SOCIETY OF ACTUARIES

PENSION SECTION NEWS

June 2009, Issue No. 70

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NEW COLUMN! PERSPECTIVES FROM ANNA

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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.

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