned through work or by immediately drawing down assets. This issue was explored in two ways: First, participants were directly asked how they knew they could afford to retire when they did. Second, participants were given several scenarios of hypothetical working singles and couples in their mid-60s and asked whether, under the circumstances described, these people could afford to retire. The findings reinforced each other. The thought processes that people use for their own situations mirror the thought processes that they apply to the hypothetical examples. However, the hypothetical examples allow for a deeper understanding of how retirees approach the issue of how people make the assessment that they can afford to retire.

This calculation most often takes five steps. First, people add up their average monthly expenses. Most people have a good sense of their monthly expenses without having to gather any information, although some people do go through checkbooks or other records to determine how much they typically spend each month. Implicit in this initial focus on expenses is both the goal of maintaining the same lifestyle and the expectation that expenses in retirement will closely approximate expenses just before retirement.

> *It is easy to know what your expenses are.*
>
> — Female, Hartford

> *You sit down and really figure it out. You really sit down. It isn't like at a red light and its time to go, you go. For me, it took me around six months to really look at everything. It seems like things kept changing. Each week there'd be a different question. It comes down to that monthly check. What's it going to be? And they can give you some pretty good estimates but it's really, are you financially going to be okay?*
>
> — Male, Phoenix

> *I worked it out and I knew that I could afford it.* [How did you work it out?] *Well, I just got all my figures together and put it down on paper and it looked like I could do it.* [You added it up?] *I knew I could do it. As long as I didn't have a catastrophic illness, aside from that, I could do it, whatever.*
>
> — Female, Chicago

Second, participants get a sense of how much they will receive in guaranteed recurring income from Social Security, defined benefit pension plan payments, or other life annuity type income. Third, they calculate the difference between expected expenses and expected income and then, in step four, try to figure out whether they can afford to make up the difference through expected average returns on their investments. Most of the retirees state that one should assume a rate of return on investments of 6 percent. Some state that less than 6 percent should be assumed and a few believe that more than 6 percent should be used. Finally, if the expected income fills the gap, they decide they can retire.

> *You figure out this is what we spend and this is what we have [income sources]. Now, what are we going to do about the piece in the middle?*
>
> — Male, Hartford

When discussing their overall calculations of when to retire, most participants report making these calculations based almost on feel: "You just know."

Of course, this income must last a lifetime. To accommodate that, most participants say they will try to maintain their principal for at least the intermediate term and just live off the earnings. Following the approach of no drawing down of assets, a 6 percent return would always provide the same amount of money in nominal terms and never run out. However, a number say that those in their mid-70s can start some depletion of assets. None of the participants express any concept of systematic withdrawal strategies or any ideas about methods of dipping into principal in a systematic way that could maintain lifestyle, and still protect financial security in consideration of the uncertain timing of death. None express concern about what a drop in values relatively early in retirement could do to financial security later in retirement.

> *We take it day by day…I can't worry about what is going to happen tomorrow.*
>
> — Male, Chicago

Only a few focus group participants speak of consulting with financial advisors *prior* to their retirements — but having planned for retirement with the advisor was found to be beneficial. It also made retiring much easier, once the time came.

> *My husband was retired for 15 years but he, all his adult life, planned very carefully for a nest egg. And thank god he did, because I'm able to be comfortable now.*
>
> — Female, Phoenix

> *I had a financial planner for the last 10 years prior to my leaving. So I pretty well knew where everything was and what I had to do. So, it was like that* (snapped fingers)*, once I did that 10 years of planning with him.* [Now, did you project out your income?] *Yes.*
>
> — Male, Chicago

Even with projecting out costs, mistakes are made. One male participant developed a 20-year projection prior to his retirement. It included expenses and cost of living; calculated the lowest amount of income he would need and the highest his expenses could be; and set the projected income to always be higher than expenses. But he acknowledged one *major* mistake he made, which he is still trying to figure out: He underestimated prescription drug costs.

Of course, there are always a few who did not do any thinking about the financial aspects of retiring. They just retired without doing any calculations.

