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News Flash: Retirement Takes Over Long-Term Care

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By John Cutler

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Chairperson's Corner

By Grace Lattyak

I recently interviewed some college students for a potential new hire position in Aon's retirement practice and was asked the inevitable question "Is there a future in retirement with DB plans going away?" I actually love being asked this question, because it allows me to share my point of view on why it is a really exciting time to be a retirement actuary. Even if DB plans were eliminated (which I don't think is in our future), there would still be a retirement "problem" and we, as retirement actuaries, are best positioned to help solve it. We may have to be more creative if our work is less mandated by IRS or accounting requirements, but our actuarial skills, specific depth in understanding retirement programs, and ability to problem solve are needed by those providing retirement benefits to their employees or citizens. Attending the 2016 SOA Annual Meeting & Exhibit in Las Vegas this October energized me and underscored my confidence in the ability of retirement actuaries to adapt to a changing landscape through innovative thinking.

Shortly before the annual meeting, our 2017 Pension Section Council met as a group for the first time and discussed our priorities for the upcoming year. We spent time brainstorming about the topics we want to make into concrete projects next year and will be narrowing down that list and taking action in future months. Topics included:

- Public sector plans
- Retiree medical issues
- Retirement adequacy and lifetime income
- Pension risk transfer
- Communicating risk
- New plans like state-sponsored plans

If you have suggestions for other areas where you would like to see us focus—let us know!

We also have our communication, continuing education and research teams already hard at work planning content for 2017.

A couple of highlights:

- **Research:** During our meeting, Marc Des Rosiers walked through his recently published paper and framework¹ that he developed for evaluating DC plans. I would recommend checking it out, particularly if you are helping clients design DC plans. The research team is committed to continuing to produce research that can both help you in your job today and further the capabilities of retirement actuaries in the future.
- **Communication:** In this issue of the *Pension Section News* you will be able to read our last installment of the Diverse Risk essays—some of which I heard presented at the annual meeting. I think these essays help move our thinking as retirement actuaries forward and challenge us to tackle retirement plan risk in creative ways. Our communication team will continue to make accessible the thought-provoking ideas being discussed in our community through the *Pension Forum*, the *Pension Section News* and podcasts.
- **Continuing Education:** Fresh off a very successful annual meeting, the continuing education team is finalizing the webinar schedule for 2017. It promises to be another great year combining training applicable to our day to day work with sessions focused on research and how our practice may evolve in the future.

I am very excited to dive into 2017 with the new council. We are going to miss our outgoing council members greatly—Carol Bogosian, Julie Curtis and Larry Pollack. All three have made significant contributions to the Pension Section and our profession. Luckily they are all going to stay engaged in volunteering with the SOA!

Throughout the upcoming year, I welcome any feedback on the work of the Pension Section Council. We are also always seeking new volunteers. Feel free to reach out to me or any of the council members, we would be happy to discuss opportunities with you.

Warm wishes for a successful 2017! ■



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ENDNOTES

- 1 <https://www.soa.org/Research/Research-Projects/Pension/system-evaluate-contributions.aspx>

A View from the SOA's Staff Fellow For Retirement

By Andrew Peterson

This newsletter is scheduled to be published in February 2017, likely coinciding closely with when the Trump presidential term will start (for those of us based in the U.S.). While I will steer clear of any political views, it is a near certainty that the Trump administration will bring new opportunities for actuaries. This is perhaps most obvious for health actuaries who are anticipating yet to be determined changes to the Affordable Care Act.

The implications of a Trump administration for pension actuaries is less clear. Very little was discussed about retirement/old-age issues during the 2016 campaign season, so it is difficult to predict what retirement policy changes might be pushed in the new administration. There have been discussions about rolling back or modifying the new fiduciary rules, but those have generally had less impact on pension actuaries and more impact on our colleagues working in the insurance arena where product distributions approaches and commission structures are being impacted. Perhaps the rule going forward is to expect the unexpected!

The anticipation of the new administration has already had an impact on the markets with positive equity returns boosting portfolio values while increases in interest rates are lowering liabilities at a particularly opportune time for calendar year plans. How and whether these economic conditions will persist in the next few months and years is not something I will venture to predict, but they are welcomed by defined benefit pension (DB) plan stakeholders. Nevertheless, there continue to be a number of challenges facing the retirement system. In the U.S. there are challenges with key plans in the multiemployer pension system and public plans continue to make the news in certain cities and jurisdictions (i.e., Dallas) and I expect these financial challenges are not just a U.S. issue. At the same time, defined contribution plans are going through growing pains as work is being done to make them true retirement plans, not just savings/wealth accumulation plans. Overlaid on all this are challenges related to managing longevity, including questions about long-term expectations, differential mortality in different subpopulations, and so on.

So what does this mean for pension actuaries? As Grace Lattyak discusses in her chair column, even though we anticipate an evolving role, the fact is that providing good solutions for maintaining financial health in retirement is difficult and an area where our actuarial skillset should be applied. While change is often challenging, it also brings new opportunities. The SOA Pension Section Council is committed to providing education and research that is relevant both to our core ongoing work and to these changing times no matter what 2017 and beyond bring. As always, we welcome your ideas and suggestions. ■



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Perspective on the Diverse Risks Project: Are We Done or Where Do We Go from Here?

By Anna M. Rappaport

One of the big challenges in a defined contribution (DC) pension system is remembering that none of the risks go away just because the employer chooses to use a DC plan to offer benefits. The DC system however takes risk bearing away from the employer and makes it easy to forget about the wide variety of retirement risks. It shifts more risk to individuals.

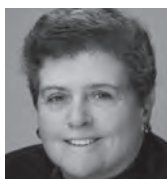
The Committee on Post-Retirement Needs and Risks (CPRNR) has recognized the shift to DC and is very concerned with how risks will be dealt with in the DC environment. The Diverse Risks essay collection explicitly focuses on a variety of risks and brings forward ideas for risk management. The last of the 18 essays have been published in this edition of *Pension Section News (PSN)*. The previous two issues of *PSN* also included essays from this collection. They were presented at the 2016 SOA Annual Meeting & Exhibit and the full collection has been published on SOA.org. Some of them have been mentioned in the press.

This raises the question of whether the project is complete and whether we are done and ready to move on. We can respond to this question in two very different ways. Yes—the essays are published and we got some publicity. Or we can respond no. I choose to respond with an emphatic NO. The essays include a collection of ideas focused on risk in the DC environment, and they present a range of solutions. My argument is that our job has just begun. We have a wealth of ideas and a variety of opportunities. I want to call on all of the members of the Pension Section to use the essays as a platform to improve risk management in the DC system. Here are some suggested next steps:



- Further develop the ideas. Many of the ideas can be taken to further steps.
- Remind everyone that risk is important in a DC environment. Keep the conversation going.
- Pick your favorite essays and share them with others, or seek platforms to discuss these essays.
- Focus on the need for income during retirement and for a plan to make assets last throughout retirement.
- Remember that long-term care needs can easily derail retirement security in a DC world.
- Focus on the importance of thinking about how disability risk will be managed in a DC pension world.
- Don't forget about women's issues in retirement.
- Think about how to help individuals who are confronted with increased risk and complexity in managing in a DC world.

I encourage each of you to choose your personal next steps to help increase focus on risk in a DC environment and to help improve its management. ■



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Management of Post-Retirement Finances for the Age 85 and Over Population: Some Advice and Lessons from Personal Experience

By Anna M. Rappaport and Sally Haas

INTRODUCTION

The SOA Committee on Post-Retirement Needs and Risks (CPRNR) has been exploring issues related to the population age 85 and over. This group is not represented in the regular post-retirement risk surveys or in the focus groups previously conducted by the Society of Actuaries. The prior focus group work with retirees who had been retired for 15 years or more indicated that retirees often did not plan for risk management, but rather they dealt with events as they happened. The focus group members were generally younger than age 85 and they were generally able to adjust to many of the situations they experienced. One of the big questions the committee had after that work was what would happen to people as they reached ages over age 85? Would things fall apart?

A lot is happening with the over age 85 population, and we can view our knowledge of it to be like a mosaic. It is a difficult population to reach by traditional research methods. Part of the mosaic can be filled in from existing SOA and other research. This article is an attempt to add some pieces to the mosaic. We decided to pool personal experience and see what we might learn in dealing with issues of the very old. Sally Haas had two parents in their 90s in assisted living, and she collected information through a few interviews. Anna had previously written up some case studies including some that progressed through various stages. Dick Schreitmuller, another member of the CPRNR, also did a few interviews. Dick's sample consisted of a few people he knew who were independent and in their 80s. Anna looked at some literature and also collected information from a discussion of the CPRNR and a number of contacts. Both of us and a number of people in the CPRNR had observations about financial management and challenges. All of these

pieces add to the mosaic, and hopefully encourage others to fill in more pieces.

We were also aware from our pooled knowledge that the family members and others who are offering help with the management of financial affairs can easily run into challenges and disagreements. This article includes the two sets of interview data and selected comments from the online discussion. We provide some added information about the challenges and some recommendations in a separate essay being submitted to the Financial Wellness Call for Essays.

Our key observations are as follows:

- There do not appear to be any specific changes related directly to age. People appear to change at different times. However, many more people need help at older ages.
- People who are living independently and do not have significant cognitive difficulty do not appear to change the way they manage their money.
- Health is the “elephant in the room.” Changes in health status often lead to declines in capability and the need for more help. They can easily dominate the situation, especially when they occur suddenly and unexpectedly.
- For some families, long-term care and health costs are a huge issue. Insurance generally does not pay for dental care and hearing aids. Health coverage usually does not pay for much long-term care and the cost of long-term care can be devastating. Some situations include other uncovered expenses.
- Once there is cognitive decline, everything changes.
- Many elderly persons have hearing difficulties. Hearing difficulties create a variety of other problems. About 2 percent of adults age ages 45–54 have disabling hearing loss, compared to 8.5 percent for adults age 55–64, 25 percent at ages 65–74 and 50 percent at age 75 and over.¹
- The money management help that people need includes help with daily tasks like bill paying, as well as advice in making decisions and managing investments. Help with daily money management is different from the services generally provided by financial advisors. Even if not disabled, this population also often needs help with making doctor's appointments, visiting doctors, running errands, performing some household tasks, etc.
- There are professionals who specialize in daily money management and bill paying. Some of them specialize in working with elders.
- People who are in assisted living very often get help with money management. The most common sources of help are

children or other family members. Family members are not necessarily well qualified to help (some may not be competent and some may not be honest).

- Couples often have a partner to help a partner in need, although in some couples both need help. Single individuals are in a very different situation than couples. It should also be noted that in some couples one person does most of the money management, and the spouse may not be much backup.
- Families are often in the role of helpers and appear to be used more often than financial advisors.
- But family help is not available to substantial numbers of people—some people have no children, some children live far away or are not willing or qualified to help their parents. People without children may not have other family members positioned to help either. Where there are no available family members, it may be difficult to find a suitable person to help. There are services or individuals who can be engaged to do so. Churches and community groups such as villages can also be a source of help.
- It is up to the individual to designate which family members or others they want to help. Powers of attorney, if executed, transfer authority to the designated persons to take over when the individual is unable to continue. Caution is needed as they can also be abused.

Health is the “elephant in the room.” Changes in health status often lead to declines in capability and the need for more help.

- If no one is designated—and help is badly needed—then the courts may get involved.
- Financial advisors who helped at an earlier age are often but not always continued. In some families the same advisors work with multiple generations. Where adult children do not work with the same advisors as their parents, the children may try to make a change.
- Over solicitation by charities is a common problem and it can easily be a form of abuse.
- This group is often targeted by fraudsters.

- Some older persons are approached by family members and others for gifts. Handling of gifts can be a thorny issue, particularly for family members who are helping their older relatives.
- Where there are multiple children or family members, there is the potential for conflict and resentment with regard to managing the finances of older family members.
- Properly executed legal documents are part of the story leading to a good support system. But they are often not enough.

DETAILS OF INTERVIEWS CONDUCTED BY SALLY HASS

In August of 2016, I collected survey responses on post-retirement financial risks for individuals over the age of 85. I utilized the survey developed by Dick Schreitmueller. The following are my survey results, notes and thoughts.

There were 17 participants between the ages of 85 and 97—12 were in an assisted living facility, the remaining five were living independently. There were 13 women and four men. Out of the 17, only one had never married. There were two married couples the rest were widowers. All were Caucasians. In most cases, I interviewed them directly but in a few cases I interviewed their adult children.

1. **Do you have a spouse or a partner?** Four said yes.
2. **How is your general health?** The majority answered “good.” Only one answered “poor.” The majority used a walker or cane. Many seemed hard of hearing and some had vision issues. (*Note that in at least some cases, poor mobility or hearing did not cause people to say they were in poor health.*)
3. **Do you get more than one pension not counting Social Security?** 15 answered “yes.”
4. **Do you have substantial savings that can provide retirement income?** 15 said “yes.”
5. **Do you have a financial advisor or helper? Is this a relative or friend?** Only one in this group utilized a financial advisor, but several had done so at younger ages. Only one reported managing their finances independently. The rest utilized help from family. (*Note that the reason that some had discontinued the use of a financial advisor is probably worth more research and explanation.*)
6. **Who usually pays the bills?** Three reported that they paid all their own bills. 14 reported that relatives paid the bills.
7. **Who usually participates in financial decisions such as investments, vacations, donations?** Three reported they make the decisions without help. 14 relied on children.

- 8. **Who usually decides how to invest savings?** Only one utilized a professional advisor. Two reported that they made the decisions independently and the rest relied on children.
- 9. **Have you ever thought of buying an annuity?** If so, who would help you decide what to do? Several did not know what an annuity was. They had not thought about buying one and made it clear that they did not want to buy one now or in the future.

In addition to the direct interview questions, Sally made several significant observations:

- Only two in this group used computers to pay bills (some had used them at younger ages)
- They were fearful of frauds and scams
- A few had suffered losses due to fraud and scams
- Several had been in the assisted living facility for more than five years. A route for people who had been in assisted living more than 10 years was entry when one member of the couple needed help. The person needing help died after two or three years, and the surviving spouse stayed after their death.

The surviving spouse has given up their prior residence and community and was linked to the assisted living.

