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RETIREMENT DECISIONS: AVOIDING DANGEROUS ASSUMPTIONS AND MISSTEPS

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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 It is common to underestimate life expectancy and end-of-life costs and overestimate the amount that can be safely withdrawn from retirement accounts.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*

About the Authors

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Management and has 25 years of experience in the area of retirement planning. Her practice specializes in portfolio management, estate planning, asset protection strategies, investment income strategies, and retirement and money counseling. She founded Spraker Wealth Management, Inc. in July, 2008 after leaving her original firm to pursue "active portfolio management" for her client base. She is widely quoted in the press and in 2008 and 2009 was recognized by Wealth Manager Magazine as one of the Top 50 Female Financial Advisors in America. Susan is a member of The National Association of Personal Financial Advisors (NAPFA) for fee-only advisors, and the Financial Planning Association (FPA).

Anna Rappaport, FSA, is president of Anna Rappaport Consulting, chair of the Society of Actuaries Committee on Post-Retirement Needs and Risks and Senior Fellow on Pensions & Retirement for The Conference Board. She is an internationally known frequent author and speaker, and a past president of the Society of Actuaries.

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