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CHAIRPERSON'S CORNER

Cynthia Levering, ASA

As I write this and look out the window at my back yard, the grass is bright green, the trees are full of leaves again and the flowers are blooming. It's hard to believe it's Memorial Day already and we are hurtling into summer. Soon the schools will be closed for vacation and we will all begin our annual pilgrimages to wherever it is we go to unwind, be it the beach or the lake or the mountains.

Time Value of Time

As I get older, I often think about an article I read in Contingencies magazine by Peter Neuwirth a number of years ago about the time value of time and how time seems to go faster as we get older. We've all heard the phrase "Time is money" and in a message to new accountants by Jean Price called "Life According to FASB," she argues that a parallel could be drawn between time and cash—the most basic asset class. However, she also argues that time is even more valuable than cash since the amount of time available to each of us is finite and our time is being used, spent, invested, and possibly wasted at a pace we cannot control.

Even though as pension actuaries, we are tasked with developing mortality assumptions to value liabilities, we can't predict how much time any of us truly have. We can, however, think about and manage how we spend the time we do have and look at time spent now as we do other investments that may pay benefits in the future. With that in mind, I encourage you to familiarize yourself with the activities of the Society of Actuaries in general and the Pension Section Council in particular and consider becoming involved in some capacity. As you will see in the near future, we have a great slate of candidates for the next election who have already made the decision to give of their time to benefit our profession.

What Has The Pension Section Council Been Doing With Its Time?

As you may know, our main focus for the past several years has been *Retirement 20/20*. Our recent activities include the following:

- We completed our third conference in November of 2008 where we examined the features of several actual systems, such as the Dutch Collective and the Ontario Teachers Plan, with regard to self-adjusting mechanisms in particular—the *Retirement 20/20* Conference Report will be available soon.
- We are continuing to work on our "Measurement Frameworks" to compare and contrast various existing systems as well as any new systems that are designed.
- Emily Kessler and I presented a webcast in March to update SOA members on our work.
- Andy Peterson and I participated in the pension symposium at the

end of the Enrolled Actuaries meeting to discuss current key retirement issues and identify lessons for the future.

- Our "Outreach to Actuaries" group has been looking for additional opportunities and venues for us to get our message out to local actuarial clubs and other interested groups (if your group is interested, contact Ann Gineo at *agineo@sibson.com*).
- Emily presented her paper entitled "Constructing New Retirement Systems: Choosing between Insurance and Investment, Choice and Default" at a recent Wharton Conference on retirement risk management. She also presented these ideas at a recent regional meeting of the Association of Canadian Pension Management.
- We have been working with an advisory group to design a "Call for Models" contest to solicit ideas for new retirement paradigms. The Call will be sent out soon and we plan to host a conference in the spring of 2010 to showcase the winning models and highlight those that best advance the debate and meet the core principles of *Retirement 20/20*.
- We have opened a dialogue with the Academy to explore how we can partner on public policy concepts related to *Retirement 20/20*.

As you can see, we have been very busy with this initiative. However, we have also been working on other projects. We recently helped to sponsor the Public Pension Finance Symposium. We have redesigned our web page and conducted a survey of our membership—you can be looking for the results in the near future. We are looking for ways to address other issues important to our membership, such as enterprise risk management, IFRS transition in both the United States and Canada and longevity issues, including working with the RPEC (Retirement Plans Experience Committee—Gavin S. Benjamin, Chair) to assess the availability of mortality data to create an updated table and projection scale.

In addition, we are launching a new column called "Perspectives from Anna." I encourage you to read Anna Rappaport's discussion about the adequacy of retirement resources. Anna is the head of our Committee on Post-Retirement Needs and Risks and that group has done an enormous amount of research on this topic for a number of years. She highlights a number of references and is asking for readers to write in with their thoughts on this issue—I strongly encourage you to do so.

Is it Your Time?

As you can see, the council is working on many projects. To those of you who are already involved, I offer my sincere thanks. If you have not yet become involved, I am sure there is something you can find of interest that would involve as much or as little of your time as you are willing and able to give, even if it is just taking the time to fill out a survey or the poll question in this newsletter. If time is our most valuable asset, we certainly want to use it as productively as we can. I guarantee that you will discover volunteering to our profession is time well invested, and a very rewarding experience!

Cindy Levering, ASA, EA is Chair of the Pension Section Council for 2009. She is a senior vice president with Aon Consulting in Baltimore, Md. She can be reached at *cindy_levering@aon.com*.