LINKING THE INTERVIEWS TO EXPENSE INFORMATION

EBRI research provides insight into how expenses change after age 65:

- Household spending drops after retirement by age within retired cohorts.
- Housing is the largest area of expenditure by far.
- Health care is the one area of spending that does not decrease by age: mean spending increases both as a dollar amount and a percentage of total. Recurring health care costs, doctor and dentist visits and prescription drugs, remain stable throughout retirement. Nonrecurring health services, nursing home stays, home health care usage and overnight hospital stays, increase with age and are much higher in the period before death. The percentage of total spending devoted to health care increases by age group.²
- Not surprisingly, spending on transportation, entertainment and clothing decreases more rapidly by age group than housing and food expenses.
- Some categories show a lot more variability than others.

Table 1
Mean and Median Household Spending in 2011 Adjusted to 2013\$ by Age Group

	Age 65-74		Age 75-84		Age 85+	
	Mean	Median	Mean	Median	Mean	Median
Home	\$18,720	\$12,642	\$14,732	\$10,805	\$13,111	\$8,781
Food	4,526	3,982	3,994	3,228	2,520	2,152
Health	4,383	3,104	4,624	3,109	6,603	2,814
Transportation	5,169	4,025	3,666	2,794	1,972	1,241
Clothing	1,311	724	950	569	888	434
Entertainment	4,300	2,380	3,277	1,655	1,609	714
Other	3,583	1,148	3,565	1,034	3,188	734
Total	\$42,805	\$34,036	\$35,315	\$29,884	\$30,610	\$22,263

Source: Figure 2 from EBRI Notes, Sept. 2014 – How Does Household Expenditure Change with Age for Older Americans?

ISSUES FOR FURTHER RESEARCH AND RELATED OBSERVATIONS:

To what extent should age 85+ be explicitly considered in planning? How should health issues enter the planning?

Some of the interesting questions that these interviews raise are: How long are people likely to be at the stage that they need help? How much help will they need? Can it be provided by family and friends?

Why had several in this group utilized financial advisors at younger ages but they are not doing so now?

Another area for research is how well families are able to provide the support needed, and what goes wrong with family help. *Note that the vast majority in this group were relying on family for help in paying the bills and with managing their finances.*

Another area for research is understanding lengths of stay in assisted living and other housing/care options. The data on average length of stay in an assisted living is 22 months, but if a couple takes up residence, the length of time in the facility for the surviving spouse could be significant—especially so if the reason for the move was due to a decline in health for one member of the couple and there was an age difference between the two. This is further compounded by the gender difference in life span. Two of the people interviewed had lengths of stay of 10 years or more.

How much time people can expect to spend as an “old-old” person and with limitations? Is it getting longer? Do we need to encourage people to set aside more money to cover these costs? Is family support and assistance for parents being considered adequately in retirement planning?

What are the options for individuals who do not have children or other family members available to help?

How should the potential for cognitive decline be taken into account in planning?

How does Medicaid fit in?

SOME QUOTES FROM THE ONLINE CONVERSATION

The CPRNR had an online conversation based on both their personal and professional experience. All of the participants have some experience as retirement professionals, but in very different roles. Here are some key quotes and comments about them.

Thinking about late in life: *“‘Late in life’ is more defined by activity, physical and mental health than by age.”* This is confirmed by the interviews that Dick Schreitmueller did and the comments of several others.

The importance and role of family: The interviews and online discussion showed a major role for family.

“I believe that most seniors are more trusting of family members and family friends than they are of professionals, even though sometimes they should not be. Spend a little time in any nursing home, particularly those that have primarily Medicaid patients, and the horror stories abound.”

“Any senior who has any health issue or loses mental capacity, needs an advocate who will act in her best interest. This is going to be a very serious problem as boomers continue to age, particularly since we’ve had fewer children.”

Help from children does not always produce a good result. Advisors see children as being helpful or not, depending on the situation. *“It’s hard to see adult children have a sense of entitlement to their parent’s wealth—or maybe it is just the lack of a fiduciary perspective. Is this new in this generation? Can we normalize treating your parents’ finances as if you were a fiduciary?”*

Children who are trying to do their best may not be well qualified. *“Sometimes children who have been named as financial agent for their parents think they have to do everything themselves because ‘Mom appointed me.’ In reality, delegating duties, especially for which the child has no familiarity/training can be a better way to go, especially when caring for one’s parents disrupts one’s own personal and professional life. Children sometimes don’t know to delegate because that is not a part of their lives.”*

“Sometimes, and I find this odd but common, children strive to carry on their impression of their parent’s lifetime frugality and won’t spend money on things/assistance that would help their parents. Often this notion of frugality seems to be based on their memory of their parents radiating ‘don’t waste money’ when in reality the parents had a very sensible notion of when to spend and when to save. I have personally spent time advising children of clients with multi-million (dollar) portfolios that they don’t need to skimp, for example on an extra duty nurse on Sundays or to limit the choice of retirement facilities to those with daily fees within the long-term care daily maximum benefit.”

Sources of specialized help: Money management includes daily tasks such as paying bills and balancing checkbooks, as well as tasks like managing investments and making significant decisions. It is critical that someone can do the daily tasks, and family members often help when help is needed. There are also specialized services to help.

“There is a long-standing, and I believe reputable, organization in the American Association of Daily Money Managers, (<http://aadmm.com/>)—some of whom have completed, (along with numerous financial advisors, attorneys, etc.) the course for the Registered Financial Gerontologist (RFG) certification from the American Institute of Financial Gerontology (AIFG) currently housed at the University of North Carolina- Greensboro (www.aifg.org).”

“There are more people than before who don’t have kids to help them and that is a big issue. In such instances, we work with a trust company, such as Fiduciary Partners in Wisconsin, who specialize in helping people with daily financial life as a separate product line from investment management.

To my surprise, we are also promoting such institutional relationships for clients who do have children. We have seen too many times that the wrong child steps up or that kids don’t understand the fiduciary relationship.”

Comments from advisors: *“In the vast majority of cases where our very elderly clients need help with their financial planning, the children are also clients and will ask us for assistance in deciding how best to help their parents make good financial decisions.”*

“However we do have the occasional client, I’m thinking of one in particular, where the children are not clients and are virtually unknown to us. In the case I’m thinking of one of the children has convinced the client to remove about one third of their assets from management and invest in a real estate venture. This might be a perfectly legitimate investment but we were not asked to vet the project (we offered) and were unsure of the risks involved. Since the client is competent there is no reason to question this decision other than the possibility that the client is reluctant to refuse a request by the child. That same client has repeatedly refused the request of their children to remove their assets from our management.”

Comments about advisors: There is a wide variety of advice and experiences. This comment provides a “mixed experience” and raises some red flags. This comment reminds us of the importance of understanding the relationship to the advisor and how incentives align between the advisor and client.

“In terms of financial advice, my 89 year old grandmother has been guided by a planner at her bank. This has provided a great deal of emotional comfort to be able to receive guidance from the same institution from which she has been banking for decades. The flip side to this though is I don’t know that the advice is particularly suitable.

Comment from Sally: I spent 30 years as a retirement and life planning educator. I think the role of family support of elderly loved ones needs far more attention as adult children make their own plans for retirement. As a result of these interviews with the 85+ group as well as two interviews with directors of assisted living facilities, I am wondering whether the time spent as an old person (over 85) is often expanding or elongating. Since costs during these years are likely to be higher this could pose a significant risk.

The products sold are high fee and the features imbedded in them are of little value to her. Additionally, extra work and expense was put in establishing a trust, but she doesn’t have much wealth so the benefits of a trust are likely de minimus and the complexity is high. So even though she has advice and is happy with it, I think the misincentives still lead to suboptimal outcomes. She has a strong degree of independence though, so all this decision making has been done outside of family support”

Abuses, gifts, cognitive decline and personal experience: The dialogue included repeated stories about things going wrong with ideas about how to make them right. Over solicitation by charities has been cited as a problem by several people. Adult Protective Services agencies offer help to seniors where financial exploitation is an issue. Loneliness and cognitive decline increase the vulnerability of seniors to financial exploitation. One of the big challenges of care-giving adults is knowing what to do about gifts.

“I can help manage the finances, but they need a lot of help. My Dad started making mistakes on the taxes a few years ago and they keep getting big bills from the IRS to collect back taxes and penalties. My Mom, a smart woman, has no idea how to handle the investments. They NEED an advisor now, but didn’t when my Dad was fully with it.”

“My Dad was a very successful educated businessman—yet in the end (he lived to 91 yrs)—it was tough protecting him from folks wanting to issue him credit cards which we kept taking away because he got into a habit (some of you may laugh, go ahead he wouldn’t mind) of calling Lands End and buying extravagant gift cards for different family members he suddenly had an inkling to give a gift to—his teenage grandchildren had no interest in Lands End but started getting \$1000 gift cards. It was something he just got enamored with and forgot right after he did it that he did it so each time felt like a new idea to him.”

“Over solicitation by charities are a real problem, along with book clubs, shopping services and various political organizations. Unfortunately, my sister burned through her entire life savings in about 18 months to a combination of these. As she kept withdrawing funds from her IRA, her advisor (a bank broker) was concerned and reported it to the appropriate state agencies, his manager and compliance department as

required by brokerage rules. The state never did anything. Unfortunately, banks don't operate under as strict standards. She also burned through her savings account and regularly overdrew her checking account. The bank was happy to continue to honor checks even when there was insufficient funds since they knew she would have Social Security deposited shortly and they were collecting hefty fees. My sister did not live nearby and was very skilled at hiding all this from the family, most likely out of embarrassment. I only discovered it when she had to go to a nursing home and I took over her finances. In settling her estate, I wound up settling with the bank for a refund of about half of the overdraft fees, which was still nearly \$2,000."

"The only personal experience I have is with my mother who died in 2014. She was living on my father's Air Force pension and Social Security and although she was not poor, she was supporting my sister and had little disposable income. I took over her finances in about 2010 and discovered that she had about \$500 per year in charitable donations—almost all of which came from telephone solicitation. When I asked her why she responded to these calls she indicated that the people seemed so nice and she didn't know how to say no. I told her that in future she should ask them to send information about their cause and that her financial planner would review them and consider donating. We never got anything in the mail and they stopped calling."

Recognizing cognitive decline from a professional perspective: "One of the more cruel aspects of cognitive decline is that the person to whom it is happening is unaware and so does not know to ask for help. Plus the initial stages are not visible even to those close to the situation (because of lack of training/awareness on their part and/or lack of access e.g., to finances where cognitive decline often shows up first)." Some of the discussion of this topic also indicates that people try to hide decline.

Here is personal perspective on the same issue, but from a highly skilled professional: "In my own life, I found that my father had inadvertently set up a signal for me to know when to take over and that signal was helpful to me: When visiting my parents from out of town many years later in their CCRC I noticed after dinner at a restaurant that my retired Latin teacher mother leaned over to help my tax attorney father compute the tip. Ouch.

Comment from Anna regarding lifetime income: Sally reported that in the interviews she got a negative reaction to the question about annuities. I observe that nearly all of the people interviewed had pension income in addition to Social Security. Overall this group has much more guaranteed lifetime income than the population at large, and very likely, less need for annuities that offer additional guaranteed lifetime income. However, SOA research has shown that many people are not considering their need for guaranteed income when planning.

(My father was a retired tax attorney/benefit consultant and sent his children a memo each year from the time we entered college that included an updated balance sheet and some other summary personal financial information. We all ignored those memos although admired him for his diligence!)

At that dinner, I looked at the two of them and suddenly realized: I did not get his memo this year. That gave me permission to step in and offer help to my mother with their daily finances, to which she readily and with relief agreed. Kids need a signal, and they need permission to move in and help." Often people who are not in day to day contact with others are more able to see change, and recognize that something is happening. Those people who are in day to day contact experience change gradually. It should also be noted that when people are in denial, their spouses may support that point of view.

Other signals that help is needed may be unpaid bills or changing handwriting.

SUMMARY OF INTERVIEWS CONDUCTED BY DICK SCHREITMUELLER

Dick Schreitmueller conducted interviews with a few people who were living independently at ages over age 85. Generally this group was more affluent than the group included in the 2015 Society of Actuaries' focus groups conducted with people who were retired for 15 years or more and who were resource constrained. The focus groups did not generally include people in these age ranges, so this information extends what was learned in the focus groups. These interviews totally confirm the online discussion quote: "Late in life" is more defined by activity, physical and mental health than by age." These interviews can be seen as reflecting the situation before there is a substantial decline, whereas the interviews by Sally Hass can be seen as reflecting a later stage and more need for help.

CONCLUSIONS

The over 85 population includes people in a wide variety of different situations, and with a wide variety of resources. Health issues are a challenge for many. Mobility and concern about falls is a major issue. Some of those who are living independently and have not been faced with cognitive decline are able to continue managing their money as they did previously. Based on input from a few situations, some households are doing that. Those faced with cognitive decline may recognize it or not, and they are subject to a variety of problems if they do not recognize the decline. They are particularly vulnerable to over solicitation by charities, fraud, and pressure for gifts. Health care costs are often higher than at younger ages, while less may be spent for transportation, food and entertainment. The period of transition from being able to manage day-to-day to not being able to manage may be particularly difficult. Based on a few interviews of people in assisted living, it is common for them to have help with daily financial management from family members. It is also common for people in assisted living to use walkers and

Table 2
 Over age 85 money management: Data from five personal interviews
 People with good financial resources living independently

Interview questions	Male #1 Age 85		Male #2 Age 87		Male #3 Age 88		Male #4 Age 87		Female #1 Age 85	
	Your situation now?	Changes since you were 65?	Your situation now?	Changes since you were 65?	Your situation now?	Changes since you were 65?	Your situation now?	Changes since you were 65?	Your situation now?	Changes since you were 65?
1. Do you have a spouse or partner?	No, I'm a widower	My wife died 10 years ago	No, I'm a widower	My wife died 7 years ago	Yes, married	No change	No, I'm a widower	My wife died 5 years ago	No, I'm a widow	My husband died in February
2. How are your general health & mobility?	About 95%	Balance issues, lost upper body strength	Good but I've had a few falls	Must walk slower	Good but have balance issues	Slowing down	Good, but walking is unsteady & knees arthritic	Slowing down	OK but I've had vertigo & some falls	Problems with balance & vision
3. Do you get one or more monthly pensions, not counting Social Security?	Yes	No change	Yes	No change	Yes	No change	Yes	No change	Yes	Widow's pension began
4. Do you have substantial savings that could provide retirement income?	No	Savings are reduced	Yes	No change	Yes	Savings grew	Yes	Savings grew	Yes	No change
5. Do you have a financial advisor or helper? Is this a relative, friend, professional?	No	No change	No	No change	No	No change	Yes, a professional but I rarely use him	My wife used to join in. I'm now more confident	3 people: a banker (my son), stock broker & lawyer	Yes, my husband handled finances
6. Who usually pays the bills for your household?	Me	No change	I do	My spouse used to participate	I do	No change	Me	No change	I do.	No change
7. Who usually participates in financial decisions like investments & donations?	Me	Was a joint effort with spouse	I do	My spouse used to participate	Me & my spouse	No change	Me	My spouse used to participate	Broker suggests investments	No change
8. Who usually decides how to invest your savings and use them for income?	Me	No change	I do	No change	Me & my spouse	No change	Me	My spouse used to participate	I do, with help from the broker	My spouse used to do this
9. If you ever thought of buying an annuity, who would help you decide?	Me	No change	I wouldn't need help	No change	Independent annuity advisor	No change	Me, don't want one	No change.	Stock broker	No change

wheelchairs. For people whose income comes primarily from Social Security and pensions, there are different challenges than for those people who have significant assets to manage. The issues are also different if their income is more or less than adequate to cover regular expenses. In either case, there are spending decisions to be made, but they can be easier or more difficult. There are also challenges to the family members who are offering help.

