Informal Discussion Transcript

Session 3B – Societal Changes and Adaptations as a Result of Longer Life Spans

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SALLY HASS: As a retirement educator in the workplace, I certainly agree with much that's been presented here today, but the two huge things that I think American workers are out to lunch on and definitely would make a huge difference in their retirement adequacy in terms of being able to fund their life in retirement, is simply working longer and the delay of taking Social Security. So I'm wondering whose responsibility is it to get those messages across, and how can that be done?

JONATHAN FORMAN: I'll take a stab at that. I mean I do think the Social Security Administration got off on the very wrong foot on this by sort of encouraging people to retire as soon as they could. There were TV ads saying you can apply online for that matter. We also communicated that you're eligible at 62 and then at your normal retirement age. The real normal retirement age in the formula is age 70. So we should be changing what we're communicating to people. The best deal is at age 70, because until that age your benefits are actuarially increased at a very favorable rate. So I do think the government has a role here, but it's shocking how desirous people are of remaining ignorant on these things. I think the largest audience I've ever spoken to on Social Security was 100. The usual audience is about 20 at a Kiwanis Club meeting or something like that. But there are 40 million people drawing Social Security benefits, and less than a million, I'm sure, understand how it's computed and how it works.

ANNA RAPPAPORT: Can I add to that? I think break-even analysis, which is one of the common methods that has historically been used for Social Security analysis, makes the situation worse. There's good behavioral finance research now that shows that how you frame the Social Security decision matters. It also shows that break-even analysis absolutely encourages early claiming. So we need to get the right messages out. I wish employers would just tell employees: You really need to look at the options and here are a few places that you can go for information. I believe the matter of working longer is also a very tricky question. Businesses that don't have shortages of people don't seem very interested in thinking about this, but it's so important to our entire society. I am distressed at the policymakers because I think they are contributing to making the situation worse. I don't think they even know some of the issues. One of the issues we raised yesterday is a technical issue, that there is no definition of bona fide termination of employment. Companies that want to hire their retirees on a limited basis face legal uncertainly. Fixing this would be a very simple thing.

DOUG ANDREWS: I usually get associated with government solutions, but I'd like to push myself away. You should be sitting on my left, Jonathan. I don't think it has anything to do with governments. I think the age that you retire at should be analyzed based on what you can afford, and also it needs to be analyzed on what other opportunities you have, and so it's great for us to talk about how people should work longer, but Anna says in her research and interviewing people, a lot of them have been retired much earlier than they expected. So I think we have to make information available to people on what they can afford and let them judge. In that respect, I'd like to talk about Jonathan's information on the financial planners that tell people you know, use the 4 percent rule and you're going to get $40,000 a year, and then he showed all of these annuities. Even the annuity deferred to age 85, you were only going to get $25,000 a year. I mean if you were looking at the 4 percent rule and making a decision you'd say, "Oh great, I can afford to retire, I can get $40,000 a year." We've got to be very careful with the information that's out there, and so maybe if you want a role for government, it's regulating the financial advice that can be provided.

JONATHAN FORMAN: Or right now in that regard, right now the pension system makes it very hard for employers to give financial advice to their employees. So we need some relaxation there.

ANDREW PETERSON: One final point that Rob [Brown] made, which I think is a key one is just in the U.S. context, people, I think, claim early as well because they're worried about the solvency of Social Security, and so this mindset of "I better get what I can now, because I might not be there later" drives decision making.

CHRISTINE FAHLUND: I am a financial planner and I do believe in the 4 percent rule, but the way we frame it at T. Rowe Price is you have to come back every year and review your situation using stochastic modeling to see if you're on track, because it's not just markets that are going to be volatile, it's going to be your expenses. Furthermore, even though you plan a budget around, say, $40,000, that amount is going to need to increase for inflation every year. And retirement expenses don't adhere necessarily to that plan. I think that's the thing that we're most worried about is all the additional expenses that nobody planned for. They had a budget for the 4 percent, but it's just not going to cut it. As a result of all that, at T. Rowe Price we did a lot of analysis that supports what you've been saying about the incredible benefit of delaying and what it does for your Social Security. Delaying can almost double that initial purchasing power. That alone is huge, but at the same time if you continue working, you have that many more years of salary and benefits, and you're also cutting the number of years you're going to have to support retirement. Even cutting that by five years can be significant, as you know. So that took us to the idea of behavior, which Anna was just mentioning and how people just don't find it attractive to wait to retire. We came up with a phrase "practice retirement," and a concept that says look, when you hit 60, we're going to give you permission to start retiring and playing while you continue your full-time job. So the focus is on you've always wanted to take the cruise, take it now, what are you waiting for. There are plenty of things that you can't do because of time constraints, but there are a lot of those dreams that can come true during your 60s while you're still working. When you get tremendous pushback — "I couldn't afford to do that" — our response is if you don't have any other money, you could spend some of the money that in the former years you were contributing for retirement. Don't touch your nest egg — let that continue to compound. Usually those additional contributions don't have enough time when you're in your 60s to compound anyway, so you get 90 percent of the benefit without saving more than whatever you would need to contribute to get an employer match. So we see practice retirement as a new approach that's fresh and positive, and encourages people to use their salary and benefits to fund their fun.