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EDITOR'S COLUMN

Art Assantes, FSA

We have a wonderful lineup and I would like to thank the contributors to this edition of the *Pension Section News*. As always, Cindy Levering has provided us in the "Chairperson's Corner" with a timely update of the Pension Section Council's activities. What you will notice is just how active the council has been in gathering and disseminating information on important topics such as the characteristics of retirement systems that will need to be developed as the economy and the needs of our population evolve into the future. The council has spent considerable effort on the *Retirement 20/20* initiative and I would encourage our readers to go the *Retirement 20/20 Web site* and read the postings.

As you know, the "Chairperson's Corner" is a regular feature of the *PSN*. Now we'd like to introduce you to a new recurring column, "Perspectives from Anna" by Anna Rappaport, chairperson for the SOA's Committee on Post–Retirement Needs and Risks. This committee has been very active in studying the risks that people face in the post–retirement period. In her column, Anna provides a description of resources on the committee's Web site—specifically several surveys that review how individuals invest their assets after retirement; the phases of retirement; the impact of longevity on retirees' quality of life; and the spectrum of risks that confront individuals once they have retired. In addition, she points our readers to non–SOA resources so that they can further explore the growing body of research and literature on post–retirement issues. In a second article, "Retirement Decisions: Avoiding Dangerous Assumptions and Missteps" co–authored by Anna and Susan Spraker, Anna discusses the many assumptions and mistakes that individuals make leading up to retirement, and Susan introduces and discusses seven rules to follow for achieving a successful retirement.

As you quickly look over the *PSN*'s table of contents you will also see that we have a thought-provoking article from Larry Bader. In his article, Larry clarifies the pension finance model's application to liabilities and expands on the model's utility. He stresses that pension liabilities are very much like bond liabilities and that the traditional life contingencies based actuarial model handles expected future pension cash flows in the same manner as a bond portfolio's cash flows. He points out some actuaries' assert that without a market of tradable liabilities, the Law of One Price does not apply. But Larry asserts that a simple, common sense rule of "like liabilities should have like values" should be applied and that pension liabilities should therefore be valued using the same discount rates as bonds. He concludes by saying that the markets—not the actuary—should be setting the discount rate assumptions when it comes to determining the economic value of pension liabilities.

Anne Button wraps up this edition of the *PSN* with a report on the 2008

Future of Life-Cycle Savings and Investment Conference. At this conference, the presenters pointed out the financial challenges that workers face as they enter the traditional retirement period of their lives. In her article, Anne summarizes the divergent views offered by conference presenters on the benefits and shortfalls of phased retirement.

Arthur J. Assantes, FSA, is president of Hooker & Holcombe, Inc. in West Hartford, Conn. He can be reached at PSN.Editor@PensionEdge.com.

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NEW COLUMN! PERSPECTIVES FROM ANNA

Anna Rappaport, FSA

As we think about "adequacy" of retirement resources

As pension actuaries, we are often asked to think about "How Much is Enough?" What is the right amount of pension for an employer to provide to long service employees? How much do we need to save to be financially secure in retirement? Traditionally, Income Replacement Ratios (IRRs) were offered as an answer to the question: What would I need to keep income flowing at a level equivalent (in terms of standard of living) to my pre-retirement paycheck?

Increasingly, we have recognized that IRRs are not a complete answer for the individual planning her/his retirement, and while we have not yet agreed on new answers, here are some resources and ideas to help us think about the issues and complement the literature on replacement ratios. I would be very happy to see readers write to the Pension Section News with more ideas on this important subject.

I want to encourage readers as they seek resources to look at the work of the Committee on Post-Retirement Needs and Risks, whose findings will be featured often in this column. In 1995, the Society of Actuaries pension research committee recognized that most of the work in retirement planning was focused on the pre-retirement period, i.e. on the accumulation of enough money for retirement—an important task, to be sure. Much less attention had been given to the post-retirement period. With the rising frequency of lump sums as a payout option, post-retirement income management has grown in importance. The work started with a call for papers on data requirements and modeling techniques for the post-retirement period, and the task force sponsoring that work was eventually converted into the standing Committee on Post-Retirement Needs and Risks. Materials on our Web site include reports of four surveys (conducted from 2001 to 2007) of public knowledge about post-retirement risk and strategies to help manage risk, as well as several other reports on the topic.

Among our latest additions is a report posted in March, 2009, *Will Retirement Assets Last a Lifetime?* This report contains results of a joint study with LIMRA and InFRE (International Foundation for Retirement Education), designed to provide insights into how people are managing assets during retirement, and is a follow-up to a series of focus groups conducted in the fall of 2005, *Spending and Investing in Retirement, Is There a Strategy?* Both of these reports focused on individuals who had retired with significant assets to invest, and sought to understand how these individuals made their investment decisions. The focus group report includes many thought provoking quotes, and offers a lot of insight into how people think about this topic. Among the lessons learned is the discovery that not many people are focusing on the long term, or on how

circumstances continue to change during retirement.

