

 Mortality and Longevity

 Aging and Retirement

2020 Living to 100 Discussant Comments 2B: Retirement Strategies



Discussant Comments Session 2B: Retirement Strategies

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Thank you to the Society of Actuaries for inviting me to provide comments regarding the two papers *An Actuarial Approach to Retirement Strategy Metrics* by Mark Shemtob and *Review of the Demography of Retirement in the United States* by Jacob S. Siegel. I will comment on the papers in order and refer to the papers by the name of the author rather than by the title.

Retirement Strategy Metrics – Mark Shemtob, FSA, MAAA, EA, MSPA, FCA

This paper examines the very important question of what approach should be used to determine the amount that should be withdrawn from a retirement account to provide reasonable assurance that the account will not run out of funds before the death of the beneficiaries and will satisfy the income requirements and any legacy desires. This question will be faced by millions of individuals who may receive advice from individuals with a wide range of backgrounds who may be partial to specific approaches. This paper also addresses the question of what an actuarial approach to answering this question should be.

This paper provides a good overview of the methods commonly used and identifies their weaknesses. It presents a reasoned approach to how to weigh the competing objectives of income and legacy. It illustrates the approach proposed clearly.

I agree with the author that this is an appropriate area for actuaries to turn their attention to developing an approach. This is a problem that will be faced by most retirees. This is an area that is lightly regulated and there are a wide range of practitioners with different motivations and qualifications providing advice, such as life insurance agents, mutual fund representatives, and certified financial planners. This question has world-wide application. This might be an area where an actuarial approach could be developed that could be promulgated by the International Actuarial Association.

This paper got me thinking about what I would consider to be the essential components of an actuarial approach to this question. I discussed this question with two of my long-time acquaintances who are both actuaries and who later in their career established a business providing this type of advice. They both obtained a CFP (Certified Financial Planner) designation. I appreciate the helpful insights of William Jack and Patrick Longhurst, but these thoughts are my own.

If there is an actuarial approach, then it must be one that can withstand scrutiny and an actuary using the approach must be seen to be acting professionally. I suggest the following components for an actuarial approach. There may be others, but this is a list to get started in developing an actuarial approach.

- The analysis should use a stochastic method.
- The analysis should not be based on a fixed expected age at death. (It is most common to use a fixed expected age at death.)
- The analysis should not combine the income and legacy objectives into a single measure, because for most retirees the income objective dominates the analysis.
- The analysis should include tax considerations, which differ by jurisdiction and individual situation; but it is after-tax income (and after-tax bequest) that should be the focus of the analysis.

Those are my suggestions to contribute to the development of an actuarial approach to this problem. I have the following specific comments regarding the method presented in the Shemtob paper. Please bear in mind that I read a preliminary draft of the paper and it is possible that some revisions or clarifications will be provided in the final paper.

- Despite using a stochastic approach, it generates an expected age at death. I would prefer that each stochastic path is presented.
- The approach presents a clever way to calculate expected values of income or legacy by weighting by the probability of life or death, respectively. However, it then continues to combine the results and ranks the simulations on a score out of 10. This approach is confusing and lacks transparency. For example, there might still be a shortfall for a strategy ranked 10 out of 10 – would a retiree understand this either in the beginning or when the shortfall occurred 20 or 30 years down the road?
- It is very important to include tax effects in order to provide the most effective advice.
- I understand that it is a major communication challenge to present the results of stochastic analysis over an uncertain time horizon when there are multiple assumptions included in the analysis. I am told that this is a principal reason why a fixed expected age at death is used – to simplify the communication and decision-making process. However, I found the colored graphs on pages 23 to 25 that show sources of income and deficiencies over the time horizon to be the most useful presentations in the paper. I suggest that this communication approach be adopted, perhaps with modifications or supplemental support.

Finally, while I think this is a very important question that will be considered by most households, I am concerned that the majority of the recipients of this type of advice are relatively well off. There is also a need for this advice by those with limited savings and great uncertainty regarding the financial viability of retirement. The illustration in this paper is an example – not only is the individual entitled to a Social Security benefit, but she has \$1,000,000 in savings, and owns her own house (so any long-term care requirements can be assumed to be taken care of by the sale of the house). The individual in the illustration is so well placed that few of the retirement options analyzed are likely to make a significant difference to this individual's well-being in retirement.