ANNA RAPPAPORT: I'd like to add to the practice retirement concept. Depending on your situation, you may also be able to negotiate with your employer to work at a 90 percent level and have some extra vacation. There are various companies that will allow some buying of extra vacation, so you might be able to do more of that. I think that's an exciting concept, and I like that a lot.

ROB BROWN: And sabbaticals are wonderful and they can be done in the private sector.

DOUG ANDREWS: Analyzing the expenses though is a very important item. One of the studies that I refer to in my paper is one done by Statistics Canada. They used a synthetic cohort approach, and found that people in their early retirement years were spending 95 percent of what they had spent when they were in their 40s. This is quite contrary to what we talk about. We focus on how your expenses are going to go down in retirement, so you don't need nearly as much income. So expenses are a critical part of the planning.

JONATHAN FORMAN: And in terms of practice retirement, they should practice living on what they're going to have in retirement because it's usually a lot less than they expect, and it’s a lot less than they’re making in their last year before retirement.

LES LOHMANN: One of the things I’ve been impressed with in my life is what I’ll call collective intelligence, and people have an amazing ability with very little education to be able to determine what is really going on, and where I’m headed here is really the inflation issue. I recall and I know mathematically it’s correct, that you cannot fund if inflation is greater than your rate of return, and we’re living today in an environment where we have artificially suppressed discount rates. Extremely artificially depressed. So that asset holders are being punished enormously. A person who owns a rental property is getting a rent that’s related to the discount rate, and so it’s very, very low. They are having cash flow difficulties and things of that nature. So people who thought that they could buy properties and retire on the income from that are having a very difficult time. What else does the depressed discount rate influence? Well, it rewards option holders, high executives of companies, and it punishes stockholders, stock buyers. It does that by changing the price earnings ratio. In low discount rate, the price earnings ratio is higher than it would be in a discount ratio that would reflect the demand for credit that is currently existing in the United States, and actually throughout the western world. So you have a situation where because the discount rate is low, option holders, executives at companies, exercise their options and do very, very well. They sell that stock to people who think they’re going to see more of that, but from these historically low discount rates, we have to anticipate that we may, and I don’t know when it will happen. Japan has had zero interest rates for a very, very long time, but we have to anticipate that they might artificially increase those discount rates, and of course it also goes to the issue of monopolies, OK, how many monopolies do you need to destroy a market. The answer is one, and we have that. One person decides what the discount rate is going to be, and that’s what it is. I think we’re sort of missing the point. The collective intelligence recognizes that trying to save for retirement is impossible. If you don’t have a government-based, unfunded plan, the best plan to be in is the military or the congressional retirement plans, OK, a civil service plan. Any funded plan is in deep, deep trouble, because they cannot keep up. We’re also faced with the lie about what the actual inflation rate is. There are mathematical methods to determine a true inflation rate, and it’s really based on the amount of new money over the amount of money that was there before minus one. The CPI [consumer price index] is being artificially lowered and lowered. People know that. They can recognize that. They may not understand it, and so I think we’re facing a bigger and bigger problem with the disconnect between what is really going on and what we’re being told is occurring, and I think we as actuaries, we as people are concerned about living to 100, need to replace appearances with facts, much more than we’re doing. We need to help the common person understand that their observation, that they’re being paid too little for the assets that they hold is true, it’s accurate, and it would be interesting to see.

ANDREW PETERSON: Les, we have a few others that wanted to make comments.

LES LOHMANN: Sorry. Please discuss that a little bit, the inflationary issue and the artificial nature of the discount rate.

JONATHAN FORMAN: It’s unfortunate that the interest rate is low, but the proper response that we should be educating people about is that they need to save more and work longer to make up for that. That’s what my family is doing.

DOUG ANDREWS: Rob said that he thought this was unintended consequences. On the other hand, there’s a whole school of thought that this is financial repression and that one of the big areas that is suffering are our pension plans for example, and insurance companies, because they’re large holders of bonds, and bonds are artificially depressed.

They're being told that they have to increase their capital requirements. They're increasing at a time where returns are very low. You talked about when is inflation coming, that's the next step, because the bonds are nominal bonds, so if you have good inflation it makes it easier to pay off your bonds. So yes, there are ideas that do support your theories.

BETH PECKINPAUGH: I'm both an actuary and a financial planner. I do not follow the 4 percent rule, but my question is we talk a lot about life expectancy, and it's increasing. As a financial planner working with an individual, I struggle with what's the planning age when we talk about adequacy and when we talk about having enough money. Someone yesterday, one of the speakers, indicated that 10 years after life expectancy, people have a very little chance of still being alive. Does anybody want to field that question? What is the appropriate planning age, if you will, so that we make sure that as financial planners, that we're really planning long enough? What is the distribution, I guess?