The core work of the committee is the post-retirement risk survey series. The four past surveys have some repeat topics, but each one also branches out and focuses on one or more special topics, so that taken together a wide range of issues is covered. Some of the central lessons that the survey series holds for us, as we explore adequacy and ask ourselves "How Much is Enough?" are as follows:

- Change doesn't just stop happening when we retire, but too often we focus solely on income replacement and resources at the point of retirement. In the 2007 risk survey, there was a major focus on identifying and categorizing the different changes that take place during the post-retirement period, and on how prepared we are to respond to those changes. The *Phases of Retirement* report details our findings in this area.

- Longevity is recognized as a key risk, but many people do not fully understand that life spans are variable and that many of us are as likely to survive to age 100—and beyond —as we are to die in the first few years of retirement. And, unlike people in their teens and twenties, who believe they are never going to die, many retirees underestimate their future life expectancy. The 2005 survey explored retirees' understanding of longevity, and the report titled *Longevity: The Underlying Driver of Retirement Risk* brings together our findings and identifies various resources of relevance to this topic.

- In several of the survey reports, we have included questions to help us understand how risk is managed and what strategies are used to confront those risks. Putting the results together, cutting expenses and saving more in advance of retirement are top strategies, while insurance products—such as annuities, long-term care insurance and supplemental health insurance—are not. Perhaps not surprisingly, supplemental health insurance is used more than long-term care insurance or annuities.

Full reports of all four surveys as well as special issue-based survey-by-survey reports are on the *Post-Retirement Needs and Risks Web page*. The special focus of the 2009 survey will be on how individuals are dealing with the economic crisis as they think about and manage post-retirement risk.

Another new report in 2009 provides a different window into the issues surrounding retirement resource adequacy. *Segmenting the Middle Market: Retirement Risks and Solutions: Phase I* looks at the 25th to 85th percentiles of Americans age 55-64 and 65-74, and divides them into segments by wealth level, marital status and sex. It offers insights into both financial and non-financial wealth. For the middle income market segment overall, about 70 percent of wealth (excluding the present value of Social Security and defined benefit pensions) is non-financial.

Housing represents a major part (often the largest part) of the asset portfolio of middle Americans nearing retirement, and Social Security is also a very important source of income. For Americans over age 65 who are not working, Social Security accounts for more than 80 percent of the income in the bottom half of the population. This leaves us with two lessons as we think about adequacy of retirement resources:

- We can't forget about housing and options for management of housing wealth in retirement. As the largest component of retirees'

non-financial assets, there is a need to think further about ways to convert this non-financial asset into an income source and when we will need to take such action.

- When to stop working and when to claim Social Security benefits are, taken together, the most impactful decision that most people will make. However, some crucial decisions are made *for* people, not *by* them, and failure to plan for certain contingencies (divorce, a primary wage earner's prolonged unemployment, disability or death) all too frequently has disastrous consequences. One of the most sobering statistics that comes to mind is that four out of ten elderly widows have only Social Security and no other source of income.

More is coming on housing. A very important set of recent papers on housing wealth and retirement has been collected, and a monograph will be published and posted on our Web site in the near future.

As we expand our picture, we know that there are a number of different risks at play in addition to those most typically considered. Traditional replacement ratio analysis addresses adequacy by focusing on income immediately before and after retirement. This is effectively a surrogate for spending before vs. after retirement, without consideration—explicit or otherwise—of the wide range of risks that retirees face. For a quick exploration of this risk spectrum, look at Managing Post-Retirement Risks, a new report from 2008 that provides an overview of fifteen risk categories along with strategies that have been identified to assess and manage those risks.

I have told you a lot about resources from the actuarial profession. Now I want to bring outside resources in and point out the *Elder Economic Security Initiative*™: The Elder Economic Security Initiative is a public policy-driven initiative, led by Washington, DC-based Wider Opportunities for Women (WOW) that "…seeks to build economic security for older adults through a multi-pronged approach that includes organizing, advocacy and research." Undergirding this work is the Elder Economic Security Standard™ Index (Elder Index), developed by the Gerontology Institute at the University of Massachusetts Boston and WOW. The Elder Index is a measure of how much a couple or an individual over age 65 needs to live at a minimum level ("modestly" is the term they use). It is calculated separately for couples and singles, for homeowners with and without a mortgage and renters, and by health status. It is based on market costs using credible state and federal datasets drilled down to the county level. For 2008, selected US average values for the Elder Index are as follows:

Source: Fact Sheet from the Elder Economic Security Initiative, Wider Opportunities *for Women, Washington, DC. March 2009*

This compares to a Federal Poverty Level of $10,830 for an individual ($14,570 for a two-person family), and demonstrates that the federal poverty level is set much too low and needs to be redefined. As we think about adequacy, the Elder Index gives us a place to start from a different direction—based on actual needs and spending habits, rather than on available funding or tax policy.