We can think about life after age 85 as being like life at a high altitude on top of a mountain. To do well at the high altitude, we need to prepare for different and more difficult circumstances. Life past age 85+ is somewhat like that. This is new territory for each family as a member first reaches those ages. For our society, it is a new reality to have so many people in this territory so it is important to develop both individual and public policy strategies to help families deal with it successfully. ■

Thank you to the members of the CPRNR who contributed to the online discussion and to Dick Schreitmueller for the in person interviews. Particular thanks to Paula Hogan who made extensive contributions to the online discussion.



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ENDNOTES

- 1 Quick Statistics about Hearing, NIH/National Institute on Deafness and other Communication Disorders, downloaded, September 2016.
- 2 See EBRI Issue Brief No. 411, Utilization Patterns and Out-of-Pocket Expenses for Different Health Care Services Among American Retirees

Wrapping This Up or Moving to the Next Stage? Risk Strategies Pertaining to the Many and Diverse Risks Found in Retirement

By John Cutler



One of the joys of working with the Society of Actuaries is that I have been an active member of the SOA's Committee on Post-Retirement Needs and Risks for several years. (Kudos to Anna Rappaport who encouraged the SOA to address post-retirement issues, leading to the formation of the group and who has been chairing it for years.)

This last year I served as chairperson for the Project Oversight Group for the committee's call for essays on the topic of diverse risks and the strategies people use in retirement to handle them. While a great deal of information is available about the challenges caused by these risks, there are major gaps in knowledge and actions to address them. These issues have become much more complex as the retirement system has focused more on DC plans. The goal of the essay contest was to explore the kinds of solutions that might be available to address those risks and to encourage more focus on dealing with risks in a DC environment. The use of DC plans makes it easy to overlook many of the risks.

This issue of *Pension Section News* wraps up the publication of the essays accepted in the fall of 2015 after the committee first issued the call. They have been published in three issues of *Pension Section News*, and this completes the publication. To restate, the three major topic areas were: (1) defined contribution plan risk management strategies; (2) decumulation strategies for retirement; and (3) long-term care financing.

In October 2016, at the 2016 SOA Annual Meeting & Exhibit, the committee hosted three sessions to bring these essays to the wider actuarial community as well as get some reactions to the suggestions found in the essays.

For me, there were two overall impressions from the annual meeting. First, was on how many essays centered on the topic of decumulation. Some focused on what people should be doing. Others focused on employer-sponsored benefit programs.

The second impression is that the notion of bringing these essays to the annual meeting was a success. By that I mean the authors and the members of our committee got as much from the audience as we gave to them in terms of information. In the last session—which otherwise stood between our audience and their flights home—we had an engaging debate about what happens to social programs (Medicaid for instance) in all this talk about retirement planning.

IMPRESSIONS FROM THE OTHER SESSION MODERATORS

Carol Bogosian (Session on The Big Picture of Risk Management in a DC World)

The audience was able to obtain ideas for DC plans such as designing DC plans better for “humans,” regulatory needs to

allow better optimization of DC plans and thought processes individuals can use to aid them in their path to a better retirement outcome.

Cindy Levering (Session on Decumulation Strategies for Retirement)

I think the audience liked that these essays contained not only rigorous actuarial analysis and survey results but also practical ideas and tools that the average person could relate to. In particular, the worksheets developed by Chuck Yanikoski for determining which assets to liquidate are accessible to a broad group of retirees who may not have access to an advisor. Steve Vernon's chart comparing various retirement income generators can be used to create logical approach to designing a decumulation strategy. Elizabeth Bauer offered some thought-provoking public policy ideas to promote annuitization.

Andrea Sellars (Session on Important Issues in Risk Management: Public Policy and Longevity Risk, Long-Term Care, and Retirement Age)

Evan Inglis' prize winning essay "The 'Feel Free' Retirement Spending Strategy" drew several questions around the level of assets needed to make the strategy effective and how the strategy compares to other spend down strategies used in the

market, e.g., the 4 Percent Rule and the Required Minimum Distribution. One other question from the audience that stood out involved John Turner's longevity proposal and the fact that a public/private long-term care solution will need to be integrated with Medicaid and Medicaid eligibility.

Publication of the essays is just one step. They contain many ideas that can be developed further and are a platform for action. We hope that all of the readers will look at the essays and take action or contact the authors, as they see fit. Thanks, again, to all those on the diverse risks committee! ■

For all the essays, go to <https://www.soa.org/News-and-Publications/Publications/Essays/2016-diverse-risk-essays.aspx>.

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John Cutler, J.D., is a senior fellow at the National Academy of Social Insurance as well as special adviser to the Women's Institute for a Secure Retirement (WISER). He is also a consultant since retiring from the federal government in 2015 and has several clients involved in LTC/LTSS reform efforts. He can be reached at johncutler@yahoo.com.

Interview with John Cutler



John Cutler

Tell us a little about yourself

I'm an attorney who has mostly practiced law in what one would call the public policy arena. Having said that, my career also included creation of the Federal Long Term Care Insurance Program so I've certainly enjoyed being in the thick of actually creating something concrete.

What attracted you to the Essay Contest?

This essay contest shows the value of the Committee on Post-Retirement Needs and Risks (CPRNR). The essays can cut across topic areas. Mine, for instance, combined my knowledge and interest in long-term care (LTC) financing with retirement. Most of my peers in the LTC world separate this out but I have come to believe LTC financing is really best viewed as a subset of the way people approach their needs in older age/retirement.

What steps, if any, would help make the ideas in your essay a reality?

Since I work in the policy arena, I naturally tend to look toward a solution that comes from the states or the national government. Having said that, retirement policy is by and large something people and organizations (banks and investment firms for instance, not to mention financial advisors) deal with all the time. But the government has to be involved to "allow" these great ideas to come to market. (Also, government is needed to step in when people and/or organizations go too far.)

What else would you like to tell us?

A few years ago, I published a paper for a previous Call for Papers for the CPRNR. The idea behind that one was basically "what if we have a retirement crisis and no one comes?" Just because we all recognize the age wave is no guarantee policymakers will. In fact, inertia usually works well for those in Congress and the administration if the alternative is to rile everyone yet have no credible solution. So how does that relate to us? What it means to me is that our charge is to create the private products and public solutions that policymakers can take off the shelf and use when the right time comes along. ■

News Flash: Retirement Takes Over Long-Term Care

By John Cutler

Protecting oneself in older age from risks is the sine qua non of retirement planning. But far too many people don't approach retirement (or retirement planning) well. From a policy perspective, we know about half the senior population will have some sort of long-term care event or need that meets the government's Health Insurance Portability and Accountability Act (HIPAA) definition of severity. And one in six (14 percent) will see serious use of long-term care services (like over five years).

The way to protect against the financial burden for this varies. The main way is for people to self-insure, drawing down what they have saved and invested. Others see their house as their best tool for converting wealth to long-term care financing. Both have limitations we won't dwell on here. Some others go into continuing care retirement communities (CCRCs). But too few think of this as a real solution (though it is nice to see the housing component included and not just the medical side). Still others use life insurance ... if they have enough and it is structured to be tapped for long-term care. Another not so good solution.

What an actuary or policymaker would say is that what's really needed is protection designed solely for the long-term care risk. And there it is. Along came long-term care (LTC) insurance.

Unfortunately, LTC insurance as a stand-alone product is not working. In addition to near systemic pricing uncertainty, there is resistance from buyers. The best scenario, in fact, is that only one-third of the public will buy the product. So yet another solution that wasn't, as it turned out.

And it is not as if the long-term care insurance carriers have not tried to alter the glide path of these products. My take is that carriers have responded to the perceived lack of value by going in two different directions. One is to create shorter/cheaper insurance in the hopes more people will buy it. That probably is not going to work if people think it is too cheap a solution. Why bother to buy what amounts to a piece of paper saying you are protected when you really aren't for a substantial long-term care event?

The other direction carriers have taken is to enhance the product. Here the idea is to meet the value needs of the buying public by tying the LTC insurance to annuity and life products. While the cost is higher, the perceived value is greater—at least in theory. These are not truly new products and the merger of the two product lines just for the appearance of adding value for consumers does not represent new or creative thinking about how to really increase the market. My guess is that after an initial flurry of sales, this market will be just as small as stand-alone products.

As an aside, there aren't many successful ideas coming out of the advocacy/policymaking universe either. The Community Living Assistance Services and Support (CLASS) Act was essentially employer-based disability/long-term care insurance. The Federal Long Term Care Insurance Program (FLTCIP) experience is that employer-based insurance without a premium subsidy has a take-up rate of about 6 percent. Since I was the architect of this program, I'm quite happy to say it is a long-term care insurance success, with over 270,000 enrollees. However, as a policymaker myself, this is NOT a policy success.

SHIFT TO RETIREMENT PRODUCTS

We need to recognize that long-term care risk is a component not just of aging but of retirement. Placing the solutions in the retirement space is critical to reaching the bulk of the population. I believe a retirement focus is the next likely arena for long-term care (aka, long-term services and supports or LTSS) reform. In the retirement policy world, the concept of annuitization of retirement is the current "big" idea. Combined with the additional element—recognition of risk—this would be both a powerful protection but also a natural one for individuals to understand.

One particularly exciting idea is to tap into IRAs and 401(k) products for long-term care. For IRAs, tapping into these funds is currently allowed as a penalty-free event only in case of a permanent disability. It makes sense for this to be extended to LTC as well. What is interesting is that the cost to the federal government should be essentially neutral since these products are already tax-protected. Going further, one can see changing the regulatory structure around 401(k) products so the funds can be treated as a retirement risk protection account (an idea proposed by, among others, Anna Rappaport of the Society of Actuaries). The funds could be used to purchase a variety of options including lifetime income, supplemental health insurance and/or long-term care protection. It should be noted the Treasury Department issued regulations on longevity annuities last year, yet another indication of this interest in melding retirement and long-term planning.

A related idea here would be to standardize annuities as was done with Medicare supplement insurance. Jeffrey Brown et al.¹ recently wrote that many policymakers would consider the optimal choice in retirement to be a decumulation strategy based

on annuitizing large sums of assets. Yet people do not know or trust annuities: They would rather keep what they have. (In social science parlance, they have a strong bias in favor of the pre-existing default.) Having a few core standard annuity products offered via a regulated private market at a distinct age (like Medigap is at 65) might better focus consumer interest.

SOCIAL SECURITY

With all the concern over Social Security solvency it might be odd to suggest changes here to add long-term care protection. But if you look at work by Nancy Altman and others, this concern about Social Security is somewhat misplaced.² One idea that might help long-term care coverage within the Social Security context is what Bing Chen (then at Boston University) proposed in 2007.³

Chen's idea was to create a Social Security/long-term care plan by trading off a small portion of Social Security benefits that would provide a basic level of long-term care protection via social insurance as a base. Supplemental private long-term care insurance would be added on top. (Of note, he exempted low earners from the trade-off, relying on Medicaid as the safety net for them.) The importance of this approach is that it augments social insurance with private insurance by combining several sources of funds that currently exist in both the private and public realms.

It is probably obvious to many in this field that most policymakers undervalue private insurance. But, at its core, private long-term care insurance is not just an insurance mechanism (like Social Security); it also has the strength of holding/moving money over time and gaining the power of compound investment. Social Security for all its strengths does not do this. Social Security is a pay-as-you-go program and does not rely on the time value of money. Instead it relies on the power of taxing everyone. By combining the two concepts, you get the strength of each.

ROLE OF MEDICARE

Another approach that merits interest lies in enhancing Medicare, though one does not normally think of this as a retirement product. But given Medicare's role, along with Social Security, in protecting against the financial risk or ruin for seniors, it has to be on the table. It is an artificial divide to say Medicare is health insurance and not recognize its financial importance. When Medicare was passed, more than one in four seniors were in poverty. That has been cut dramatically. Along with Social Security increases, Medicare has reduced that number to more like only one in 10 seniors.

That means a part of any retirement calculation is reliance on one's health care by Medicare. (And for poorer people, the dual eligibility for Medicaid as well.) Technically, Medicare really only covers short spells (up to 100 days) for post-acute care. Yet one surprising development over the last couple decades is how much

is going to skilled nursing facilities (SNF) and home health, what most people would think of as long-term care. Coverage has risen from just 3 percent in 1988 to more like 18 percent of the total Medicare budget in 2011. This does not count drug coverage, which is more important to an SNF or home health user than to a healthy 65-year-old. It does not take much to imagine we are seeing Medicare becoming that "short and fat" program which many advocates had sought as a long-term care reform proposal.