ANNA RAPPAPORT: I think if you're talking about the appropriate planning age, it depends to what extent you're using guaranteed life income for some portion. If you have a base layer of guaranteed life income that really covers expected minimum expenses, and if you understand that, then you have less of a question of planning age. Or if you buy a longevity annuity as was discussed, then you can get from a financial point of view that I don't have to worry about the planning age. If you don't do any of those things, then I think it's a very difficult question, because if you planned to the median, you would plan for half of the people to fail. So, do you plan for 95 percent success, or for 90 percent success, or for a lower level of success? You have the additional problem that there is long-term care risk, particularly when it's not insured. I just published a paper with Vickie Bajtelsmit, who did the modeling, that looked at benefit adequacy using stochastic modeling. The dramatic finding was that the median assets needed for success in retirement are so different from the tails of the distribution. Of course, the tails are very dependent on assumptions, but if you don't insure some of the tail risk, success is a very difficult question.

BETH PICKENPAUGH: It's hard to sell those annuities, especially now with interest rates so low. It's even hard for me to recommend them with interest rates so low. It takes a huge chunk. So it is something that I really struggle with.

ANNA RAPPAPORT: And I think some planners plan to a horizon five years or 10 years after the median. You can also buy annuities in staggered steps.

BETH PECKINPAUGH: I plan to 93 for women and 90 for men. I think that's a little longer than most, but when you start reading the data, I have trouble cutting that down. Anyway, just wanted to throw that out. Is there somebody who I can talk with about the distribution of ages above the expected age? Like how is the distribution of ages, if 50 percent of people are still alive after that? How is that distribution, like from expected age to the end tail pieces? How is the distribution in that changed, or has it or has anybody ever cited it?

ANNA RAPPAPORT: One of the interesting people to talk to is Larry Pinzur, who chairs the retirement practice experience committee. This is a perfect question, because one of the things that started the Living to 100 series more than a decade ago was that the portion of the mortality tables that related to the very high ages was often patched on with models and there wasn't a lot of strong experience data. The Living to 100 effort has focused on improving the knowledge about those ages, and trying to get more accurate information, data and mortality tables. It's also pretty clear probably that the client base of the typical planner has very different life expectancies than the population as a whole. Another name is Rick Miller, a planner who has worked with the SOA on doing educational work on longevity tailored to the needs of planners.

ROB BROWN: I would also go and look up the Human Mortality Database. Have I got the name exactly right? Just Google it. I mean there are good data. I'm not saying that the distribution is Poisson or anything like that, but there really good data as to what is the mortality rate beyond age 90 is do exist.

JONATHAN FORMAN: For your clients, because they will tend to be higher income, I think your life expectancy assumptions are a little on the young side, and — but it will be hard for you to convince your clients that they're, in fact, going to live into their 90s, but the figure I gave was a couple age 65. There's a 50 percent chance one will live to 91. If you look at the Social Security tables to answer your specific question, the Social Security tables start with 100,000 people at birth, and then they tell you how many are still alive at each age beyond that, so when you got to 91 you would see maybe there was 10,000 alive or whatever it was, and then you could go from there and you'd see how few, and when you get to 100, you get a 50 percent chance of making it to 101. There are not a lot of people making it to a supercentenarian age.

DOUG ANDREWS: I think, as Anna said, it's the wrong question to ask, what is the age to use. We need to do the planning around lifetime income of a certain amount so there is some layer, and then we can have additional discretionary funds, but one of the things that really helps the discretionary funds issue is if you have mandatory universal health care in place for everyone, and also if you have a universal long-term care plan in place for everyone. It takes a lot of the big questions off the table. Then you're looking at income related to life.

BETH PICKENPAUGH: I don't see that happening. I fight the lonely fight out there.

ANNA RAPPAPORT: I also think that paying off a mortgage is a good strategy, because paying off the mortgage you've reduced the amount of regular income you need. I think late Social Security claiming, paying off the mortgage, then evaluating whether you need a little piece of additional guaranteed income makes sense. If so, the longevity annuity might be a very good option.

ANDREW PETERSON: We're running out of time. Do you have a comment you'd like to make?

FROM THE FLOOR: I have a couple quick thoughts to make. The first one is that it seems to me that one of the fallacies of retirement planning is that we assume that people have to maintain their financial status quo throughout their lifetime including their retirement, and I think that retirement policies specifically should be about combatting poverty, not maintaining status quo. That is making sure that in retirement and old age there are mechanisms to avoid poverty, and sort of tied to that is in terms of working in retirement planning. Probably retirement planning should be about teaching people what they can consume with what they choose to accumulate during their working lifetime, whatever that may be, because people in the world today change financial status every day as they get promoted, hit the jackpot or get laid off, as well as retire. I just wanted to share that.