The risk surveys tell us what people think about how they manage risk. Reducing spending is an important component of reducing risk and an important strategy. Some people spend a lot and others not very much. The Elder Index is interesting to me in that it provides a framework and a benchmark for thinking about how much we can afford to reduce spending while maintaining a decent minimum standard of living. It also gives employers a different benchmark to help them determine how their employees may fare in retirement compared to average Americans.

The last item for today is a paper by Somnath Basu, *Age Banding: A Model for Planning Retirement Needs*. This paper segments spending by type of expense, explicitly setting out three age bands, 65-74, 75-84 and 85-95, and making adjustments to expenses to reflect the age band. The ideas and approaches in this paper are interesting and offer the way to yet another dialogue.

So I want to encourage all of us, as we think about adequacy, to focus not just on our immediate spending needs (and therefore income requirements) at the point of retirement, but also on how our needs, capabilities, and preferences change as we move our way through retirement as well as on how long we want the money to last. Technology gives us the models and other resources to be much more sophisticated in our retirement income planning, and the above mentioned analyses give us ideas to feed to the models as they continue to evolve.

P.S. I feel very privileged that the *Pension Section News* has invited me to write a column. Periodically, I have ideas, am involved with projects, find information or read something that I really want to share. This is a great opportunity to share with all of you.

Anna Rappaport, FSA, is an internationally recognized expert on the impact of change on retirement systems and workforce issues. She is a former consulting actuary at Mercer and former president of the Society of Actuaries. Currently, Anna is president of Anna Rappaport Consulting in Chicago, Ill. She can be reached at *anna@annarappaport.com.*

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CAN PENSIONS BE VALUED AS MARKETED SECURITIES?

Lawrence N. Bader, FSA

Market pricing of liabilities is central to the financial economics model of pension plans ("pension finance"). A pension liability is valued at the price at which a reference security trades in a liquid and deep market.[1]

Many actuaries question this approach. They observe that pensions do not trade in the financial markets and therefore should not be valued like traded securities. Pension cash flows differ from those of marketable bonds: they are contingent upon future events, such as pay increases and mortality, that do not affect ordinary bonds. This note aims to clarify the application of the pension finance model and respond to the questions.

Application of the Model

The pension finance model measures economic value, without regard to current accounting or funding rules—though its advocates believe that accounting and funding rules would benefit from closer adherence to financial economics. Economic value is a useful benchmark for exploring a host of pension issues. Examples include the effect of a pension plan on the financial condition of the sponsor, the cost of possible plan improvements, and whether each taxpayer generation pays correctly for public plan pensions earned while it receives governmental services. Economic value is not a termination measure; for example, it uses retirement age assumptions consistent with an ongoing plan. Rather, it measures the consensus value that the capital markets place on the cash flows promised by the plan.

Pension finance treats the ABO as the economic pension liability. The "roll-up" of accrued benefits for pay increases under a final pay plan should be understood as part of the cost of those pay increases. Because future pay increases are not a current economic liability, neither should the pension increases resulting from them. It seems difficult and contradictory to include future pension increases in a definition of economic liability in a way that includes the future pension increases while excluding the pay increases that produce them.

The reference portfolio has cash flows that match the liability in amount, timing, and probability of payment. Amount and timing are clear enough, but the probability of payment is more problematic.

- A riskless reference portfolio should be used to measure the economic liability of very strong sponsors, or sponsors of plans that are well funded and conservatively invested.
- To measure the economic liability of weaker sponsors with plans that carry some default risk, the reference portfolio should carry comparable risk.

- A solvency test or minimum funding target differs from a measurement of economic liability in requiring a riskless reference portfolio for all plans. Only a riskless portfolio can assure payment of all pensions. Any lesser portfolio would pass on either direct costs or risks either to third parties, such as the PBGC for private plans, or to future taxpayer generations for public plans.