> [How much did you think about it? Was it a decision like this (snapped fingers)?] *Yes* (snapped her fingers). [No calculations? No adding up the money?] *No calculations, for my husband either.*
>
> — Female, Chicago

Sometimes even the best planning can go astray because of the unexpected. In addition to exhausting assets, when faced with critical illnesses people can change their financial courses of action — with the results being felt throughout their retirements.[4] The following man, for example, did not have the same sources of income after he retired that he had planned on because of an unexpected illness.

> *When I retired I had rentals, they were all full, and everything was nice. I hadn't planned on getting ill — and at one point I didn't think I was going to make it, when they play with cancer. So I turned everything over to a friend of mine, and said sell everything and turn it into cash, and figure out what we can do with it.*
>
> — Male, Phoenix

For many of the retirees, retirement is mainly based on an assumption of a continuation of the current situation. There is often no planning for inflation, or for the financial consequences of the death of a spouse, and little planning for adverse circumstances (except that a noticeable minority had bought long-term care insurance and a few had purchased life annuities). Invariably prices rise and unexpected things happen (e.g., a three-year bear market), and this lack of planning and foresight clearly leaves many retirees in trouble later in their retirements. The basic strategy for dealing with these unanticipated situations is to reduce spending, but this presupposes only a gradual effect, which is not always the case.

Did Investments Change After Retirement?

Most of the participants made only minor adjustments in their asset allocations after they retired. But adjustments are the rule, not the exception. Most of those with money in defined contribution plans rolled the money out of the plans. Those with their own financial advisors are especially likely to have rolled money out of the plans. This tendency may be the result of the advisors' influence (so they can have more control over the asset allocations) as well as the participants' confidence in the advisors' ability to direct their investments.

There was no set pattern regarding focus group participants becoming more or less aggressive in their investments postretirement. Indeed, some people invested more conservatively after they retired (usually because of concerns about market downturns), some did not change their investments, and others invested more aggressively.[5] Having their investing strategies come under the influence of new advisors *after* retirement seems to be the main reason these retirees became more aggressive in their investing after retiring. Most of the retirees who did not change their investment strategies saw no need to do so. They were satisfied with the returns, did not need to increase returns, or did not feel they could afford to become more conservative or aggressive, and therefore did not make changes.

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[4] For more information: Johnson, Richard W., Mermin, Gordon B. T., and Uccello, Cori E.; Issues in Brief, April 2006, Number 45; *How Secure are Retirement Nest Eggs?,* Center for Retirement Research at Boston College; http://www.bc.edu/centers/crr/ib_45.shtml

[5] One cannot impute proportions of the population who moved in each direction based on qualitative research.

For those who did make changes, there is no trend when it comes to investments becoming more conservative or aggressive after retirement. The main reasons for investments becoming more conservative after retirement are increased concerns about investment losses and desire for the more dependable returns that fixed or bond investments offer. A few retirees report that their allocations to equities rose after they stopped working. The main reason for a move to equities seems to be the retirees' exposure to new sources of advice. Prior to retirement when money is invested in 401(k)s and similar plans, advisors (professionals or spouses/friends) do not exert much or any influence on asset allocation. When money is rolled out, asset allocation can be more influenced by advisors, particularly professional advisors, which may lead to increased use of equities.

HOW INCOME IS WITHDRAWN

Most participants withdraw funds from nonqualified investments first, preferring to let qualified money continue to grow tax deferred. Also, they tend to withdraw from investments that are not performing as well as others. As one retiree says, "If I have an investment paying 2 percent and another paying 4 percent, I will withdraw from the one paying 2 percent."

Few of the retirees withdraw the same amount of money each month. Rather, they withdraw money on an "as needed" basis. It appears that the retirees generally live on a narrow range of income, but occasionally withdraw money to pay for vacations, large purchases, and unexpected expenses such as medical care.

Most of these retirees monitor their assets on a quarterly basis, when they get reports from their investment companies. They do not have goals for what levels they wish their assets to reach in a specific period of time, such as five years. Rather, they rely on "feel," stating they will "know" when their asset levels are getting too low and will "know" how to adjust when necessary. This feeling does not come from a calculation or analysis — therefore, the participants could not explain any systems or any mathematical approaches to support them. The points at which adjustments would be required appear to be based on experience gained over their lifetimes.