NEXT STEPS

For those of us toiling away in the long-term care universe, this potential shift to retirement thinking is something for the researcher in all of us to watch. But the policymaker and advocate would be more active: Discrete ideas always attract attention. The CLASS Act is an example; love it or hate it, you had to pay attention to it. Product designs could (should) be created around the idea of better accessing 401(k) and IRAs for long-term care. Also, a standardized annuity suite of products could be structured (including longevity annuities).

Further design work on Chen's idea of adding LTC to Social Security is also an obvious idea, particularly in how private insurance can enhance Social Security with the addition of private financing and the power of investments. Design work on how one could alter Medicare's structure is also called for. Augmenting skilled nursing facility and home health care makes more sense than continuing to restrict the program to its origins as post-acute coverage.

This is the time to broach those topics and put new ideas on the table. ■

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ENDNOTES

- 1 Jeffrey Brown et al., "Are Cognitive Constraints a Barrier to Annuitization?" Boston College's Center for Retirement Research Issue Brief no. 15-6 (March 2015).
- 2 See Nancy Altman and Eric Kingson, *Social Security Works! Why Social Security Isn't Going Broke and How Expanding It Will Help Us All* (New York: New Press, 2015).
- 3 Yung-Ping "Bing" Chen, "A Trade-Off Proposal for Funding Long-Term Care," Georgetown University Long-Term Care Financing Project (June 2007).

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Interview with Karl Polzer



Karl Polzer

Tell us a little about yourself.

I have worked as a policy analyst, researcher, and advocate in Washington, D.C. for more than 25 years and continue to work as a consultant. Most of my activity has been in health and long term care policy. I have worked for CMS, the National Health Policy Forum at the George Washington University and for the American Health Care Association/National Center for Assisted Living. I also have co-chaired the Long Term Care Discussion Group for the past five years. Recently, I began researching economic inequality in the United States and exploring ways that we can enhance financial security and economic inclusion for all Americans.

What attracted you to the Essay Contest?

In researching an article for a previous SOA monograph called “Managing the Impact of Long-Term Care Needs and Expense on Retirement Security,” I became concerned that such a large percentage of Americans have little or no retirement savings. At the same time, I happened to be researching growing economic inequality and wealth concentration in the larger U.S. economy.

My essay explores how the emerging U.S. defined contribution system may be contributing to disparities in wealth in several ways. For example, people with higher incomes are more likely to have jobs that offer retirement savings plans and more able to contribute to them. People with higher incomes also receive a larger tax break for contributions. I also explore how those with more capital are more able to take investment risk that may end up yielding far higher returns over the long term. Finally, I propose that the United States establish a universal retirement savings system along the lines of those in Australia or the United Kingdom.

What steps, if any, would help make the ideas in your essay a reality?

Establishing an inclusive national retirement savings and investment system is a huge undertaking and would require increased awareness of the financial risk facing so many Americans and involvement of senior policymakers and key interest groups. The recent focus on income and wealth inequality by the president and in the elections could create an opportunity for this issue to gain momentum.

What groups would need to be involved?

Establishing a universal, or near-universal, retirement savings and investment system would involve a large number of groups including policymakers, employers, financial companies and advisors, and non-profits such as philanthropies. Such a system would make sure that everyone in the workforce would have a defined contribution plan operated by a fiduciary organization (unless they chose to opt out). Ideally, government tax subsidies would be more progressive and calibrated to better meet the needs of lower- to middle-wage workers.

While establishing a universal system would be extremely difficult, there are some hopeful signs. Several states already are moving in this direction and there has been growing discussion at the federal level. For example, a Bipartisan Policy Center commission looking into how to improve retirement security and stabilize Social Security recently proposed setting up a near-universal retirement savings system. (See: <http://bipartisanpolicy.org/library/retirement-security/>.) On the Hill, Rep. Joseph Crowley (D-NY) is providing leadership and has proposed legislation that would move toward a universal system by requiring employers of 10 or more that don't offer retirement plans to establish and help fund individual retirement accounts for employees. Proposals such as this need to be evaluated and refined.

What else would you like to tell us?

I have enjoyed collaborating with the Society of Actuaries on these two projects, which I think have made important contributions to research and have helped policymakers come up with ideas for change. ■

How the American Retirement Savings System Magnifies Wealth Inequality

By Karl Polzer

Economic inequality and wealth concentration have emerged as central issues in the U.S. presidential race. While these concerns appear to have risen to the forefront quite suddenly, forces driving wealth concentration have been building for decades. As more analysts probe the dynamics beneath these once-dormant issues in various policy areas, they may find that America's continuing shift to a defined contribution (DC) retirement system is playing a role in increasing the concentration of wealth.

While the DC system has many merits, it currently creates significant barriers to entry for many people at the lower end of the economic spectrum and those entering the workforce. About one-third of Americans report having no retirement savings at all.¹ More than half of households with DC accounts have very little in them. Among households with DC savings, the median balance in 2013 was \$4,700 for those in the lowest quartile by net worth. The median balance was \$12,100 for those in the next quartile (with net worth of 25 percent to 49.9 percent), almost 40 times less than median balance for those in the top 10 percent. A similar pattern can be seen comparing balances by family income (see Table 1).

Among the factors contributing to the difference in account balances between those at the top and the bottom is that people higher up the economic scale are more likely to have access to a retirement plan at work. People with low incomes wanting to start an IRA outside the workplace face barriers including minimum account balance requirements and high fees.

People with more income put more money into their retirement accounts—so they start from a larger base. By granting tax-favored status to retirement contributions, U.S. policy widens this base somewhat more as people's tax rates rise. The more you make, the bigger your tax break.

Table 1
Median Combined IRA, Defined Contribution Retirement Plan Balances for Families with Such Accounts, 2010 and 2013

	2010	2013
Total	\$47,155	\$59,000
Family Income		
\$10,000–\$24,999	\$12,860	\$10,300
\$25,000–\$49,999	\$18,219	\$18,000
\$50,000–\$99,999	\$34,294	\$45,000
\$100,000 or more	\$168,257	\$171,000
Age of Head of Household		
35-44	\$33,223	\$42,700
45-54	\$64,302	\$87,000
55-64	\$107,170	\$104,000
65 or older	\$76,091	\$118,000
Net Worth Percentile		
Bottom 25%	\$5,359	\$4,700
25-49.9%	\$12,806	\$12,100
50-74.9%	\$43,940	\$52,000
75-89.9%	\$144,680	\$165,000
Top 10%	\$442,612	\$450,000

Source: Employee Benefit Research Institute estimates of 2010 and 2013 Survey of Consumer Finances. Income and asset values are in 2013 USD. For families with incomes <\$10,000, sample size was not sufficient for reliable estimates.

One of the most powerful drivers of what may be a widening gap between balances over time is how individuals invest their DC savings. Greater tolerance for investment risk can mean much higher return over time. Stocks compared to bonds and cash, for example, tend to generate significantly higher returns

over long periods of time, though greater fluctuations can make them riskier in the short run. Therefore, it stands to reason that young people should put a greater percentage in their retirement accounts in stocks since they have an investment time window of many decades. But data show they tend to do otherwise. As seen in

Table 2
Asset Allocation Distribution of 401(k) Participant Account Balance to Equity Funds, by Participant Age, Tenure or Salary (Percentage of Participants, 2012)

Percentage of Account Balance Invested in Equity Funds				
	Zero	1%–20%	>20%–80%	>80%
All	51.2%	6.2%	27.4%	15.0%
Age Group				
20s	68.8%	2.9%	17.1%	11.2%
30s	53.0%	5.0%	26.0%	15.9%
40s	46.2%	6.1%	30.2%	17.5%
50s	46.2%	7.7%	31.6%	14.6%
60s	51.1%	8.4%	28.0%	12.5%
Tenure (years)				
0–2	66.7%	2.7%	19.0%	11.6%
>2–5	59.5%	4.2%	23.0%	13.3%
>5–10	50.2%	6.1%	28.6%	15.2%
>10–20	40.5%	8.1%	33.9%	17.5%
>20–30	37.4%	10.6%	35.6%	16.4%
>30	41.0%	12.1%	33.0%	14.0%
Salary				
\$20,000–\$40,000	61.3%	5.4%	23.2%	10.2%
>\$40,000–\$60,000	51.4%	7.5%	29.3%	11.8%
>\$60,000–\$80,000	44.3%	8.5%	33.9%	13.3%
>\$80,000–\$100,000	38.6%	9.3%	37.9%	14.1%
>\$100,000	30.8%	10.1%	43.0%	16.2%

Note: Row percentages may not add to 100% because of rounding. “Equity funds” include mutual funds, bank collective trusts, life insurance separate accounts and any pooled investment product primarily invested inequities. The tenure variable is generally years working at current employ, and thus may overstate years of participation in the 401(k) plan.

Source: Tabulations from EBRI/ICI Participant-Directed Retirement Plan Data Collection Project. Reprinted by permission.

Table 2, 401(k) participants in their 20s are more likely to invest none of their money in stocks compared with older workers. People with lower incomes tend to be similarly risk averse.

People on tight budgets or who are starting out in the work force may have relatively less tolerance for investment risk because they have little capital that they can afford to lose. By necessity, they may perceive a high likelihood of having to draw on funds available for retirement savings for more immediate purposes arising in the event of a job loss, the need for pay for education or the need to make an alternative investment, like a down payment on a house. This is only common sense but differences in long-term rates of return can greatly magnify or diminish retirement account balances over time.

Table 3 illustrates how different levels of risk tolerance can widen the gap between levels of wealth by comparing balances begun by setting aside 10 percent of the income of a worker making \$10,000 a year with the same percentage set aside from the salary of a worker making \$100,000. In this example, the

lower-paid person is assumed to have a 10 percent tax rate and the higher-paid worker a 30 percent tax rate, and they are assumed to re-channel half their respective tax savings back into their retirement funds. Using this assumption, the tax break increases the original differential between account balances a little, moving it from 10-1 to 11-1.

As long as the two accounts earn the same return on investment (ROI), the proportional difference between balances will remain at 11-1 over time. But differences in ROI can change the balance differential dramatically. For example, if the higher-income worker invests in a fund that averages 10 percent ROI annually and the lower-paid worker's account makes 5 percent, then balance differentials generated from the original investment will increase from 11 times to 28 times after 20 years, 44 times after 30 years, 70 times after 40 years and 112 times after 50 years (as shown in Table 3). Balance differentials are far greater if the lower-paid worker's account makes only 3 percent, rising to 152 times after 40 years and 293 times after 50 years.

Table 3
Growth of Retirement Funds Invested by Low- and Higher-Wage Workers, Compared at Different Rates of Return

		Amount Invested	Growth in Balance				ROI
Income	Tax Rate	10% of Salary Plus Half of Tax Savings	20 Years	30 Years	40 Years	50 Years	
\$10,000	10%	\$1,050	\$2,786	\$4,538	\$7,392	\$12,041	at 5% ROI
			\$7,064	\$18,322	\$47,522	\$123,260	at 10% ROI
\$100,000	30%	\$11,500	\$30,513	\$49,702	\$80,960	\$131,875	at 5% ROI
			\$77,366	\$200,668	\$520,481	\$1,349,995	at 10% ROI
How Many Times Greater is One Account Balance Than the Other? (10 = 10 times)							
10 times (before tax break effect)		11 times	11	11	11	11	at 5% ROI
			11	11	11	11	at 10% ROI
			28	44	70	112	\$10K earner at 5%, \$100K earner at 10%
			41	79	152	293	\$10K at 3%, \$100K at 10%
			4.3	2.7	1.7	1.1	\$10K at 10%, \$100K at 5%

The myRA accounts now being organized by the federal government for people who don't have access to retirement plans channel invested money into derivatives of government-issued bonds guaranteeing an ROI near the rate of inflation. While myRAs may serve a valuable purpose in giving young people a way to accumulate seed capital in a stable environment, investment professionals might argue that they are a questionable choice of long-term investment for people in this age group because of the very low ROI. Something like a myRA, however, could make more sense for the very old living primarily on fixed incomes seeking to protect small accounts from inflation and sudden market fluctuations, especially if it could deliver a somewhat higher yield along with a stream of income protected from inflation.

If the risk-taking behavior is reversed in the above example, the wealth gap closes. If the higher-paid person puts her \$11,500 in a conservative fund earning 5 percent and the lower-paid person puts his \$1,050 in a higher-risk fund that averages 10 percent ROI, then the 11-1 differential diminishes to just over 4 to 1 in 20 years and to almost 3 to 1 in 30 years. The wealth gap virtually disappears after 50 years.