The reference portfolio consists of securities that trade in a liquid and deep market. A holder of such securities could either reduce or augment his holdings at about the same price—that is, the bid-ask spread must be small. Recent events remind us that, at least for risky securities, these conditions do not always hold. For some securities at some times, bid-ask spreads may be wide and trading thin. Under these conditions, current transactions may represent special needs of particular investors, rather than an investor consensus of the value of the securities. The pricing of such transactions is not a suitable guide for valuing pension liabilities

Supposing that there is a liquid and deep market, what is the justification for using marketable securities to value nonmarketable pension liabilities? Some actuaries assert that the Law of One Price [2] cannot apply to pension liabilities, which are not tradable and not subject to arbitrage. The application of bond market pricing to pension valuation, though, is based not on the Law of One Price, but on a simpler notion: Like liabilities have like values. A dollar owed to a pensioner is very like a dollar owed to a creditor, as each must be paid when due. The differing ability of the recipients of those dollars to transfer their rights does not justify a substantial difference in the payer's assessment of its obligation. Are there other differences that would make these obligations substantially different for the payer? Some actuaries point to demographic contingencies, to which we now turn

Life Contingencies

How does the traditional actuarial model handle the life contingencies of pension payments? Consider a single payment to a single pensioner: a $1,000 endowment due a few decades hence, with a survival probability of 80 percent. The traditional actuarial model multiplies the $1,000 by 80 percent to arrive at an $800 expected payment. It then discounts this $800 by the selected discount rate. The resulting value is identical to that of an $800 deterministic cash flow. In other words, the traditional model uses the expected payment as a stand-in for the payment probability distribution. Generalizing from an endowment to a group of life annuities, we can say that the traditional model uses demographic assumptions to find an expected payment stream, and then discounts that stream as if no life contingencies were involved. In other words, the traditional model treats the expected cash flows exactly like ordinary, deterministic bond flows. In treating the expected pension cash flow as a deterministic stream, pension finance actuaries only are following long-established actuarial practice

Perhaps supporters of the traditional approach would argue that they reflect the demographic uncertainty by choosing higher discount rates than the market applies to bonds. But from the perspective of a plan sponsor or insurer, the uncertainty would, if anything, make pension obligations more onerous, not less, and would call for a lower discount rate than the bond market suggests.

Conclusion

Both pensions and marketable bonds are made of the same stuff: contractually required cash flows. The contingent nature of pension flows differs from that of bonds. But the major contingency, future pay increases, is not reflected in the pension liabilities that pension finance recognizes. As

for demographic contingencies, pension actuaries have always ignored the demographic uncertainty inherent in the expected pension flows. They cannot point to that uncertainty as a problem in the pension finance model without indicting their own practice. Pension finance departs from the traditional model only in asserting that the trillions of dollars of daily trading in Treasuries and similar securities offer a more objective and accurate guide to the economic value of cash flows than the judgments of individual actuaries.

Lawrence N. Bader, FSA, is retired and lives in Cary, N.C. He can be reached at *larrybader@nc.rr.com*.

Notes

[1] See Principle 4 from Reinventing Pension Actuarial Science, Lawrence N. Bader and Jeremy Gold, The Pension Forum, Vol. 14, No. 2, January 2003. A reference security, or a reference portfolio, has cash flows that match the liability in amount, timing, and probability of payment.

[2] The Law of One Price states that tradeable securities with the same cash flows must have the same price.

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RETIREMENT DECISIONS: AVOIDING DANGEROUS ASSUMPTIONS AND MISSTEPS

Anna M. Rappaport, FSA and Susan S. Spraker, PhD

One of the significant changes for Baby Boomers approaching retirement has been the increased responsibility placed on individuals to make more decisions and take additional personal responsibility for their retirement planning. At the 2008 Society of Actuaries Annual Meeting, the authors presented a session focused on key decisions that individuals must make as they plan for retirement. We presented the topic from two perspectives: that of a financial planner/wealth manager and that of an actuary. Each of the authors has been working in the retirement field for 25 years. In addition, Anna has 45 years experience as an actuary. This article is organized into two sections with part one providing key research findings that were presented by Anna at the session and part two providing financial planning considerations and perspectives that Susan believes are critical to a successful retirement based on her work with individuals.

Part One—Key Research Findings: Major Knowledge Gaps

Research has repeatedly shown significant gaps in knowledge about retirement. Points that I (Anna) believe are particularly relevant include:

- Many people are short-term focused as they plan for retirement. Retirement planning often does not include serious and deliberate analysis of one's own personal life and particular financial issues and challenges.
- When people focus on retirement planning, it is common to focus primarily on investment management issues. Savings and investments are very important, but only part of the picture. Professional advisors vary in their approaches, and unfortunately many are primarily only investment focused.
- There is significant misunderstanding about life spans and their variability. It is common to underestimate life expectancy and end-of-life costs and overestimate the amount that can be safely withdrawn from retirement accounts.
- It is common to only consider average investment returns without weighing the downside risk and potentially severe retirement impacts during prolonged market downturns (i.e., "tail risk").
- There is a lack of understanding about financial products that can mitigate risk and when they might be most helpful. The most commonly identified "risk reduction strategy" among retirees is to reduce spending.
- There is over optimism about expected returns on investments and ability to manage investments. There are serious misunderstandings of investment risks. Many people think that the stock of their employer is less risky than a diversified equity portfolio.