> *I know where I am, I know where my assets are. I track them once a year seriously but more often than that. I have all my stocks on a computer and every morning I go and look to see what they are worth.* [You know what you're worth every day?] *Yeah, I guess I do. The only thing you don't know is the value of the house, but it's only going to go up, 99 percent of the time. I don't want to change my lifestyle; in fact I want to have a better lifestyle ... So I guess, the problem is, you're looking for something hard and concrete, you ain't going to get it from this group. Like Sam said, you just know. It's hard to explain it to somebody who's not in this situation. You just know. If I didn't look at my computer every morning I wouldn't probably feel as comfortable as I do. Like the other day, a couple of days ago, the value of my stocks went down $30,000, in one day ... three days later it came back. I didn't feel any poorer but if that happened every day obviously I would have to change. I don't know what that point is, but I would feel it. I would start saying that okay maybe now I have to adjust. But until that time comes, I don't want to adjust.*
>
> — Male, Chicago

EXPENSES AFTER RETIREMENT

Most retirees in the focus groups assumed that they could afford to retire based on their assessments that they had enough money to preserve their preretirement lifestyles. While many of the retirees find they spend more in retirement, others are spending less. They are happy to stay home (rather than travel) and use coupons at restaurants when eating out. However, most found that they were spending more money in retirement, on a monthly basis, than they spent prior to retirement. There are two reasons for this. The main reason is that retirees have more leisure time after they stop working and the activities they prefer to fill this time with can often involve spending money. Some retirees indulge in hobbies, such as golf or fishing, much more frequently than when they were working. Many find they go out to eat with friends more often because they have more time available for socializing, and eating out is a preferred way to socialize.

> *I think I travel more and more entertainment and dining out. It's probably because, I don't know, you feel like you should now or something. Before you were working and now, you know, you just spend the money and do it.*
>
> — Male, Chicago

> *I don't want to change my lifestyle now.*
>
> — Male, Chicago

> *If I want it, I buy it.*
>
> — Female, Hartford

> *I spend a lot more money than I thought I would spend, mostly entertaining myself.*
>
> — Male, Hartford

> *We had a financial planner for a good 10 years and he could tell us how we would be. And we are okay. But in the past few years I have noticed a lot of things are costing more.*
>
> — Female, Chicago

Another factor that caused costs to be higher than expected is the rise in the cost of certain items; gas and pharmaceutical costs are mentioned most frequently. In this time of historically mild inflation, the rising cost of living is an unwelcome surprise to many retirees. It is interesting that retirees should be surprised by inflation because it has been a fact of life for all Americans. It is likely that the impact of inflation, while having always been there, is now felt more acutely because of the relatively greater role fixed income sources play during retirement.

> *I didn't see myself changing drastically...traveling around the country; we did when the kids were growing up, we just didn't change lifestyle. I overestimated living expenses tremendously — except for gas and medical expenses, medical insurance expenses. But other than that, it worked out pretty much where I thought it would work out; I had some surprises though.*
>
> — Male, Hartford

A small number report spending less after they retire. The typical reason for this is the absence of nonreimbursable costs associated with work, such as auto-related expenses brought by commuting.

> *It costs a lot of money to go to work. You have to eat out; you have to have your suits cleaned and stuff like that. Hey, I got up to my Levi's and tee shirt. It's a great thing, it's a neat thing. So that's one of the savings that people don't realize how much they save by not having a job, so you put that into your income.*
>
> — Male, Chicago

> *I experience that I've got more money in my pocket now since I retired than I did when I was working. I tried figuring that one out.*
>
> — Male, Chicago

The key point is that almost none find that their retirement expenses are as they expected. But it is important to remember that these focus group participants are relatively young for retirees. They retired within the past 10 years, and most retired well before age 65. Living costs become less predictable at older ages because of the corrosive impact of inflation and the increased likelihood of requiring expensive drugs, medical care, and long-term care.

One method to ensure that expenditures stay within a "planned" range is to live on a budget and to take only a specified amount of money from combined income sources (e.g., savings, Social Security, and other sources). None of the focus group participants organize their finances this way. All participants state that they take out and spend money "as needed." While almost all report that unexpected or irregular expenses invariably arise (e.g., a vacation, the purchase of a car, a household item, or a medical expense) and that withdrawals are regularly made for those purchases, none of these retirees live on budgets.

