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Perspectives From Anna: Thinking about Using Assets During Retirement

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I have been thinking about managing accumulated assets during the post-retirement period for more than 20 years. As a result of the research and discussions in the Society of Actuaries (SOA) Committee on Post-Retirement Risks, I have gradually changed some of my thinking about the use of annuities and assets during the post-retirement period and about what solutions may work in different situations.

Much of my career was spent as a retirement consultant in a large firm where most of the clients had defined benefit plans. Many of those clients also had defined contribution plans. For those people who had both types of plans, the idea was that the defined benefit plans would provide income in addition to Social Security and that the defined contribution plan would provide a pool of assets. This worked well for people with long careers under both types of plans but not for many others.

I have always been a strong proponent of lifetime income, longer-term thinking and planning, informed decision-making and risk management. For many years, I had an expectation that longer-term thinking was a key part of retirement planning and that people could be expected to think about the long term. I thought that annuities were a retirement solution for many people. Focus groups, in-depth interviews and surveys that the SOA conducted have changed my thinking about what is realistic for many people. I now understand that there are a variety of solutions that can fit different needs and that we need to focus on a range of solutions for various situations.

SOME CHARACTERISTICS OF THE U.S. RETIREMENT SYSTEM

Economic security during retirement can come from Social Security, employer plans, personal resources and continued work.

- Social Security is the largest share of retirement income for many Americans and actually for most Americans, if we exclude the 25 percent with the greatest wealth. For some of this group, Social Security is the only source of income.
- Social Security replacement ratios are higher for the lower income levels.
- Social Security-claiming age is extremely important. The amount of monthly income is about 75 percent greater for those who claim at age 70 versus those who claim at age 62.
- For married couples, the Social Security benefits claimed by the higher earner also affect the survivor's benefits, if the higher earner dies first. This can be extremely important to many widows.
- Many people do not have employer-sponsored benefits.
- Of the people who were employed by employers who offered retirement programs, those with long service did much better than those with sporadic employment. Defined benefit plan benefits are generally better for those people with long service, and defined contribution plan values are generally greater for those people who have long participation in the plan.
- Personal savings can be a big part of retirement security, but many people do not have much financial assets beyond the amounts provided through employer-sponsored benefits.

WHAT SOA RESEARCH TOLD US ABOUT RETIREES

In a series of focus groups and surveys, retirees told the SOA how they thought about retirement planning and income. Some key findings include:

- Many people do not think long term. It is common for people to plan by looking at their current regular bills and cash flow and trying to get them into balance. Many people felt they were OK if they could pay their regular bills over the next couple of years.
- Some people do not do any formal planning.
- Many people prefer to hold onto their assets rather than develop a systematic plan to use them during retirement.
- Many people do not plan for significant unexpected expenses or shocks. They commonly said "I will deal with it when it happens."
- Even more individuals do not plan for long-term care.
- People are resilient, and some are willing to make significant reductions in spending.
- When we think about the combination of holding onto assets and not doing risk management, the implied plan

is that the assets they hold can be used for emergencies if necessary.

- Professionals are busy figuring out how to get people to develop income plans that protect from risk, but often they do not recognize the way the average retiree thinks about retirement finances.

- Family is often a huge source of help when help is needed. Help is often hands-on, and it is unclear how people without family manage through some of the challenges that require everyday help.

- When people have a major long-term care event requiring paid care, it can be a big problem. If they spend down their assets, they may have to rely on Medicaid or family, if they have one.

RETIREES ARE FACED WITH BIG TRADE-OFFS

Retirees who want to use their assets systematically in retirement are faced with many options and important and complex trade-offs.

- Using assets gradually over time by systematically withdrawing from an asset account provides the retiree the flexibility to change their mind later. It preserves liquidity for the remaining balance. However, investment and longevity risk remain with the retiree.

- Buying a life annuity transfers the investment and longevity risk to an insurance company. But the decision is irrevocable, and there is little or no liquidity.

- There are also options that combine these two strategies and blend some liquidity and some guarantees. For example, while a pure life annuity has no return of capital on death, some annuities have limited return of capital on death, based on their provisions.