- The risks in retirement are complex, interrelated and dynamic. Transferable and poolable risks include longevity improvement, the costs of disability and long-term care, the cost of acute health care, economic loss due to death of a spouse, and investment risk and interest rate risk. Risks that can't be transferred or pooled include the inability to hold or find a job, premature retirement risk, dependents' needs and certain aspects of inflation risk. These are some of the key risks.
- While people repeatedly say when asked that they want guaranteed income, they usually choose lump sums when given a choice. The value of lump sums is often perceived to be greater than an actuarially equivalent income stream.
- Social Security and defined benefit pensions are a major source of income for some of today's retirees. Prior to retirement, many people underestimate the importance of Social Security and overestimate what they will get from pensions and savings. This underestimation may increase and become more critical given the decline in defined benefit plans and recent market contraction.
- About four in ten retirees retired earlier than planned, often because of job loss or personal (or family) health problems. People continue to retire early but those not yet retired say they expect to retire much later. In the 2007 Risks and Process of Retirement Survey, 61 percent of the retirees retired prior to age 62 and 77 percent prior to age 65. However, among the pre-retirees, only 29 percent expected to retire prior to age 65 and 32 percent said that retirement did not apply to them (they were not planning to retire).
- Many people lack financial literacy. Questions included in the Health and Retirement Study show that many people around retirement age are not able to answer a question about compound interest or about the stock market. This makes it very difficult to communicate about the time value of money.
- Most respondents to the 2007 Survey think that delaying retirement by three years would make them a little more secure or no more secure. Only about 15 percent think it would make them a lot more secure. The main reason that they expect greater security is the continuation of employer-provided health coverage.

A key theme running through many of these findings is that while a lot changes during retirement, very little comprehensive and realistic planning takes place.

Following the format used at our meeting session, the second half of this article will focus on real world observations from Susan's work in helping people plan for retirement.

Part Two—In The Trenches With Real People: Seven Laws of Successful Retirement:

1. *You Must Define Retirement.* It's often a myth. If you knew you had plenty of financial resources, what would you want to be doing now and in the future? How would you live your life differently? Who would you want to be? What would you want to accomplish? This should be the outline, the first piece of the puzzle of retirement planning. If you knew you had only 5-10 years to live, what would you say you have missed? What else would you want to do or experience or be? And finally, if you had only one day left, just 24 hours, what would you want to do with that time? Who did you never get to be?

   Answering these questions is all about goal setting. Without goal

setting, thinking about or planning for retirement is an empty and misleading numbers exercise. Goals are about living a rich life, a life of wealth, and we each have our own unique perspective of what wealth entails. To attain (and maintain) true wealth, our goals must be regularly reevaluated. This reality exercise will yield more wealth than reading escape novels and watching unreality TV. Retirement can be all about reaching our true life goals, but the process must start with goal setting. I never met a client whose life goals had anything to do with new clothing or furnishings or appliances or electronics, or a boat… in fact, most clients are trying to get rid of clothes and boats and "stuff."

Most people don't approach goals systematically because they are too busy "running around," and because they are not accustomed to writing anything more thoughtful than a grocery shopping list or an e-mail. Writing goals means quietly pondering what's really in our hearts and putting words to those feelings. It's just not a "normal" exercise we're trained to do. In fact, there is no retirement training. It's very much like parenting. It's an in-flight experience on auto pilot. Then, one day, there's "an event." To have a successful retirement, it's important to write specific goals with specific price tags and time lines, and then review them and update them every year. The importance of this exercise cannot be overstressed.

2. *You Are Not Entitled To Retirement.* We earn it…or we don't. The federal government and our employers are not responsible for our welfare—we are. Too often, people think they can simply quit work because they reach an age that was magic back when average life expectancy was 65 and Social Security kicked in. Social Security and Medicare were never designed to last for 30 years. Those systems are broken, and cannot continue for long the way they are currently designed. Within just a few years (seven years, according to the latest Social Security Trustees report) too few workers will be supporting too many pension beneficiaries, and Medicare is already paying out more in health benefits than it is bringing in from payroll taxes. There's no longer anything magical about age 65. The real magic number is THE NUMBER. THE NUMBER is the amount of money in any year that each of us needs to reach his/her life goals. It is NOT 65. That number is an illusion.