> *You automatically know what you can spend. You kind of go on automatic pilot and know how much is too much and how much is enough.*
>
> — Male, Chicago

> *There are expenses on impulse. If I want to do it and there is money in the bank and there is money coming in, why not do it?*
>
> — Male, Chicago

When asked by the moderator how they know how much to spend and what they can afford, the main answer is that these retirees have a feel for it: "You just know." The participants cannot quantify how they arrive at these feelings. They imply that it is based on their experience and that they develop these feelings and assessments without making calculations, any systematic analyses, or even any knowledge of what these feelings are based on.

> *I would know when I would start worrying.*
>
> — Male, Chicago

> *Just don't drop below a certain level of assets.*
>
> — Male, Chicago

Some retirees do report trying to live frugally and trying to control expenses. These retirees appear to be the ones who have been retired longer than others and have, thus, been subject to inflation for a longer period. A number of these participants assert that they grew up in modest circumstances, and therefore feel it is relatively easy for them to live rather modestly in their later years.

> *That is the challenge, not to spend a whole lot of money.*
>
> — Female, Chicago

> *My income is not the same as it was when I was working. But it's enough for me to live on. It's adequate.*
>
> — Female, Phoenix

> *We grew up poor and you never overcome your childhood.*
>
> — Female, Chicago

The Belief in Reducing Expenses

Most of the retirees are not certain that they will be able to maintain their lifestyles for the rest of their lives. This is due, in part, to their lack of working out systems that increase the likelihood that they *can* maintain their lifestyles. But few are worried about running out of money or having markedly reduced lifestyles. There are two reasons for this. First, many of these retirees are receiving guaranteed streams of income from defined benefit plans in addition to Social Security. This guaranteed base of income provides a definite sense of security. It is important to note that those who do not have guaranteed income from defined benefit plans are considerably less likely to feel as comfortable about their long-term financial security.

The guaranteed income from defined benefit plans and Social Security seem to serve a double purpose. The double stream of guaranteed income frees retirees from having to get more of their income from investments. Most investments bear risk and many of these retirees have heavy equity investments. Thus, those with defined benefit plans are freer of worry about market performance because less of their income needed to pay necessary expenses is derived from the market. Also, those with defined benefit plans know that this income will never run out. Even though the retirees expressed that they are not worried about running out of money later in life, there is some concern about this in the backs of their minds. But those with defined benefit plans have legitimate reasons for being less concerned about their finances in old age.

The second reason that these retirees feel relatively sanguine about their long-range financial security is that almost all feel sure they can reduce their spending if their financial situations change. As stated, most of them report growing up in homes of very modest means. They say their lifestyles were not very elaborate growing up and that they would have no trouble cutting back if they had to.

> *We might go to celebrate at the Spaghetti Warehouse.*
>
> — Male, Chicago

To support this, a number of participants contrast their values and expectations with those of the next generation to retire: the baby boom generation. These retirees state that baby boomers have very high lifestyle expectations and will not want to cut back as they age. Yet these retirees report that they will have no regrets about cutting back if they have to.

> *A lot of us live on, I guess you call it, fixed incomes, but a lot of us that are older, do things in a lot more moderation than I think the younger generation thinks about. The younger generation, if you don't go to a movie at least once a week the world is going to fall in and if you don't go to a restaurant five times a week, how in the world are you going to survive ... I'd rather be beat by a bull whip than go sit in a restaurant and eat* [he had been in the food service industry] *... me and my George Foreman grill, we just have a ball ... I answer to nobody but my dog. As long as his bowl is full, we're happy.*
>
> — Male, Phoenix

> *When you do a* [focus] *group with the baby boomers it will be a totally different panel.*
>
> — Female, Chicago

> *They* [baby boomers] *live like there is no tomorrow!*
>
> — Female, Chicago

Two things that greatly concern these retirees are the possibilities of high medical expenses and long-term care expenses. Medical and long-term care expenses are perceived as real risks and quite expensive. Most of these retirees feel they are vulnerable to these risks. A small minority have bought long-term care insurance. Those who have not bought long-term care insurance tend to feel that the risk of needing long-term care is significant, but feel long-term care insurance premiums are too high. These expenses are thought to be ones that cannot be reduced and can cause financial insecurity at the end of life.