- There is another trade-off between spending and doing more now versus saving for later. I often remember that it is important to "Do it while you can." If plans for retirement include physically ambitious activities, it is important to remember that abilities often change. And couples never know how long both will be capable (or even there) to pursue their interests.

ANALYZING THE TRADE-OFFS

Understanding what is involved in the trade-offs of asset use is complex, and the analysis is not easy. The challenges are even greater when one realizes that there are many different income options available. In partnership with the Stanford Center on Longevity, the SOA sponsored several projects on different forms of lifetime income and a framework for analysis and measurement of the trade-offs. The analysis used a form of "efficient frontier" particularly focused on the payout period.

Anyone who wants to compare income options and understand the pros, cons and trade-offs should look at this work. Steve Vernon, Wade Pfau and Joe Tomlinson authored the reports, which are found at *https://www.soa.org/research/topics/research-post-retirement-needs-and-risks/#income*. Some of this work is also summarized in the 2018 Securing Future Retirements essay collection, at *https://www.soa.org/essays-monographs/2018-securing-future-retirements*.

The first report sets up a framework for using income options in defined contribution plans. One of the reports focuses on the analysis of options that are suitable for use in a 401(k) or other employer-sponsored defined contribution plan. Another report focuses on options that are suitable for individuals, including the use of reverse mortgages. One of the reports focuses on the legal framework that plan sponsors could use to incorporate income options into defaults.

A fifth report, which is currently in draft form, focuses on the use of a strategy that combines late claiming of Social Security with required minimum distributions (RMD). That strategy provides for a transition fund to help the individual reach the delayed Social Security claiming age. The report authors demonstrate why they believe that this type of option would be a suitable default option in an employer-sponsored plan, and I agree with them. Plan sponsors must choose which, if any, income options to include in their plans, and this is a valuable paper for them. The authors also demonstrate that this option could be good for Americans with up to about one million in savings who do

not want to go through a lot of complex analysis. However, they also provide indications of how to use the option as a starting point and to tailor it to individual needs. Actuaries interested in retirement income planning should study this work and see how it fits in.

There is a lot of personal preference involved in these trade-offs, and a scientific answer, such as those provided in the papers, is helpful. But it is still up to the individuals, with their plan sponsors' or administrators' support, to choose.

With regard to the trade-off about doing more now versus later, I do not have any specific analysis to cite. People generally do not know what will happen or when, but they still must make decisions.

There is a big need for a better process for thinking about housing as part of retirement planning.

THE RISKS AND THE EARLY STAGES OF THE SOA RESEARCH

The SOA research started about 20 years ago with the identification of post-retirement risks and the construction of a risk chart titled "Managing Post-Retirement Risks." In 2019, the SOA is working on the fourth edition of the risk chart that will be significantly expanded. There are more than 15 risks in the 2011 version of this publication. Some risks can be protected against by insurance or financial products, but others cannot. The complexity of the risks and methods of protecting against them may serve as a barrier to formal risk management. The cost of risk protection is also a barrier. The financial products may cover one, two or three risks. This research confirms the complexity and range of risks.

Another of the earlier stages of the SOA research focused on the assets held by middle market people nearing retirement and in retirement. That work, "Segmenting the Middle Market," used data from the federal government's Survey of Consumer Finances. The important findings from that survey were that for the mass middle population, the value of nonfinancial assets—primarily housing—was substantially greater than the value of financial assets. The results of that study raised major questions about what options are feasible for the mass middle population. For many of them, there were not significant financial assets to be invested and spent down. For me, this work changed my outlook so that whenever I thought about a big retirement financial topic, it was important to ask where housing would fit into the discussion.