I would suggest that illustrations for those with fewer savings would show options that present difficult choices, such as whether to pursue a risky investment strategy with the hope of generating higher income for a longer period, or assuming that one will die within the 20 years following retirement and risk drawing more income in the earlier years of retirement.

My acquaintances told me that there is a small group of CFPs in Canada who are offering a free service to those with little savings. That is a very welcome development. An actuarial approach should be viable regardless of the circumstances of the individual.

A Review of the Demography of Retirement in the United States – Jacob S. Siegel

I reviewed a very preliminary version of this paper. These comments may be helpful as the paper is developed. Clarify the objectives and structure of the paper and then check to see if they have been met. In terms of structure I suggest adding a section on areas for future research and a conclusion. For the tables, insert headings and show the unit of measure. Some formulas presented may not be familiar to actuaries so further explanation may be helpful for this audience. It would be clearer if the paper is written to be either explanatory or a discussion, so that the reader can anticipate whether items stated without references are intended as facts or opinions.

The stated objectives of the paper include:

- Review leading aspects of demography and bring them up to date
- Spell out a methodology for developing median ages at retirement
- Identify next areas of research.

Regarding concepts of retirement, this paper makes useful distinctions among definitely retired, partially retired, and definitely not retired. Finding the data to fill this matrix would be a very useful contribution. The nature of retirement continues to change. No longer is there a firm breaking point such as age 65 once was. In our team's research we have developed an overlapping generations model, that has two "generations" of partially retired starting in the mature-working stage (ages 50 – 65) and continuing through the old-working stage (ages 66 – 81), until full retirement after age 81. This reflects the changing nature of retirement, but finding accurate data to populate these stages is extremely difficult.

In the Siegel paper, the categorizations result in a 2 by 2 matrix with the other cell labelled "status indeterminate", which is described as mostly women who have not been in the labor force for many years or ever. It is important that we do not ignore this group in the design of our social safety net. Lack of labor force attachment may be the result of social norms regarding child rearing or parental support. Social benefits based on labor force measures such as employment income or years in employment are likely to be poorly defined and may result in inadequate benefits and possibly years in poverty for a category important to society's functioning.

Siegel discusses labor force participation rates and notes that there have been declining rates for men but increasing rates for women. The question is what to expect in the future. In looking into what others think about this issue I found an article by Kimberly Amadeo¹ who presents five reasons why she thinks the participation rate will not return to previous high levels.

1. With an aging population people are less likely to participate as fully, for health reasons and because of other demands on their time.
2. Since the financial crisis we have developed a group of long-term unemployed and the longer people are unemployed the more difficult it is to re-enter the labor force.
3. Our economy has changed from the time when there were many manufacturing jobs resulting in a significant decline in middle-skill jobs, especially affecting those ages 25 to 54.
4. Increased opioid dependency has not only resulted in many deaths but also made many workers less able to work effectively. This is truly a crisis that needs to be recognized and corrective action taken.
5. There are more people with chronic disabilities resulting in less ability to participate.

This paper also addresses the question of the factors affecting the decision to retire. It presents the traditional argument in economics that rational individuals weigh the trade-off between income (by continuing to work) versus increased leisure (by retiring) and make their decision. I find this to be too simplistic an explanation. Many

¹ <https://www.thebalance.com/labor-force-participation-rate-formula-and-examples-3305805>

individuals do not control the decision to retire. During the financial crisis (2007 – 2009) many workers were terminated and unable to find alternative employment, despite when they may have chosen to retire.

The paper also cites Munnell and Rutledge who claim that better health is one of the most important factors contributing to the retirement decision. However, Siegel questions this point indirectly by stating that several research studies show that older workers are experiencing more chronic conditions and disability, particularly as a result of obesity and hypertension. Moreover, with the opioid crisis there is further reason to doubt that improved health is an unquestionable generalization regarding the population.

Moreover, Munnell claims that the movement away from defined benefit pension plans and shifting of investment risk to workers have increased the incentives to retire later. This is a highly euphemistic phrasing. The move away from defined benefit and the shifting of investment risk to workers has increased the uncertainty regarding whether workers think they can afford to retire and not outlive their savings.

Perhaps this is the thread that ties these two papers together. People are not in full control of the retirement decision; are uncertain regarding their income in retirement, how long it must be paid, and whether their savings will be enough. Approaches such as that presented by Shemtob provide a way to answer such questions and provide greater certainty.

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