Key Concerns

During retirement, there are many issues of potential concern to retirees. The participants, as a group, were given six cards (in no particular order). Each card had a "concern" listed on it. These concerns were:

- Health care costs
- Inflation
- Investment risk
- Maintaining lifestyle
- Need for long-term care
- Outliving assets

The groups were then asked to rank these concerns in order from highest to lowest by level of concern. The groups took different approaches and thoughtfully deliberated the issues to arrive at consensus. In every case but one, they were able to agree on rankings. Although there are some differences in viewpoints, the consensus across groups is as follows:

1. Health care costs
2. Need for long-term care
3. Inflation
4. Investment risk
5. Maintaining lifestyle
6. Outliving assets.

There are three main reasons for this ranking. The first is level of control. The retirees reported that they feel they have little or no control over health care costs, the need for long-term care, and inflation. Most feel some control over investment risk because, while they cannot control the markets, they can modulate their risk to some degree by changing asset allocation or exiting the market. They feel a great deal of control over maintaining lifestyle because they can control expenses. They feel some control over outliving assets because, again, they feel that cutting expenses can lead to the retention of sufficient assets.

The second reason for the ranking is the relative impact of the issue. The retirees believe long-term care and health care (despite Medicare and the prescription drug benefit introduced on January 1, 2006) are high-impact needs that could rapidly deplete their finances. This is interesting, because most do not have long-term care insurance. Furthermore, they do not want to buy it because it is "too expensive" in their view, even though many seem able to afford policies. Inflation and investment risk are not expected to have major impacts on the retirees' financial situations. Longevity is also not seen as a high impact financial issue.

> *The biggest intangible is medical costs.*
>
> — Male, Phoenix

> *I still think that long-term care is my biggest fear, because the rest of things could be a problem, but that's the one thing that could wipe me out — long-term care or the lack of long-term care coverage.*
>
> — Male, Hartford

> *That is the one* [medical costs] *that scares everybody.*
>
> — Male, Phoenix

> *How do you plan for the unexpected? By definition, it is not going to happen, that's why it's unexpected.... It could be a "good" unexpected ... The only thing you can do is have insurance of some sort, what else can you do? ... I don't know of anybody of all the people I know who have got a special fund for the "unexpected." If it happens and bleeds half your retirement pay, then that's part of life and you just have to live with that.*
>
> — Males and Females, Phoenix

Concern About Longevity

Most of the focus group participants appear to underestimate their own life expectancy. They tend to base life expectancy on family history without much expectation of living longer than their grandparents did. In general, most of the retirees do not think they will live into their late 80s, and few think that they will reach their 90s. This way of thinking will impact their financial preparedness if they live past their expectations. They show fairly little trepidation of outliving resources, have no contingency plans if they do, and do not worry much about it. Importantly, concern about outliving resources appears highest among those who do not receive income from traditional pension plans.

> *I don't put any emphasis on that* [life expectancy] *at all.*
>
> — Female, Chicago

> *I don't think of it too much.*
>
> — Male, Chicago

> *It's important that I leave money behind so that I don't run out for myself while I am alive. If I plan it like that one heiress did that she died with three thousand dollars in the bank, you know, from some illness — that was good timing, some people have a lot of luck. But otherwise, I'm afraid when I go, I hope to have something to leave to somebody because that means I had security that I wouldn't run out.*
>
> — Male, Chicago

Attitudes Toward Financial Advisors

Overall, the focus group participants are not active investors nor do they appear to be financially sophisticated.

> *I am very good with money, I am very thrifty. On the other side of the same hand, I am also very unknowledgeable because when I worked, I worked with the controller of a big oil company and when it came time to do the 401(k) and change it, he said this is what you want to do, who better than him who lived on half his income all his life. And then when I rolled it over, the broker said this is what we need to do...He's a certified financial planner so I assume he knows more than me. I'm mostly in stock but I can't tell you. It's a mental block maybe.*
>
> — Female, Chicago

A little under half appear to have longstanding relationships with financial advisors. While participants may not have had financial advisors prior to retiring, when it came to deciding what they should do with their 401(k)s, a good number of them discussed it with financial advisors.