Risk tolerance involves the relationship between what a person has in assets compared to what they can afford to lose. In preparing a report for the Society of Actuaries' 2014 Annual Meeting & Exhibit,² I began developing the equation below to illustrate how retirees' need for funds to meet the basic expenses of living may constrain their ability to tolerate investment risk.

$$\text{Relative Investment Risk} = \frac{\text{What I need}}{\text{What I have} - \$\$ \text{ Risked}}$$

or, when underlying concepts are expanded:

$$\text{Relative Investment Risk} = \frac{\text{Expenses Exceeding Secure Income} * \text{Expected Years of Life}}{\text{Investable Assets} - \text{Maximum Potential Loss of } \$\$ \text{ Invested}}$$

Figures 1 and 2 use this equation to illustrate the variance in investment risk tolerance for retirees deciding how to invest funds in a retirement account depending on a number of factors. Scale is arbitrary and for illustrative purposes only. In this model, the more that expenses exceed secure income such as Social Security (the numerator),

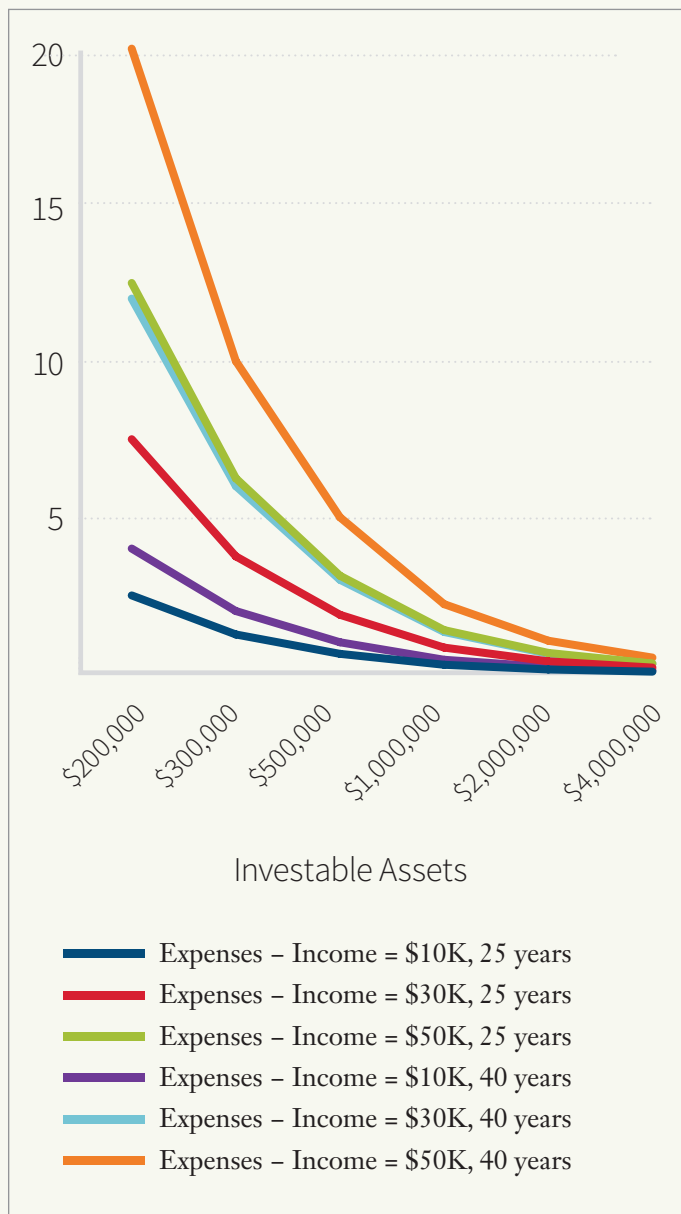
Figure 1
Retiree's Relative Investment Risk: The Higher the Value, the Greater the Perceived Risk (\$100K Investment, 25 Years of Expected Life)



the greater the risk. The greater the difference between total investable assets and total potential losses (the denominator), the less the risk. The more years of expected life, the greater the risk.

The DC system magnifies wealth inequality through differences in individual risk tolerance and returns on investment. This contrasts with the disappearing defined benefit system, in which fiduciaries and institutional investors³ manage pooled assets on behalf of all plan participants.⁴ It also differs

Figure 2
 Retiree's Relative Investment Risk: The Higher the Value,
 the Greater the Perceived Risk (\$100K Investment, 25 &
 40 Years of Expected Life)



fundamentally from the Social Security program, which is somewhat progressive⁵ in structure.⁶

The DC retirement system's tendency to concentrate wealth parallels the rising income and wealth inequality in the United States, which has been documented and analyzed by economists including Joseph Stiglitz,⁷ Thomas Piketty,⁸ Emmanuel Saez⁹ and others,

as well as recent U.S. Federal Reserve survey data.¹⁰ Piketty makes the general case that if the rate of return on capital is greater than the growth rate of a nation's economy, then wealth will tend to concentrate at the top of the economic spectrum. Growing awareness of this phenomenon has raised many concerns. Without shifts in policy, greater concentration of wealth could lead to a smaller middle class; higher levels of poverty; greater pressure for spending to meet the needs of the elderly, disabled and poor; constrained aggregate demand for goods and services; and less capacity to raise tax revenue.

To gain insight into why people who begin with more capital have higher rates of return, Piketty examined available data on the financial performance of university endowments in the United States and found that returns increase rapidly with the size of the endowment. Portfolios of all sizes endowments were highly diversified. However, the larger endowments were far more likely to use "alternative investment strategies," including higher-yield strategies such as including shares in private equity funds, unlisted foreign stocks, hedge funds, derivatives, real estate and raw materials, and other relatively high-risk options. He notes these kinds of investments require sophisticated expert advice that is costly and may not be available to smaller portfolio managers.¹¹

Building on Piketty's insights, this paper suggests that differences in rates of return may result, not only from inability to afford the best investment advice. Lower rates of return can naturally result from the lower risk tolerance of a potential investor who cannot afford to lose savings that may be needed for survival.

In theory, the DC system, pinioned on a base of Social Security, could offer all workers an opportunity to share in the benefits of a free-market economy. For this to become reality, however, would require major changes. These include getting all Americans started in the retirement system at an early age and invested in options that provide the best long-term chance of financial security.

In the United States, many ideas have been advanced to help reduce wealth inequality that could be applied to the DC system. The Urban Institute, for example, recently included "establishing automatic savings in retirement plans" and "matched savings such as universal children's savings accounts" in a list "promising policies to shrink wealth inequality and racial wealth gaps."¹² Other proposals in the United States include setting up automatic IRAs;¹³ setting up and funding "seed accounts" for newborns;¹⁴ and setting up and funding "starter IRAs" while providing hands-on financial education for young people to prepare them to navigate the DC retirement system.¹⁵

Some states and cities are experimenting with models for universal accounts geared at saving for college and promoting long-term financial inclusion. In Oklahoma’s SEED OK experiment, accounts were opened automatically for every child in a treatment group. A small initial deposit was made and held in state 529 college savings accounts and financial education was provided. Versions of this type of approach have been implemented in Singapore, Canada, Korea, the United Kingdom as well as Maine, Nevada, Connecticut and Rhode Island. In the Oklahoma program, only one family chose not to participate and initial deposits grew by more than 40 percent over seven years, despite initial losses during the Great Recession, according to a recently published evaluation.¹⁶

Many of the United States’ trading partners offer models for near-universal savings and retirement systems. Under the Pensions Act of 2008, Great Britain is setting up a system in which workers must opt-out of retirement savings plans, rather than opt-in. The United Kingdom also has created the National Employment Savings Trust (NEST) to serve those who do not have an employer pension; NEST will function as a low-fee pension scheme in competition with existing institutions and funds. Features of the new system include automatic enrollment, mandated contributions and a choice of diversified investment funds, including those based on a person’s age.¹⁷ Australia’s “superannuation” system requires employers to contribute a percentage of employees’ income into diversified retirement funds managed by trustees.¹⁸ By 1999, 97 percent of Australia’s full-time employees and 76 percent of part-time employees were covered by the superannuation system. Over the years, Australia has increased required contributions and continued to refine the system, which has been credited with raising levels of capital accumulation and improving retirement security.¹⁹

In conclusion, increasing inequality, wealth concentration and economic insecurity have emerged as major issues in the United States and most other Western nations. The United States’ defined contribution retirement savings system presents a laboratory that may provide some clues about how wealth is concentrating. Unless major policy changes are made, the American retirement savings system is likely to continue leaving a good share of the population without adequate savings and accelerate growing disparities in wealth. ■



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- 4 The defined benefit system, however, has issues of its own. For example, most workers do not have access to these traditional pension plans. Vesting periods and benefit formulas can create major barriers for workers changing jobs frequently.
- 5 Debate continues over whether Social Security is more progressive or regressive in structure (that is, whether the program tends to redistribute funds from the wealthier to the poorer, or vice versa). Progressive characteristics include that Social Security benefits are distributed in a narrower range than individual incomes and asset levels in general. Regressive characteristics include that, unlike the income tax, Social Security tax rates are not adjusted by income and Social Security taxes are not levied on income exceeding a set amount.
- 6 An argument can be advanced that anticipated income from Social Security, which is indexed to keep up with the cost of living, complements the DC system in that its presence allows individuals to take more investment risk. Furthermore, the barriers to entry, risks and inequity inherent in the DC system, could lead policymakers to consider bolstering Social Security benefits for those at the lower end of the economic spectrum (rather than trying to displace Social Security benefits with private accounts, as has been debated in the past).
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- 11 See Piketty, *Capital in the Twenty-First Century*, 447–51.
- 12 See “Nine Charts About Wealth Inequality in America,” Urban Institute, accessed March 15, 2016.
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Interview with Morris Tenenbaum



Morris Tenenbaum

Tell us a little about yourself.

I am a Certified Nursing Home Administrator and have been actively involved in operating long term care facilities for over 40 years. For the past seven years I have served on the Finance Committee of the American Health Care Association. On the state level I am the chairman of the Foundation for Quality Care, a nonprofit entity whose mission is to improve quality of care through education and research. I also sit on the Legislative and Payment Services Committee of the New York State Health Facilities Association.

I have authored numerous articles and papers over the past several years proposing various ways to solve the LTSS health care financing conundrum.

What attracted you to the Essay Contest?

As someone who has been involved for years on LTSS I am intimately familiar about the problem of paying for the ever increasing cost of health care in general and long term services and support in particular but there are very few ideas put forward to address the problem. I believe that society needs to expand their vision

to include existing resources to help solve the payment issue. I thought that the Society of Actuaries would be an ideal forum to present this concept and to stimulate some discussions to help solve the problem outside of reliance upon government.

What steps, if any, would help make the ideas in your essay a reality?

- Actuarially evaluate the soundness of my proposal.
- Pass legislation to develop incentives.

What groups would need to be involved?

Employers, legislators, consumer groups and insurance companies.

What else would you like to tell us?

We need insurance companies to recognize the potential market my suggestion would open up for them. Additionally, we have to create an environment where the consumer, the insurers and government can be assured that long term financial planning is practical and predictable. ■

A Better Public-Private Approach to Resolving LTSS Financing Dilemma— Catastrophic Shared Stop-Loss: Adapting Life Insurance to Meet Long-Term Care Needs

By Morris Tenenbaum

A catastrophic, shared stop-loss program would provide long-term care for a majority of people by allowing participants to tap into life/death insurance benefits before accessing Medicare and Medicaid, thereby extending private coverage longer than current mechanisms do. Participants who reach the common LTC formula (three years of nursing care, six years of home care) would automatically be eligible for coverage, as needed. Death benefits could be used as a loan to avoid taxes and, when the patient dies, insurance would pay off the loan and heirs would still be entitled to the remaining assets.

In the case of the New York State Partnership, which serves as a model, the government is not only reducing its spiraling cost exposure—in 2013–14, the estimated savings to Medicaid was \$34 million, part of a 19 percent annual decrease over the last eight years—but consumers feel secure in knowing they have the coverage they need, no matter what.

THE IMMEDIATE NEED FOR NEW LONG-TERM SERVICES AND SUPPORT FINANCING

The challenge of designing a comprehensive and sustainable long-term services and support (LTSS) system is considerable. The number of Americans who need LTSS is 12 million today, and an estimated 27 million by 2050. While 42 percent of people turning 65 will not use LTSS, 16 percent will spend \$100,000 or more for it. To manage this risk, a reliable insurance mechanism is needed to help pay for these costs.

This rising need occurs against a backdrop of significant fiscal constraints, and levels of assistance and types of services vary widely.

Almost a third of the entire adult population—66 million Americans—are acting as unpaid caregivers for family members. Many are giving up jobs and income and paying out of their own pockets to help. Financial losses can be devastating for all but wealthiest people. Paid caregiving at home or in a facility is very expensive, especially over the long term, for people who rely on Social Security or disability benefits, pensions and retirement savings, and retirees don't have enough resources to pay for LTSS.

Private LTSS is not being utilized because of high costs and confusion about coverage, as well as a focus on more immediate financial demands. Younger consumers have no idea whether to buy long-term health insurance and how much to buy, and insurance companies don't know how much to recommend. Of those in need of LTC, only 7 percent are able to rely on private options. For Americans over 40, 65 percent have little to no planning for living expenses in retirement and only 8.2 million people are covered by private LTSS, representing fewer than 6 percent of Americans over 40. Even people earning more than \$100,000 per year are foregoing LTSS insurance, expecting to rely on Medicaid and possibly transferring assets as the only viable way to pay for long-term care.

Another factor is the sale of long-term care insurance is not sufficiently profitable to carriers. Low interest rates lead to low investment yield, resulting in increasing premiums and much tighter underwriting for new policies. Also, the number of people on claim for four years or more has increased, mostly with older policies, and lapse rates are much lower than expected. People are also using services longer.

Spending for LTSS by Medicaid, the primary LTSS payer, will grow 6 percent annually, faster than GDP. Today individuals typically must exhaust almost all of their savings and spend a substantial portion of their income on health care and LTSS before they qualify for Medicaid.

OBSTACLES TO REFORMS

There are many hurdles to overcome, including fiscal constraints, which are difficult to conquer in a less than vibrant economy. Lawmakers are reluctant to increase spending. Also, partisan disagreement on the role of federal government continues to produce gridlock, and adding to social insurance programs like Medicare is unfeasible in the current climate.

Failure to provide solutions will overwhelm the existing structure, given the inevitable and increasing retirement of the baby boom generation—"the silver tsunami." For the next 18 years, 8,000 people will reach the age of 65 every day.

The vast majority of experts in the field call for a systemic overhaul of long-term care financing but little has been done. The Federal Long-Term Care Commission calls for “a sustainable balance of public and private financing” that (1) “provides the tools and protections to enable Americans to comprehend and better prepare for the financial risk of needing LTSS; and (2) ensures that individuals with limited financial resources or for whom the cost of their care exceeds their financial resources have access to needed high-quality services and supports.”¹

THERE IS A WAY

The first step is to leverage life insurance/death benefits for LTSS by creating dual purpose coverage or “catastrophic shared stop-loss” insurance. Automatic (passive) enrollment minimizes resistance and costs. Medicaid would become the last resort for final coverage.

A program that provides some relief to individuals with catastrophic LTSS costs will generate greater Medicaid savings. New York State data shows that government will save money with this approach, which extends private coverage longer than private mechanisms today.

This is more palatable to fiscally conservative lawmakers and can accelerate death benefit as a loan to avoid taxes. When the patient dies, the loan is paid off by the benefit.

New York State Partnership for Long-Term Care model is currently set up to handle this type of system and is creating significant savings to the state, and it can be replicated in other states. The program lets individuals or couples who purchase a partnership policy to hold onto all or part of their assets (depending on the type of policy they purchase) under the Medicaid program if their long-term care needs extend beyond the period covered. Passive enrollment gives participants a helping hand at the point they need it.

Initial Purchase

The consumer buys catastrophic shared stop-loss insurance for life and/or long-term care. This addresses two major risks— income protection and long-term care costs. Consumers may also convert life insurance. A life insurance supplement of \$100,000, for example, can act as a deductible for elder care, providing \$300,000 long-term care coverage. About 70 percent of American have life insurance.