3. *You Absolutely Cannot Start Planning Early Enough.* The sooner you start working on YOUR NUMBER, the sooner you can "retire." "Early retirement" is a scary term and something to be avoided, if possible.

4. *You Might Have To Go Back To Work.* Take responsibility for your own current—and especially future—financial security. If you didn't figure out your real number, and you still want to reach your goals, which often is only vaguely defined as "I want to keep my lifestyle," then you may have to earn more money and save more for when you are actually unable to work. Taking responsibility also may mean not putting all the financial earnings burden on one spouse.

5. *Figure Out Your Risk Profile.* Then and only then, together with the goals knowledge, can you come up with a retirement plan and an investment strategy. Too many investors have portfolios that have little or nothing to do with their true risk tolerance or their willingness to suffer downside to their investments. Beyond investing, many people live with a very high risk in a seemingly innocuous way: using credit when they don't have the cash to pay

for a “want.” A lifetime of using credit because it’s too hard to delay gratification until it’s affordable is one of the main causes of delayed retirement and/or financial crisis in retirement. Many investors want all the upside and none of the downside. Said another way, we want growth of our money and the use of other people’s money (credit) with no risk. This is impossible.

6. *Stick To Your Investment and Financial Strategy.* If your investment and financial strategies do not include gifting to your grown children and supporting your children’s children, then don’t divert the funds required for your retirement to their spending patterns. If you have many years left in your lifetime, the money for later years can be exposed to more risk than the shorter term money. Growth takes time. Don’t focus or obsess only on the short term, unless you have only a few years to live. How much time are you allowing for your money to grow? The sooner you start, the more time you have, the more risk you can take, and the more likely you are to reach your goals.

7. *Give the Gift That Counts.* One of the best gifts you can give your children and grandchildren is to help them learn about their true life goals, and that money is simply one resource to help them get there. They need to learn that you are not the source of money, and that they have to stay out of debt! You can help them stay out of debt by covering your own risks of disability and long-term care costs, i.e. by buying your own policies and paying for your own care. Too many adult children go financially or emotionally broke trying to take care of aging parents who would not insure themselves when they were insurable.

Conclusion

As we ended our session at the meeting, we agreed that there were some common themes between the research findings presented by Anna and the personal experiences presented by Susan. Our view is that some of the most important things to think about in the retirement planning context include the following:

- Evaluating the timing of retirement
- Considering working longer—maybe as part of retirement
- Calculating a realistic planning horizon
- Not giving too much money to family members
- Changing to long versus short term thinking
- Controlling and managing debt
- Considering the role of spousal benefits and protections
- Evaluating how to turn assets into dependable income that will last
- Deciding where to live and whether housing wealth will be used to help pay for retirement
- Understanding which decisions are “cast in stone” and when you can change your mind

The session at the 2008 SOA Annual Meeting was in the form of an interview, and an audio version of the discussion between Anna and Susan is available for purchase from the SOA at *http://www.softconference.com/SOA/sessionDetail.asp?SID=137370*

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A REVIEW OF THE 2008 FUTURE OF LIFE-CYCLE SAVINGS & INVESTING CONFERENCE

Anne Button, FSA

I had the pleasure of attending the 2008 Future of Life-Cycle Savings and Investment conference that was held at the Boston University School of Management in October of 2008. The focus of this conference was the retirement phase of life-cycle finance and so the speakers and the attendees represented a broad swath of academics and professionals whose work is related to retirement. The conference was structured so that there would be sessions where papers were presented followed by sessions that were panel discussions on a specific topic. Audience participation was strongly encouraged throughout the conference. Topics ranged from the economic theory of consumption in retirement to health and long-term care issues to how older people behave. There was strong international representation among the speakers and in the audience. On the final day, the session on the future of pension and retirement in Europe focused on the Dutch retirement plans. This was of particular interest to me since it was one of the retirement systems that has been analyzed by the Pension Section Council using the *Retirement 20/20* Measurement Framework. The concluding session offered various speakers' thoughts on the future of pensions and retirement in the United States. The actuarial community was fortunate to be well represented on the panels of several sessions. Anna Rappaport, Jeremy Gold and Emily Kessler each spoke at different sessions. A link to the papers and more details as to the conference may be found here.