Interestingly, however, many participants do not use financial advisors because they think that they, themselves, can do a better job of investing than the financial advisors they have met. Overall, there is a significant amount of distrust in financial advisors.

> *I know a lot of financial advisors and I decided I know a lot more than they do.*
>
> — Male, Hartford

When asked what they would have done differently, a couple of participants noted they should have become more knowledgeable about investing. A few have gone to seminars on retirement income planning. There is some interest in this approach. Two were shown Monte Carlo analyses through financial advisors. The seminars were not considered very helpful and Monte Carlo analysis did not receive good reviews from those exposed to it. One particular retiree related how he met once a year with a planner whose analysis included the Monte Carlo method. The retiree could not believe it was correct in estimating that in 20 years at age 85, he would be spending double what he spends now; as he said ... "*just doesn't make any sense to me.*"

However, for the most part, financial advisors who did retirement income projections are well regarded by the retirees and the projections are considered helpful and reassuring. It appears that those who obtain advice would very much like to be reassured that their finances will be adequate for their needs.

> *I just have a financial planner and let him figure it all out. Maybe we are too trusting, who knows. I hope he is doing good.*
>
> — Female, Chicago

Viewpoints Toward Risk-Reducing Mechanisms: Long-Term Care Insurance and Life Annuities

There is fairly strong resistance among focus group participants to the use of financial vehicles to protect against longevity and long-term care risks. Obviously, there is acceptance of the concept of health, prescription drug, and dental insurance. There is also a high incidence of life insurance coverage. But interest in life annuities is very low. There is some strong interest in long-term care insurance. But in general, there is resistance to spending significant sums to protect against the risk of needing long-term care or living longer than average and running out of assets.

Long-Term Care — A significant minority of retirees has long-term care insurance, but they are very happy to have the coverage.

> *I'm very concerned because 1) I am alone, 2) I don't want to be a burden to my kid, 3) they don't want me to be a burden to them either, 4) they won't be able to take care of me anyway, they live like there is no tomorrow! So I would like to be able to be clean and neat and fed in my old age. And so I took out the long-term health care. And whether I ever use it or not, it gives me peace of mind when I go to bed at night.*
>
> — Female, Chicago

Concern about long-term care appears to be strongly influenced by personal experience. Those who had family members go into nursing homes seem more interested in insuring against this risk. Most of the retirees who do not have the coverage are concerned about the cost of nursing care. Yet most do not buy coverage because they believe the premiums are too high. Perhaps these retirees feel that the premiums required for long-term care insurance over the years could cut into their lifestyles and are reluctant to give up lifestyle against a (probably) faraway and far-from-certain event.

> *I haven't avoided it, I've thought about it. But I don't think it's practical to spend thousands of dollars a year on something* [long-term care insurance] *that may happen. If I need somebody I have four children; I think that they should chip in. And if they don't I'll put the plastic bag over my head.*
>
> — Female, Phoenix

> *The biggest fear I have is not being able to take care of myself.*
>
> — Male, Phoenix

> *If you have insurance for long-term care you don't worry about it. If you don't have it, you worry about it.*
>
> — Male, Chicago

> *There are places around that you can buy into, such as we did for my mother, where you pay the initial amount to go into for as long as it takes for her to die. Now she started off with independent living and went down to where she is, maximum care. Did not cost us anything further than what she had with Medicare and additional insurance. And every time she went to the hospital because of broken bones or something like this, Medicare and the supplement picked it up, the whole thing or very little came out of our pockets or her savings. I think if you investigate what's out there, I think you can do away with long-term care* [insurance]. *I think you are just putting money into insurance companies' pockets.*
>
> — Female, Chicago

> *We are doing the best to maintain the lifestyle that we have. But if something happens, illness, you just deal with it. And you do the best you can.*
>
> — Female, Chicago

Life Annuities — Only a few of the participants have life annuities. None of the owners sought out the product. They were persuaded by financial advisors to buy.