Stop-loss insurance attracts new customers to **insurance companies** and encourages current policyholders to purchase additional insurance.

The **employer** purchases tax-qualified stop-loss insurance in place of traditional term insurance, which generally offers a death benefit equal to one year’s salary (at no extra cost to the employer).

Today, at least \$50,000 of employee term life insurance is tax-qualified for employers.

Retirement


When the need for life insurance wanes for **retiree policy holders**, the need for long-term care insurance increases. Stop-loss insurance equals consumer choice.

Insurance companies develop and provide pay-out products for older consumers accessing stop-gap insurance, e.g., annuity options designed to protect policyholders.

With dual purpose insurance (DPI) flexibility **every option** can be covered, including individual situations and regional long-term care needs.

Long-Term Care/End of Life Needs

Consumers who need LTC can access funds available through their catastrophic shared stop-gap policy. In today’s market, this is \$160,000, sufficient for many LTC consumers.



The number of Americans who need LTSS is 12 million today, and an estimated 27 million by 2050.

If stop-gap policy funds are exhausted, consumer would be eligible for benefits under the Partnership for Long Term Care, which provides coverage after three years of nursing home care and/or six years of community-based care and/or a combination. This information is based on NYS Partnership projections.

To protect income and assets, rider payment options for consumers can be offered. This is not so with Medicaid today.

Insurance providers are obligated to dispense *only* funds insured by the stop-gap policy. There’s no open-ended commitment to pay unlimited LTC costs of a single-purpose LTC policy. To protect insurance companies from unusual catastrophic losses, there could be a partnership with the government, which financially acts as a reinsurance entity for the existing liability.

Most importantly, stop-gap would greatly reduce the use of Medicaid to pay for long-term care, making more funds available for low income and disabled populations, as well as health care reform initiatives.

Corporations like IBM, or government personnel offices, can negotiate with their respective life insurance companies to provide “whichever comes first” life insurance, with the benefit payment decision to be made at the occurrence.

POSSIBLE LEGISLATION TO SPUR CHANGE

There are steps lawmakers could take to help. They could eliminate potential tax liabilities for accelerating death benefits while the person is alive. Alternatively, the benefit can be taken as a loan and paid in full on death. The partnership program should be federalized as an adjunct to Medicare or another federal entity to ensure portability. Legislation can also be created to allow tax deductions for premiums on life insurance policies that incorporate long-term care accessibility.

As an additional incentive to the insurance industry, the program should offer a rider allowing participants to protect their income as opposed to the current partnership under Medicaid where income is not protected. ■



Morris Tenenbaum has been an LTC provider for 45 years and is currently chairman of the board of the Foundation for Quality Care in New York. He can be reached at MTenenbaum@kingsharbor.com.

ENDNOTES

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Interview with Zenaida Samaniego



Zenaida Samaniego

Tell us a little about yourself.

I worked for over 45 years, most recently as Chief Actuary at the US Department of Labor, Employee Benefits Security Administration, in Washington DC, and prior to that, as a retirement product actuary in New York. I retired four years ago at age 65, but remain actively engaged in my profession where I have volunteered soon after I became a Fellow in 1976. I currently serve on the Society of Actuaries Research Executive Committee, with responsibility for review and oversight of research initiatives and activities that advance practice, policy and societal goals.

What attracted you to the Essay Contest?

I want to share my personal experiences and lessons learned in my early years of retirement to help inform the dialogue regarding the drawdown of retirement assets and associated risks and considerations.

What steps, if any, would help make the ideas in your essay a reality?

Personal financial and health management are key. One can also benefit from selecting and working with trusted health and financial advisors who can help both monitor—and provide professional tips and insights on—personal issues that one can understand and discuss intelligently. There is also a wealth of information and resources that one can research and learn, but there needs to be more accessible knowledge, tools and policy guidance developed for the layman.

What groups would need to be involved?

Community and support groups, professional advisors, policy makers, any spouse or family, among others.

What else would you like to tell us?

I appreciate the opportunity to participate in this discussion and hopefully made some contribution. I believe that forums such as these can go far in exploring real life issues and potential solutions. ■

Diverse Risks and Considerations in Retirement

By Zenaida Samaniego

When I was very young, I wondered what I would be when I grow up. As I got older, I wondered what I would do to prepare for retirement. Now that I am fully retired, I continue to wonder what the future holds.

What I learned so far is that one's life is marked with so many milestones, starting at birth and ending at death. Throughout that time, one experiences varying rates of growth in physical, intellectual, moral, social, financial and other senses of well-being.

Financially speaking, planning starts at birth, even if one relies on others such as family as a major if not sole resource up until young adulthood, whence one begins in earnest to plan for his/her own future.

Financial planning entails saving and spending goals that may be protracted over time, and include secondary education, gainful employment, starting a family, buying a home, child care and education, travel and recreation, health care and retirement.

Enter budgeting. During childhood, one looks to his/her allowance to fund small wants, and for bigger wants, works small jobs if able to supplement said allowance. During the long period from young adulthood to middle age, such wants grow in magnitude and urgency and credit is increasingly used as a budget tool to meet current needs with the promise of steadily growing wages to repay loans. Even then, unless one has sound budgeting and planning, the risks of being overextended, experiencing sudden loss of income or unexpected health costs can be disastrous and untenable.

One is usually well advised to set aside funds not only for a "rainy day," but for a number of special purposes or spending goals. Hence, the concept of saving and investing said funds in buckets, for liquidity as well as earnings and growth commensurate with intermediate and long-term needs, applies not only through one's working life but even in retirement.

For most, retirement means the steady flow of wage income ceases and one must rely instead on income from Social Security, pensions and other distribution from retirement assets that heretofore grew from tax-deferred contributions and earnings but are now being drawn down to meet retirement needs and risks for the rest of life. However, the basic tenets of saving and investment remain, albeit with a different focus.

As a recent retiree, I want to share my personal experiences to date, with focus on some of the key questions and considerations I grapple with when planning the rest of my future in retirement.

ACTIVITIES WHILE RETIRED

How is my health? If healthy, do I continue to work part time or totally quit gainful employment? Depending on what I decide, I can have more income but less time to volunteer and for travel or leisure.

If in poor health, I know that not only will my activities be limited, but my spending needs will most likely be higher and require additional outlay from my retirement savings.

RETIREMENT SPENDING

What are my expected basic expenses in retirement? Depending on my employment status, some or all of my work-related expenses will change, such as commuting, taxes and cost of health coverage. I will also need to make personal provisions for payment of certain of these items, such as income taxes and medical insurance premiums, which previously were automatically withheld from my paycheck. On the other hand, I may expect to incur new or higher expenses from more leisure or volunteer activities. I will also need to examine whether or not my other risk protections are necessary and/or adequate. For example, do I have provisions for inflation effects on my spending levels in the future, particularly the cost of health care? Have I considered my Medicare eligibility and enrolling in same, as well as its impact on my insurance protection for medical, dental and critical care or catastrophic care costs? Do I have insurance protection or provisions for long-term care? Do I have personal insurance to safeguard against homeowner or renter, automobile or other personal property loss? How much if any life insurance coverage do I maintain, such as for bequest purposes, so that I may examine my retirement spending needs realistically? For example, am I being cautious with my spending so I do not outlive my assets, not because I dread not leaving enough to my heirs? Do I have existing debt, such as a home mortgage, car loan or credit cards? Based on the foregoing, I can tally my total insurance premiums, debt amortization, taxes, etc. in addition to my basic spending needs, perhaps adding some provision for discretionary spending as well.

SOURCES OF INCOME

What benefits am I eligible for? For example, depending on the age I claim Social Security retirement benefits, if eligible,

I know that such benefits, otherwise payable at my full normal retirement age, may be actuarially reduced by as much as -25 percent if I choose to claim early at age 62, or increased by as much as +35 percent if deferred to age 70. But first, I ask myself whether my spouse has commenced his Social Security benefits, and further if my claiming for a spouse benefit, which is generally half of my spouse's retirement benefit, fits in with my current spending levels and health considerations. This may help me decide to forego claiming my own retirement benefits until I attain age 70 when they are much higher, thus providing the best form of longevity insurance protection for me.

Medicare is an important source of health protection that provides coverage of the majority but not all of my medical spending. I will also have supplementary insurance coverage for medical and other purposes. I note that Medicare premiums are deducted from my Social Security benefits.

Another source of income is a **defined benefit pension plan**, which consists of a vested pension benefit from one or more of my former employers that may have offered such plans in the past, or more recent benefits that are increasingly made available today, such as a **cash balance plan** and/or a **defined contribution plan (401k, 403b, thrift plan)**, where I have the option to select the timing and form of payment for my plan benefits, as either cash, applied toward an income annuity or a periodic benefit stream payable in my retirement.

Deferred annuities (IRAs, nonqualified) provide another source of current or future income. As with defined contribution plans, IRAs are subject to required minimum distribution (RMD) rules, which means I must distribute a required percentage (per the IRS life table) starting generally in the year I attain age 70 1/2 (or retirement, if later under defined contribution plans).

Investments (bonds, stocks, mutual funds and equity real estate) can generate income from interest, dividends, capital gains, rent and depreciation, etc. For example, where I have reinvested mutual fund earnings in the past, I can choose to receive in cash all future dividends and realized capital gains especially as they are taxed anyway in the year earned.

Savings (bank, CD) constitute my main source of liquid (rainy day) funds and help me better manage the distribution of my aforementioned sources of retirement income.

FINANCIAL CONSIDERATION

How adequate is my retirement paycheck, i.e., my current sources of income to cover my basic spending today, plus a margin for inflation?

Regardless, I will want to review my current spending for reasonableness and potential changes, particularly in connection with planned activities or pursuits at least in the next one to

three years. I may also need to consider ways to increase my income if inadequate now or expected to be in the next year or so. Having backup funds, preferably cash in bank reviewing or short-term investments, worth at least six months of my living expenses, is useful in cases of emergency (e.g., home repair, out-of-pocket health spending and other unexpected but necessary expenditure), as well as to bridge the time gap until I start my RMD and/or Social Security retirement benefit.

If I have investments that automatically reinvest dividends and capital gains, even though they are taxable to me in the year they are earned, I may consider having these distributed to me instead, thus providing additional income or deposits to my cash pool.

What other considerations do I have when reviewing my investment portfolio and/or deciding if/when and how to change my investment fund allocations by short-, immediate- and long-term buckets? For example, as I draw down my short-term bucket for immediate needs, I may want to shift some funds among the other buckets. I will also need to consider when and how I distribute my retirement savings, either to increase my income as needed to cover projected expenses or more importantly, when I have no choice but to start the RMD of my tax-qualified retirement accounts, and pay any taxes that have been previously deferred on said funds.

DECUMULATION

I will want to preserve my tax-qualified funds for last, that is, until my RMD. Until such time, I will first consider my taxable savings, such as bank deposits that constitute my back-up fund.

Next I will look at my other taxable savings held outside my retirement accounts, such as investments in bonds, stocks or mutual funds. If I sell these investments that have shown capital growth since I held them, I will be taxed on such realized capital gains. I will want to sell first any long-term assets, i.e., assets I have owned for more than one year. Capital gains rates are lower than for ordinary income, while short-term capital gains are taxed the same as ordinary income. However, I may also figure in whether my income tax bracket in retirement has dropped significantly from when I worked.

If selling real estate held for investment, long- versus short-term capital gains tax considerations also apply. I will also consider any income that I will forego relative to what I can earn if I invest the sales proceeds elsewhere, or apply such proceeds toward an income annuity, as well as any maintenance costs and tax differentials. Similarly I will need to weigh the costs and benefits if I decide to sell real estate that I occupy as my primary residence, so I can rent instead or move to senior housing. Under certain circumstances, I may look at reverse mortgages as a potential tool but need to understand the use, terms and restrictions of this complex product.

What other disposable assets of value do I have? For example, do I own a car that I no longer need to get around, or personal property that I do not use, and can trade-in for cash equal to its depreciated value? This will save me maintenance costs on fuel and insurance costs. How much life insurance do I need for bequests to my survivors and heirs? Unless my policies are paid up, I may also consider potential income from cash value proceeds as well as savings from reduction of all or part of my costs of insurance.

I may have retirement savings held in nonqualified annuities, for which I made after-tax contributions but tax on income is deferred until these funds are distributed to me. At the time of distribution, I will be taxed on the portion that is constituted by accumulated income earned on such funds.

If I have a 401(k) plan where I made after-tax contributions that I have not rolled over when I separated or retired, and I am one or more years away from my RMD, I can bypass current taxes by rolling over my 401(k) account to a Roth IRA,¹ for the portion attributable to after-tax contributions, and an IRA, for the qualified or tax-deferred portion including accumulated earnings on after-tax contributions. I will need to hold the Roth IRA for at least five years—and past age 59 1/2—after which all withdrawals are income tax free. If I want to consider smoothing my tax payments, I have the option to convert, in kind, said after-tax contributions in my 401(k) plan to a designated Roth 401(k)² within the plan, meaning my earnings will no longer be tax-deferred but currently taxed. The same withdrawal rules for Roth IRAs apply to a designated Roth 401(k).

For RMD purposes, the rules apply to all of my funds held in employer-sponsored retirement plans, including my 401(k) and thrift plans, as well as traditional IRA or IRA-based plans. The first such distribution must occur on April 1 (i) in the year following the calendar year in which I reach age 70 1/2. Subsequent distributions (ii) start on Dec. 31 in the first year following the year I reach age 70 1/2. For defined contribution plans, my required distribution starts generally on the later of (i) or (ii) the year I retire. Such rules state that the entire RMD, not necessarily from any specific retirement account, must be distributed each year over my federally prescribed life expectancy. I can delay the first distribution until the April 1 following the year I reach age 70 1/2, but I must also take RMD by Dec. 31 of that year and each subsequent year.