The absolute highlight of the conference was the after dinner panel discussion among three Nobel Prize winners in Economics: Paul Samuelson (age 91), Robert Solow (age 84) and Robert Merton (age 64) on "What Retirement Means to Me?" This panel discussion was moderated by Paul Solman, business and economics correspondent for The NewsHour with Jim Lehrer. It was a delightful experience and we learned that Mr. Samuelson thought he was too young to retire, that Mr. Solow kept working because he had too many friends and former students who wouldn't let him rest and Mr. Merton is still fully employed and has no thought of retirement. The three Nobel Laureates' discussions were wide-ranging and it is impossible to do justice to it in an article. In order for you to fully appreciate how engaging this session was I send you to the video.

A session I found to be particularly interesting was the session on Phased Retirement. It gave me serious food for thought as I think about the retirement predicament in the United States because it highlighted that what might be the "correct retirement answer" for one segment of the workforce may not help and possibly could hurt other segments of the workforce as far as their retirement is concerned. The speakers were three very dynamic women with very different ideas about phased retirement.

Anna Rappaport (Anna Rappaport Consulting), the first speaker, spoke on "Why Phased Retirement?" She looked at phased retirement from the perspective of both the individual and the employer. From an individual's point of view, phased retirement is desirable because many of today's jobs require 60+ hours per week and are very stressful; there may be family members needing care or the individual herself may have physical limitations; and there is an increased desire for schedule and project flexibility and a different life balance. Ms. Rappaport mentioned that she herself is a happy "phaser" who retired from full-time work a few years ago. She is still working but now gets to determine on her terms when, what and how much work she does. From the employer point of view, phased retirement helps keep valued talent since some expertise is hard to replace. In addition, regular staff may not have time for special projects and former employees may be ideal to help with training or to fill in when someone is disabled, on vacation or in the event of an emergency. Anna gave an example of utilities that use former employees to assist in the aftermath of large storms that cause major power outages.

Ms. Rappaport concluded with her public policy recommendations which included providing public education about implications of various retirement ages; facilitating the rehire of retirees including having a bona-fide termination of employment safe harbor; model documentation for contracting; and a reduction in the earliest age to receive in-service pension benefits from age 62 to the plan's earliest retirement age.

Alicia Munnell's (Peter F. Drucker Professor at Boston College Carroll School of Management) presentation was titled "Is Phased Retirement the Path to Retirement Security?" Ms. Munnell was strongly of the opinion that the answer to that question is an emphatic no and that the subject of phased retirement was a diversion that prevented focus on the real retirement problem which is that people do not have enough money to retire and will need to work longer in order to have sufficient income in retirement. She presented data indicating that employers resist expanding part-time employment and offered herself as an example of someone who disliked having to rely on part-time employees.

Rather than think about working part-time which not only employers do not want but that workers can't afford, she felt we should acknowledge and encourage workers to work on a full-time basis longer, at least until age 67, so that they might have a chance of having enough money to live on during retirement. Ms. Munnell did concede that workers who extend their working career may need to work at less stressful jobs as they age.

Theresa Ghilarducci's (Schwartz Chair in Economic Policy, Director of SCEPA, New School for Social Research) presentation was titled "Phased or Fazed Retirement." Ms. Ghilarducci believes that a sign of civilized society is the entitlement to a leisurely retirement at the end of a working career and that her co-presenters were too optimistic about working retirement. Her primary message was that encouraging employees to work longer may be bad public policy.

She pointed out that retirement security has been eroding over the last 15 years, with an increase in indebtedness among the elderly and that Americans aged 55 or older have experienced the sharpest increase in bankruptcy filings, from 8.2 percent of debtors in 1991 to 22.3 percent in 2007. One of her many observations that I thought was interesting was that the increase in longevity improvements was due to individuals enjoying a secure retirement since according to a study she cited, retirement improves older women's physical and mental well being and slows down the health deterioration of men. Another point of hers was that by permitting older workers to continue to work and also collect social security benefits without

any reduction until wages are in excess of approximately $38,000 (in 2009), the Act is actually subsidizing the wages that employers of older workers have to pay to attract and retain older workers and reduces the ultimate Social Security benefits workers receive when they grow old. Her argument was that many workers cannot and should not work in retirement and that they are being pushed into the workforce because of inadequate retirement income. She believes that the only way to get employers to offer rewarding and challenging work to older workers and to use these workers productively so that they add to the country's economic growth is by providing their retirees with good pensions.

I thought that each speaker had a valid argument and so as I think about the work that has been accomplished with *Retirement 20/20* and what is left to be done, I hope that any proposed end state retirement system is encompassing enough to provide secure retirement for the retirees who are not able or do not want to work in retirement but flexible enough to accommodate those individuals lucky enough to be engaged in a profession where they can continue to work as their fancy takes them.

I heartily recommend that you check out the entire presentation which is available free as a video-cast at the CFA Web site:
http://www.cfawebcasts.org/cpe/what.cfm?test_id=879

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