> *Why? Well, I was advised to do it. I mean, I don't think I would have done it on my own. But my financial advisor suggested I do that.*
>
> — Female, Chicago

> *My income isn't the same as it was when I was working but it's enough for me to live on. It's adequate, and I can do the things that I want to do or most of them anyway. But, I made investments other than at the credit union, way before I retired, I guess about six years before I retired. At the time, I didn't understand what I was doing but the salesman talked me into it. And I'm so glad that he did, because now I get a lifetime check from those annuities, plus my Social Security and my retirement pension.*
>
> — Female, Scottsdale

The retirees are not very knowledgeable when it comes to annuities; and awareness of the benefits that annuities offer is also low. Understanding of the product is low even among those who have purchased annuities, although they seem pleased by their purchases and recognize the value of this investment. Nonpurchasers have much lower understanding and awareness of life annuities than do retirees who have purchased them.

A number of the retirees appear to view life annuities as a "bet." They feel that the insurance companies are betting on when they will die and the retirees do not want to bet against the companies.

Numerous participants have the feeling that they can do a better job investing than can the insurance companies. A few participants express the view that life annuities are good for people who do not want to manage their own assets or who are financially unsophisticated. But a main theme expressed by the retirees is that they do not want to give up control of their assets.

> *Well, my husband has poor health, so I don't think he's going to live a long time. And I think I can do better than they can do.*
>
> — Female, Chicago

> *It may be all okay for some people. I don't like giving up control over my assets. Right now I think we're in a time of low inflation and it isn't going to stay that way again. I think we are heading back to the same kind of economic scenario that we had during the '70s where in the end we had stagflation, where things kind of leveled off as far as economic development and prices started going through the roof. This wouldn't be a good time to enter that kind of a product in my opinion.*
>
> — Male, Chicago

> *What you're saying is wonderful; it's like a sure thing. Okay. It's not like a craps table, but in a way it is. And I just don't like someone else saying, "I'm going to hold this for you and every time you need a piece of paper I'm going to give it to you." This is mine and I want it. I just want all the pages in a row here for me.*
>
> — Female, Chicago

A few married men who believe their wives are not financially sophisticated feel their wives should annuitize parts of their portfolios if they (the wives) outlive the husbands.

> *I tell my wife that if I should drop dead that is the first thing she should go do.* [Buy one for herself? How come?] *Because she doesn't know how to handle money.*
>
> — Male, Hartford

Advice to the Next Generation

> *It's trite but true … if you fail to plan, you plan to fail.*
>
> — Female, Chicago

The focus group participants offered the next generation the following advice on how to achieve a financially secure retirement:

- Begin to save for retirement as soon as possible.
- Pay off all debt before retirement.
- Invest in real estate.
- Have extra money for unexpected needs and emergencies.
- Get health insurance coverage.
- Make a list of the things you really want to do in retirement.

This last bit of advice, to make a list, is ironic, because planning was relatively rare for this group. The best way to deal with inflation, a few advised, is to adjust your lifestyle.

Conclusions of the Researchers

The most important finding of this research is the clear preponderance of the focus group participants having done little long-range financial planning for retirement and the low use of risk-reducing financial vehicles. Second, they exhibit important misconceptions that could needlessly endanger their long-term financial security.

Most of the retirees (again, two to 10 years into retirement) base much of their financial behavior on instinct. Rather than establishing long-range goals or developing a detailed analysis of how they should invest and spend, they tend to do things on a somewhat ad hoc basis. This may have worked reasonably well for them while they were employed and when major expenditures such as education and home purchase were self-initiated or easily foreseen. But finances in retirement are more complex, mainly because of the uncertain timing of death and the increasing possibility of large unanticipated expenses (usually for medical or long-term care costs).

The need for establishing goals and long-range planning will become more pressing for the next generation, which will have a lower incidence of retiree health benefits, defined benefit plan protection and lower income replacement rates from Social Security.

There are significant misconceptions about longevity and the long-term impact of inflation among the focus group participants. Further, most feel they can easily reduce their living expenses as they age. But in reality, it is likely that a number of them will face increased costs as they age, due to higher expenditures for health and long-term care. Thus for some participants, this intuitive sense that expenses can be reduced with aging might be detrimental to both their physical and financial health.