In a manner of speaking, RMD provides automatic smoothing of my payment of deferred taxes that are now coming due. More

importantly it enables me to smooth out my benefit distribution over my expected lifetime, as opposed to a lump sum distribution where there is a strong temptation to spend unnecessarily and increase my risk of outliving my savings. I need to weigh carefully choosing between immediate cash versus a benefit stream because managing my retirement savings over my lifetime must take priority over what may be impulsive spending today. Thus, I may invest my distribution until needed, or annuitize all or part of it to generate additional income. If I decide to annuitize, I have to make additional decisions on the timing of purchase (e.g., serial), frequency and form of payment—annuity income for a fixed period, life with or without certain period, joint life with percent continuation to survivor, cash refund or guaranteed withdrawal, to name a few.

CONCLUSION

All of the above will need careful consideration and ongoing planning from several perspectives, including tax, legal, health, bequest, etc. which can impact my own retirement. How do I make my money last so I do not outlive my retirement savings? I will also want to make provisions for my spouse or partner, especially after I am gone.

I know that I will continue to have additional questions and lessons to learn. By sharing my approaches, I do not profess that they are correct or appropriate for anyone, including myself, rather I hope I have at the very least raised awareness of what I think are some of the more important issues and concerns in retirement. Thus, I encourage others not only to ask questions and search for answers—there is a lot of information available on the Internet, government websites, and trusted benefit, financial and professional advisers—but also look forward to engaging others in a thoughtful discussion of their experiences and potential ideas for the development of practical tools and solutions. ■



Zenaida Samaniego is an active volunteer in SOA research on retirement and other practice areas. She has been retired a few years from her role as chief actuary, Employee Benefits Security Administration, at the U.S. Department of Labor. Prior to that, she worked in the insurance and financial services industry in New York. She can be reached at babymerc@aol.com.

ENDNOTES

- 1 "Rollovers of After-Tax Contributions in Retirement Plans," Internal Revenue Service, last updated Sept. 2, 2015.
- 2 Ashlea Ebeling, "The In-Plan 401(k) Roth Conversion Strategy," *Forbes*, Jan. 3, 2014.

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Interview with Anna Rappaport



Anna M. Rappaport, FSA, MAAA

Tell us a little about yourself.

I am a phased retiree, and have thought about phased retirement as an advisor to employers and policymakers, and for myself. This is an issue I have been thinking about for more than 20 years. I am age 76 today, still very professionally engaged and I hope to continue. I chair the Committee on Post-Retirement Needs and Risks of the Society of Actuaries. I served as President of the Society of Actuaries in 1997–1998 and completed 50 years as a fellow in 2013. I spent 28 years with Mercer and retired from Mercer in 2004.

I am also an artist and you can find my art work as well as a lot of my writings on www.annarappaport.com.

What attracted you to the Essay Contest?

Since the shift to DC plans, I have been very concerned that there is not adequate risk protection for employees who have only DC plans. I am also very concerned that the retirement ages have not adapted as longevity increased, leaving us with longer and longer periods of retirement. Together these two factors leave the public exposed to more and more risk. The essay contest presented an opportunity to look at these two issues together and to encourage more dialogue around them.

What steps, if any, would help make the ideas in your essay a reality?

My essay identifies a number of things that should happen to improve retirement security for women. Some people think my ideas are impractical, but I think we need to dream big and encourage dialogue about the right ideas.

For these ideas to be adopted, women need to be more involved and aware of retirement issues. In addition, various stakeholders involved with the retirement system can help. First, it will be necessary for us to get recognition of the importance of these ideas. Actuaries as advisors to plan sponsors can play a major role in promoting discussion of these concepts and in implementing the ideas. Some of the ideas from the essay can be implemented by individuals and plan sponsors today without changes in products, law or regulation. Others require such changes.

What groups would need to be involved?

Interested parties include women acting on their own behalf, actuaries, employers sponsoring benefit plans, financial companies offering products, advisors and policymakers.

What else would you like to tell us?

I am very proud of the work of the Committee on Post-Retirement Needs and Risks, and of the many volunteers who make its work possible. We focus on the individual. This essay and a great deal of what I do is informed by the research conducted by the committee. It is focused on the individual and how research works for them. ■

Women and Retirement Risk: What Should Plan Sponsors, Planners, Software Developers and Product Developers Know?

By Anna M. Rappaport

As baby boomers reach retirement age, concern grows that many Americans may not be adequately prepared for retirement. There are special concerns with regard to women in retirement. Women face the same lifetime risks as men: outliving their assets, facing a long-term care event, getting disabled earlier in life, not saving enough, not investing well enough or suffering a loss due to a scam. This raises the issue of why focus on women's issues rather than retirement issues in general. I propose we consider women's needs because they have different life paths leading to greater challenges for them later in life.

THE DIFFERENCES BY GENDER

- There are many reasons for the differences in retirement experiences.
- Women live longer and the population at the highest ages is primarily female.
- A high percentage of older women are widows and some spend many years as widows.
- Women are likely to be alone in old age whether never married, widowed or divorced.
- Overall, women have fewer years of paid work and lower career earnings.
- In the allocation of family responsibility, women often assume more responsibility at home and for caregiving at many life stages.
- Women are more likely to need help with activities of daily living later in life.

- Women are less likely to have a family caregiver.
- On a societal basis, women experience higher long-term care costs.
- Mothers are the first line of help for children and are extremely devoted to their children.
- Many women have trouble thinking about their needs first (or at the same time) when others have needs, with the result that their needs become secondary or may even be forgotten for long periods of time.

LESSONS LEARNED FROM RETIREES

The Society of Actuaries Committee on Post-Retirement Needs and Risks (CPRNR) recently conducted focus groups with financially resource-constrained retirees retired more than 15 years and with retirees who were more recently retired. Focus groups were conducted separately by gender. The CPRNR has also surveyed retirees and near retirees with regard to post-retirement risks every two years starting in 2001. Some of the findings from this work include:

- Gaps in knowledge and misperceptions are very common.
- People commonly deal with things as they happen rather than anticipating and planning for financial shocks.
- Retirees are very resilient and adapt to many unexpected changes and shocks.
- Widows often adapt quite well.
- Divorce after retirement and a major long-term care event cause major financial disruption.
- Some retirees make very large gifts to children when the children lose jobs or experience major problems.
- Dental expenses and home repairs are major items of unexpected expenses for retirees.
- Women are much more likely to be caregivers and to time their retirement because of the caregiving needs of others.
- Women are more concerned about retirement risks.
- Many people have retirement planning horizons that are too short.

HOW ARE RETIREMENT RISKS, NEEDS AFFECTED BY WOMEN'S DIFFERENT EXPERIENCES?

All Americans are faced with some key issues on the road to retirement security. However, women face these risks in a different manner than men.

Outliving their assets

This is a bigger risk for women because they live longer, which requires more assets to support their longer lives. I believe women are more in need of planning to make sure assets last a lifetime. Annuities can be of particular value for them.

Women are also more vulnerable to running out of assets if they are married or in a relationship at retirement because if one partner in a relationship is ill first and funds are spent on their care, that leaves the survivor at risk of not having enough remaining assets for their remaining single lifetime. It is much more common for the female to be the surviving partner.

A strategy worthy of serious consideration is separating assets, so that each partner in a relationship has their own assets.

Not saving enough

It is important to save early, save enough and not use it early for nonretirement purposes. Women who have made decisions to work less so that they can devote more time to family need to think about protecting their financial security. A person who works less in the paid workforce and more as a homemaker is depending on the other person's earnings to generate retirement savings. Most often the woman spends less time in the workforce and does not develop a full career and earnings history during her lifetime.

If a woman is going to depend on a partner's future earnings to build retirement security, then protecting that earnings stream is very important. An earnings stream can be disrupted by premature death and disability. Having adequate life insurance and disability insurance for the working spouse is the best means to assure the earnings stream will be available to the nonworking spouse.

Needing long-term care support in retirement

There is a bigger risk that women will need long-term care and also a greater risk they will not have a family member available to provide it.

Women should give consideration to the purchase of long-term care insurance including products that combine life insurance or annuity benefits with long-term care. Otherwise, if they plan to finance long-term care from savings, a larger amount of savings is needed.

Not investing well

This is a risk for everyone, and there is no easy answer. The employee benefit plan sponsor can help for money saved within a 401(k) plan by offering good investment options and having good default options. The individual may wish to secure professional advice.

Avoiding scams

Scams come in many different forms. It is important to be vigilant and aware of various forms of scams. Vulnerability seems to increase with increasing age.

THE IMPORTANCE OF CHOICES MADE EARLY IN LIFE

Choices made early in life are very likely to affect long-term financial security later on. Career choice can often make a huge difference, as can the commitment to pursue a career. The career and job chosen will have a big impact on benefits and risk protection. Personal choices with regard to spending and saving early also can have a very big long-term impact. Dollars saved early make a big difference later on. Women also often have a choice of pursuing a career or spending much more time raising a family. Even if they work, some women work sporadically or part time rather than pursuing a career that leads to longer-term security. Many people do not focus on the long-term impact of choices when they are young.

PLANNING FOR MONEY IN MARRIAGE AND RELATIONSHIPS

Traditionally, most people married without thinking through in advance the financial arrangements between them. The issues have become more complex as there are more divorces, more second marriages including many with children from prior marriages, and dual career households. Some people enter marriages with assets and/or debts. Family decisions affect the long-term future of both members of the couple. *The New Love Deal*¹ provides advice on structuring financial arrangements in marriage and unmarried partnerships and on structuring the arrangements so that women will not end up with a bad result in divorce or another split-up. The authors are a retired family court judge turned mediator, a family law attorney and a financial writer. Key messages are that it is vitally important to make agreements about money in relationships and think about the long term. Thinking about money needs to start at the time when the relationship becomes a partnership. Women are sometimes asked to sign prenuptial agreements they do not understand. They should never do this. If they bring assets into a relationship, they need to think about how to protect them. They need to think about what is a fair allocation of the assets during the relationship. They also need to think about ensuring money is saved for retirement and debts are not allowed to grow.

It is also important to remember that pension benefits, both defined contribution (DC) and defined benefit (DB), can be split on divorce, but there is no mandate that they be split. They are considered assets and, therefore, it is important to understand their value and recognize their importance. For pension plan assets to be split, the provisions of applicable pension law² must

be followed. Many divorces do not include proper consideration of pension assets.

TRAPS TO AVOID

- **Getting too much into debt.** Credit cards are easy to get and they make it easy to run up debt that is difficult to deal with. Don't overspend and don't run up balances.
- **Giving too much money to children.** Often adult children seek help from parents. Women are particularly vulnerable to giving too much of their assets to children.
- **Giving up a job for caregiving.** It is very tempting to devote one self to caregiving when it is needed, but the cost to the caregiver can be huge. Some of these costs include lost wages, lost retirement savings, extra spending of assets to help others and a loss of one's own health, physical and mental, during the caregiving years. If there is no understanding of the long-term price, this can be a costly decision that results in a bad result for the caregiver.
- **Spending too much on housing.** Housing is the greatest expense for most retirees as well as for many households at all ages. People are often encouraged to buy as much house as they can with the theory that house prices go up. But they can also go down, and real estate taxes can go up. Keeping a large family home in a divorce settlement or staying after the death of the spouse or when children are gone is a common mistake women make. The upkeep and costs of maintaining a residence that is too large for your needs or does not fit with your current lifestyle needs is expensive. Retirees often find the cost of repairs to be a burden.
- **Not understanding family finances.** Often one person pays the bills and handles much of the money. Most often men are the keepers of the family finances. Women must make sure they know what the family finances are and understand the insurance and investments positions even if their partner is primarily handling them.
- **Not having an emergency fund.** When there is no emergency fund, people commonly dip into retirement savings for recurring but irregular expenses and for unexpected expenses. This can easily become a habit. It is better planning to have an emergency fund and to leave retirement funds for the long term.

WHAT EMPLOYEE BENEFITS AND FINANCIAL PRODUCTS ARE HELPFUL

During working years, it is important to build up enough assets for retirement. This means saving enough and including protection so that asset build-up can continue in the event of disability during those years. DB plans, where offered, generally include disability protection of continued retirement savings as well as

pension accumulation, but they only work well for longer-term employees. DC plans offer a vehicle for retirement savings and participation is definitely recommended. It is ideal when the individual can save 12 percent to 15 percent of earnings each year for a long period. Employer-sponsored long-term disability together with Social Security protects earnings in the event of long-term disability, but more needs to be done to continue retirement savings. Such disability coverage usually continues to normal retirement age.

For individuals without access to employee benefits, savings are very important and individual retirement accounts offer access to some tax-preferred retirement savings. Individual disability insurance can also offer protection of income in the event of disability and there may be a rider (an optional add-on to the policy) available to protect retirement savings. There is no general disability protection available to homemakers. There are a wide range of investment options available for savings and that is beyond the scope of this article.

Post-retirement, it is very important to make savings last throughout life, and there are a range of options for doing this. The only method of converting savings to a guaranteed lifetime income is through purchase of a payout life annuity. Social Security payments are guaranteed for life and indexed for inflation. The amount of income provided by Social Security increases if benefits are started at a later age, and starting Social Security later is a very good deal compared to buying an annuity in the marketplace. Delaying Social Security (up to age 70) should be the first method used to increase lifetime income. If more guaranteed income is needed, then an annuity is recommended.

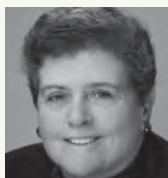
RECOMMENDATIONS: CREATING A BETTER FUTURE

This essay is about some of the challenges facing women. It offers the proposition that women really have different life circumstances which affect their retirement needs. Individuals, actuaries, financial service companies, advisers, plan sponsors and policymakers all have roles in creating a better future.

Steps to a better future include:

- A planning checklist for women; the following is a start:
 - Plan for the long term and don't forget there will probably be a time when you cannot work
 - Balance short- and long-term thinking
 - Understand family resources and what will be there for you in the event of a family breakup
 - Save enough for the long term

- Provide for continued income and asset building in the event of disability
- Provide for the family in the event of the death of income earners
- Be careful about gifts to children
- Do not overuse credit and build up debt
- Evaluate the options if you are asked to be a caregiver, and do not sacrifice your future for others
- Maintain an emergency fund
- Have a plan for dealing with longevity risk; consider using payout annuities
- Have a plan for dealing with long-term care needs; consider using long-term care insurance
- More personal retirement planning by women and emphasize focusing on the long term
- A review of financial planning software in order to produce a list of tools that address women's issues
- Advisers knowledgeable about the issues facing women, and women seeking more unbiased advice
- Benefit plan sponsors including women's retirement issues in their employee education programs and offering retirement advice
- Model financial agreements from an unbiased source that can be used by married and unmarried couples as a starting point for making deals
- Employers establishing more financial wellness programs and including women's issues ■



Anna Rappaport, FSA, MAAA, is a phased retiree and a consultant with Anna Rappaport Consulting. She can be reached at anna.rappaport@gmail.com.