OPTIONS WITH REGARD TO HOUSING AND THE BALANCE BETWEEN RETIREMENT INCOME AND SPENDING

We learned several important things about housing:

- Housing costs are the biggest expense for retirees.
- Home repairs are a big source of unexpected, unbudgeted expenses.
- For many middle market households, housing values were the largest part of retirement assets (not counting Social Security).
- Many people were entering retirement with mortgages. Whether to pay off the mortgage or not was a big financial decision that changed the retirement spending picture and, therefore, the needs for income. I prefer paying off the mortgage when it is feasible to do so.
- Most people want to stay in their own homes. They can then ultimately sell their home if they need to. However, they may need to make modifications along the way if they have mobility or other limitations.
- While many people believed that investing in housing would produce a good return, results were very variable depending on timing of retirement and location. Many people suffered large declines in housing values in 2008 that at times were devastating. There were also many mortgage foreclosures during 2008 and the period after that, partly due to very liberal mortgage lending rules and practices up to that time.
- Reverse mortgages offer a way to stay in your home and get some of the money out of the home to help finance retirement.
- There is a big need for a better process for thinking about housing as part of retirement planning.

PUTTING THIS TOGETHER—WHERE AM I TODAY?

Successful management of the post-retirement period remains an important topic. These are some important aspects:

- There is a lot of value to having a longer-term plan, but many people fail to do this. Employers and the media should stress the value of having a longer-term plan.
- For middle-income Americans, Social Security is a vital part of their retirement income, and it remains the sole source of income for some of them.

- Late claiming of Social Security is often an advantageous strategy. It is important that everyone evaluate their options before making a choice. In the evaluation, don't forget to consider tax issues; to use your actual earnings history if you are near retirement; and for couples, that the evaluation needs to focus on both people.

- People with mortgages should explore the possibility of paying them off before they retire. Better tools would be beneficial to help people blend this into the decision-making at this life stage. Paying off the mortgage reduces regular expenses.

- Everyone needs emergency funds that are easily accessible. Many people have not thought about unexpected expenses and how to provide for them.

- People who do not have adequate retirement income to retire comfortably at age 65 have a variety of strategies available to them. Working longer is a strategy available to most of them, and more needs to be done to help individuals and encourage employers to support better job options. Reducing expenses is another strategy. These are the best bets for people who reach retirement age without enough assets. Saving early is important.

- For people with defined benefit plans, these plans serve as an additional source of income beyond Social Security. If they offer a variety of payout options, care is needed in the decision about the payout option. The SOA offers a decision brief to help with this.

- For people without defined benefit plans but with assets, there are a variety of options: Delaying Social Security to 70 and then withdrawing the RMD will work for many people.

- For those who want income in excess of the RMD and who have assets, there are a variety of options for generating income and major trade-offs involved in the choice. I hope that Vernon, Pfau and Tomlinson's work, which the SOA and the Stanford Center on Longevity jointly sponsored, will lead to new user-friendly tools and easier default options to help people make these choices efficiently.

- That work from Vernon, Pfau and Tomlinson demonstrates that a thoughtful systematic withdrawal plan significantly invested in stocks can produce higher lifetime income than an annuity, most of the time but not always. And we can't predict in advance when "not always" happens. This is why that work suggests a diverse portfolio of retirement assets and income.

- One of the newer forms of annuities is a deferred annuity starting payments at a high age, such as age 85. This increases income at age 85 and enables a broader range of choices in the interim. These annuities are a good addition to retirement portfolios, and they are currently underutilized.

- Having a plan for long-term care financing is important, whether it includes long-term care insurance or not. Those who do not have insurance need more savings to pay for expenses as they are incurred. The SOA has a decision brief to help people think about these issues.

- It is important not to forget about health insurance. Medicare is a big part of the picture after age 65, but there are ongoing decisions that are needed. The SOA has a decision brief to help people think about these issues.

- For people with a significant house value and not a lot of financial assets, a reverse mortgage may help. It also may help to sell the house and downsize to a less-expensive home.

- As we think about these issues, we need to remember that many people are not planning for the longer term. A big challenge for actuaries and retirement planners is understanding what people actually do and how they think. The solutions that are offered need to include options for those people who do not plan for the longer term.

- I value guaranteed life income highly, but I recognize that people are in many different situations and that the choices they make will not always focus on guaranteed income. People with larger amounts of assets may also not focus specifically on annual income. They may rather think more about the progression of the assets if they spend what they want. Trying to hold onto assets is a popular strategy that has worked out well for many people. It gives them some flexibility to deal with a variety of risks.

- We all need to work to help people plan effectively for the post-retirement period and develop strategies to fill in the gaps when it looks like they will not have enough. ■

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