A third important finding is the methods participants used to determine that they could afford to retire. In most cases, the decision making processes appear flawed, and that can result in negative consequences for later financial security. Some did not focus on their financial ability to sustain their lifestyles over potentially long retirements. They simply reached a certain age, such as 55 or 62, and stopped working. Most considered whether a certain rate of return, often 6 percent, would allow them to meet their current expenses. There are a number of problems with this thinking. First, many of them report they are spending more after retirement than before. Hence, if they determined they could afford to retire by their ability to pay current expenses and then immediately started spending more, their future financial security could be endangered. Second, participants allowed no room for market volatility. Estimating a constant return of 6 percent is assuming things will stay the same — but market history, such as the downturn in technology stocks in 2000, has shown this not to be true. If the market turns down in the early years of retirement, future retirement funding can be permanently impaired. Third, their methods did not allow for the inevitable increase in costs. A few said they are surprised by the increasing cost of energy and prescription drugs. Inflation should not be a surprise. Counting on receiving the same nominal income year after year puts into operation a plan for reduced purchasing power that can be painful long into retirement.

Another key issue is the almost universal lack of goal setting. None of the retirees had long range goals for what their assets should be in five or 10 years. They spend what they want, to some degree, with no clear preset limits. This lack of control will lead some to overspend in the early years of retirement.

> *I don't tell my husband the price of anything. He says "Can we afford that?" I said "Yes we can." He might say that lamp is too much or the drapes or something. And I'll say "not really and don't worry about anything because no one's ever come to collect money from us, that we're delinquent with the bill." He doesn't want to be bothered with that. He doesn't even know what our taxes are. So I'm very fortunate to be in charge of the money.* [It sounds like in a couple of families there's a worrier and a nonworrier.] *He's not a worrier; he just likes to tone me down a little bit.*
>
> — Female, Chicago

The retirees try to use the common sense they have developed over their lifetimes. They have made minimal changes since they stopped working: They live in the same places, try to replicate similar lifestyles and make only minor adjustments to their investments. However, the danger is that retirement income planning is significantly different from working-years planning, and the lessons learned about managing finances during the working years could be misleading when applied to retirement.

Although much of what was observed regarding future retirement security is alarming, from a planning perspective there is one bright spot. Almost all of these retirees own homes that are nearly or completely debt free; and they currently have no plans to use the equity in their homes. If the retirees become financially pressed, their homes could become important financial resources that can be easily liquefied and hence, could supplement the retirees' investments by providing crucial funding.

METHODOLOGY

In the fall of 2005 LIMRA International and Mathew Greenwald & Associates conducted a total of six focus groups on the subject of financial management of assets during the early stages of retirement. Two groups apiece were held in three metropolitan areas: Hartford, Connecticut, Chicago, Illinois, and Phoenix, Arizona.

All of the participants were between the ages of 60 and 72 and had been retired between two and 10 years. They are financial decision makers in their households, had investments of $50,000 to $500,000 in 401(k)s or other employer-sponsored defined contribution plans, had total retirement savings of $100,000 to $500,000 at the point of retirement and now have investable assets, including investment real estate (as opposed to primary residences) of between $100,000 and $2 million.

In recruiting focus group participants, one objective was to invite people who derive at least 25 percent of their income from their own saving, as opposed to guaranteed streams of incomes from Social Security and traditional pension plans. The rationale for this was the focus on how people invest and spend money when exposed to the financial consequences of the uncertain timing of death. It was our hypothesis that this financial management task would prove daunting to many, and we wanted to know how they would respond. A problem arose in the recruiting process. There is a high incidence of guaranteed streams of income among the people in the age and financial asset categories that we were recruiting from. Second, due in some part to a lack of knowledge of how to organize plans for systematic withdrawal of assets, a few of the participants have confined their spending to the amount of the earnings from their investments in addition to the benefits from Social Security and defined benefit plans. Thus, almost all of the participants derive at least 25 percent of their retirement income from their own assets, while a few have reduced their spending to the point where they may be relying on a little less than that amount.

In addition, these participants have net worth that may be higher or lower than that of other typical retirees. The results from groups with average net worth higher or lower than that of these groups may be different.

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