ENDNOTES

- 1 Gemma Allen, Michele Lowrance and Terry Savage, *The New Love Deal: Everything You Must Know Before Marrying, Moving In, or Moving On!* (Chicago: The New Love Deal, 2014).
- 2 The Employee Retirement Income Security Act of 1974, for private pension plans and usually state law for plans covering public sector employees. ERISA provides for the splitting of pension benefits and requires the use of a qualified domestic relations order as part of the divorce. State requirements vary.

Interview with Martin Bauer



Martin Bauer, FSA

Tell us a little about yourself.

I worked for over 45 years, most recently as Chief Actuary at the I am a “recovering actuary.” After having spent about the first 10 years of my professional career as a U.S. pension actuary, I have since slowly but surely drifted towards global benefits topics, both on the retirement and broader health and benefits side. As a result, I am no longer the deep technical expert, but instead very much enjoy witnessing the varied perspectives different countries around the world take on two of the most

important risks facing all people: providing health care coverage and ensuring financial security in retirement.

When not at work, I enjoy spending time with my family. I have three boys whose enjoyment of camping and love of the outdoors I support in my role as scoutmaster of the local Boy Scouts troop. Time permitting, I also enjoy spending time sailing on Lake Michigan.

What attracted you to the Essay Contest?

The question of how to best provide financial security in retirement is a critically important one. As a society, I feel we are still not getting the balance right. Ever since DC plans have come to dominate, employees are burdened not only with having to make all the difficult decisions but also with bearing virtually all the risk. I believe that there should be a better model. Who better than actuaries to provide some creative thinking on this topic?

What steps, if any, would help make the ideas in your essay a reality?

I recognize that my idea is a bit far-fetched relative to current practice. As such, it will require a lot more thinking to distill the key thoughts that have merit and to combine them into a truly viable approach and path forward. To that end, I would want to see more discussion on this topic, with an open mind and broad participation from all impacted groups.

What groups would need to be involved?

As mentioned in my answer to the prior question, I'd want to involve all impacted groups. This means legislators, regulators, the financial services industry (banks and insurance companies), employer representatives, employee representatives, actuaries, risk managers, the whole lot.

What else would you like to tell us?

Let's just keep working on this critical topic. It's too important for all of us and we shouldn't contend ourselves with the status quo. ■

Enhanced Risk Sharing Savings Accounts

By Martin Bauer

Current defined contribution pension plans expose participants to investment risk and longevity risk. Individual account owners are ill equipped to deal with either of these risks.

What is therefore needed, and what this paper is trying to explore, are approaches that attempt to:

1. Maintain the zero risk position for plan sponsors
2. Reduce or eliminate longevity risk
3. Reduce investment risk to the individual participant
4. Maximize retirement income by
 - 4a. Maintaining the upside potential associated with risky assets, and
 - 4b. Minimizing administrative expenses

There is no solution that addresses all five of these objectives perfectly. However, it is clear that current approaches in the context of defined contribution plans fall well short of achieving an acceptable balance. The typical “live off your savings” approach, presented in recommendations such as “consume only your interest earnings” or the “4 percent rule,” completely fails to address some of the above mentioned goals. Annuities, on the other hand, do a near perfect job at addressing goals 1 through 3—but at the expense of goal 4.

This paper introduces the concept of enhanced risk sharing savings accounts (or ERiSSA plans¹). Besides admittedly being chosen to remind the reader of the original goals of the now over 40-year-old Employee Retirement Income Security Act of 1974 (ERISA), in particular the “retirement income security” part that it in the end has fallen so woefully short of, the name is deliberately new (so as to not be confused with existing concepts such as “collective DC plans” in the Netherlands) and is meant to suggest the following elements:

- Risk sharing across account holders
- Individual accounts with individual ownership
- Enhanced features by virtue of combination with deferred annuities to address longevity risk

While much of the concept can apply during the accumulation phase of defined contribution plans as much as during the

decumulation phase, this paper focuses primarily on the decumulation phase to be consistent with the objective of the call for papers.

THE CONCEPT

ERiSSA plans can be described as follows. There are individual (savings) accounts much like in traditional defined contribution accounts. At retirement, however, a small portion of the assets is used to purchase a deferred annuity, likely to age 85 or 90.

The remainder of the assets is invested based on the individual account holder’s preference and risk tolerance. This means there is room for investment in risky assets such as equities.

The difference from traditional defined contribution accounts lies in the approach in which individual accounts are credited with investment returns. Specifically, there is a separate “buffer account” collectively owned by all participants in the plan rather than by any one individual account owner. This buffer account is intended to smooth actual realized investment returns. During years of favorable investment returns, only a portion of those returns are credited to the individual accounts, with the remainder going toward the buffer. Conversely, in years of unfavorable returns, the buffer is available to supplement returns credited to individual accounts. In addition, a one-time “buy in” would likely have to be assessed at the time of joining a fund that would be credited toward the buffer.

The details of what portion of the investment returns flow into the buffer and how the buffer is accessed to subsidize poor investment returns could differ from plan to plan and might be left to the market place to decide. However, a straight-forward example might call for a “central return area,” consisting of a target return (likely equal to something close to the historic average return for similar asset classes) along with more or less symmetrical bands around this target return. For example, a fund that invests in equities could have a central return area of 0 percent to 15 percent, centered around a target return of 7.5 percent. In years in which the actual investment return falls within this central return area, the buffer isn’t impacted at all. No investment earnings flow into the buffer, nor are there any outflows. However, in years in which investment returns exceed the upper end of the central return area, some or all of the excess returns flow into the buffer. Conversely, when actual investment returns fall short of the lower end of the central return area, the buffer is used to at least partially make up for the shortfalls. The intent and expectation is that in most years, the return that is actually achieved will fall within the central return area and will therefore be acceptable to the account holder. More importantly, we expect that over the long run, the return will exceed that of risk-free assets and will do so with an acceptable level of risk.

Further, there can be rules about what to do in case of a very small or very large buffer. A very small buffer might result in the entire

unfavorable investment return hitting the individual accounts (it would have to in the extreme case of the buffer being used up entirely). Conversely, an unusually large buffer might result in additional “bonus” returns being credited to the account.

However, no one individual account owner owns the buffer, nor even a part thereof. When an account owner dies, or withdraws their assets, any contribution to the buffer that could mathematically be attributed to their account stays behind and will serve to assist other members of the plan.

COMPARISON AGAINST GOALS

The following discusses how ERiSSA plans fare against the above mentioned objectives 1 through 4.

Maintain the Zero Risk Position for Plan Sponsors

This one is easy. Employers can rest easy by knowing that the defined contribution status of their plans is not touched. ERiSSA plans don’t oblige them to do anything beyond what they are currently doing. No risk, no higher cost, no adverse accounting implications.

Reduce or Eliminate Longevity Risk

The only practical manner known to the author of how to deal with longevity risk is through insurance. A deferred annuity is comparatively inexpensive yet does a fine job eliminating the potential financial difficulties associated with very long life. Arguably, it deals precisely with the kind of situation insurance is meant for: to deal with the potentially high cost associated with a rare event.

The precise starting point (85 or 90 or maybe even 95) of the deferred annuity is relatively unimportant. It can differ between single men and single women. In cases where a pool of money has to last for the joint lifetimes of a couple, it might be tied to the younger spouse’s age. Either way, the objective is purely to eliminate the financial risk of very long life. A challenge to the insurance industry would be to find more effective ways to deal with the inflation risk so as to ensure that payouts 30 or more years in the future are still meaningful in a variety of inflation scenarios.

Note that while long life is the primary concern when discussing longevity risk, when interpreted as the risk of living for a period of time significantly different than average—longer or shorter—then the risk of dying shortly after benefit commencement has to be taken into account as well. The author is convinced that the concern of “wasting” money when buying a traditional annuity (not one with a certain period) and dying young is at least one hurdle which prevents many consumers from annuitizing their DC accounts. ERiSSA plans maintain the individual account balance aspect of DC plans. In cases of an untimely death, the majority of the assets fall to the deceased’s estate.

Reduce Investment Risk to the Individual Participant

This is the most difficult objective to address in a satisfactory manner. ERiSSA plans are not free of risk. In the most extreme adverse scenarios, the (then nonexistent) buffer does little to protect the individual account holder.

However, the author believes that some residual risk is acceptable if the overall package is more appealing, i.e., if it pushes out the kind of efficient frontier which balances risk and reward.

ERiSSA plans undoubtedly share risk. They are designed to do so by shifting returns between years, i.e., less return in particularly favorable years balanced with higher return in particularly unfavorable years. They are also designed to do so between individuals and between generations. A large buffer built up throughout a period of high returns will likely be available to help future generations throughout periods of low returns. As such, it stands to reason that from an individual perspective, investment risk is reduced, albeit not eliminated.

Maximize Retirement Income

As indicated above, the objective is to maximize retirement income. This is accomplished in a number of ways:

- a. Investment in risky assets—and the corresponding expected higher average returns over the long term—are possible. This means that over the long term, more money is available overall, which means more money goes toward retirement income.
- b. Given the knowledge that an annuity kicks in at some point, the account balance does not have to last beyond a predetermined point in the future. As a result, it is acceptable for the money to be significantly depleted at around that time. Conversely, this means that more money is available for retirement income until that point.
- c. All money—including the buffer—ultimately goes to the account holders. Excess returns that feed the buffer are ultimately used to supplement lower returns and to prop up retirement income at times when particularly needed.
- d. The concept is fairly simple. It does not require a large administrative overhead or any risk charges. In fact, the administrative requirements of the individual account component of ERiSSA plans (as opposed to the deferred annuity aspect) is well within the scope of what fund managers along with 401(k) and IRA providers currently do—for fairly low fees. Low costs translate into higher retirement income.

VARIATIONS

We mentioned above that the specifics of how such arrangements are structured are best left to the market place to determine.

This might mean different smoothing techniques beyond the simple “all or nothing” approach outlined in the central return area shown above. Also, the concept of an initial “buy-in charge” was merely mentioned in passing above. Some charge is needed to build the initial buffer as well as to avoid diluting an already existing buffer by virtue of new joiners. On the other hand, an unrealistically large buy-in charge would discourage individuals from joining in the first place.

Similarly, the use of the buffer could be more sophisticated than a simple “peanut butter” approach for all. For example, account holders who have suffered particularly large losses in the past might get a larger share.

In general, there should also be rules or suggestions around the annual withdrawal amounts. The easiest approach consists of a table that gives percentages by age of the account balance at the beginning of the year, similar to the IRS’ current required minimum withdrawal rules. Such percentages can vary based on deferral age, the targeted annual cost-of-living increase, etc. Alternatively, there could be some further smoothing to attempt to maintain a given level of annual withdrawals for as long as possible.

In reality, providers would likely want to perform extensive modeling as well as consumer research to determine the ideal combination of a nearly endless array of possible parameters. It would be up to some regulator or consumer protection agency to determine what illustrations to require to ensure the fair comparison of alternatives offered in the market place.

Regardless, the principles outlined above should hold true regardless of the specific variation.

AN EXAMPLE AND ANALYSIS

To illustrate the mechanics of ERiSSA plans, let’s contemplate a simple example:

- \$100,000 is invested into an ERiSSA arrangement that invests exclusively in equities. In fact, we assume the equities to mirror the Standard & Poor’s 500 index² with a 25 basis point (bp) fee charged by the provider.
- The decumulation phase starts at age 65, and a deferred annuity to age 85 is purchased. The cost of the annuity is assumed to be 12 percent of the principal.
- A central return area of 0 percent to 14 percent is chosen. Actual returns within that range are credited to the individual accounts without impact to the buffer. Excess returns go straight to the buffer (with no maximum), and shortfalls are compensated by the buffer to the maximum extent possible (even if it means completely depleting it).

- The initial buy-in premium is 10 percent. However, two variations are considered. In one example, the arrangement is completely new and therefore a buffer equal to 11 percent (i.e., 10/90) of the account balances exists. In the other example, the arrangement has been in effect for a while and a buffer has been built up equal to 33 percent of the account balances.
- Returns are credited annually (at the end of the year), and withdrawals are also made annually (at the beginning of the year). Withdrawal amounts equal what could be purchased for the account balance at any given time if investment returns of 7 percent (the target rate) were to be realized for the remainder of the period until age 85—at which point the capital is exhausted.

Tables 1 and 2 show the development of the relevant balances over time under both buffer scenarios. The investment returns assumed are those of the S&P 500 from 1970 to 1990.

The appendix shows the results of the calculations for the 20-year S&P 500 scenarios from 1930–50 through 1990–2010 in 10-year intervals. The development of the annual retirement income under each of these scenarios is shown in Tables 3 and 4 and Figures 1 and 2.

Overall, even in this simple example (real implementations would likely be more complex), the arrangement does a decent job maintaining reasonably steady retirement income that exceeds what would be available from annuities or via the 4 percent rule.

The exception is the 1930–50 scenario, which starts with catastrophic returns of –25 percent, –44 percent and –9 percent, which deplete the buffer and account balances in a manner that cannot be recovered from. This illustrates the unfortunate reality of the residual risk that exists with risky investments.

OPEN QUESTIONS

We recognize that there are some open questions. Specifically, there are potential questions on how the buffer is generated when a product is first launched. There are related questions about the size of a buy-in premium and about portability rules in general. Such questions, however, go beyond the scope of this paper, and are therefore best left for future research and contemplation. ■

Editor’s Note: The appendix to this article can be found online at <https://www.soa.org/Library/Essays/2016/diverse-risk/2016-diverse-risks-essay-bauer.pdf>

ENDNOTES

- 1 The use of the term “plan” to denote ERISA arrangements is a loose one. It is certainly not meant to indicate any specific involvement by an employer. In fact, it is foreseen that most such arrangements would be provided by financial institutions.
- 2 Historical returns for the S&P 500 taken from http://pages.stern.nyu.edu/~adamodar/New_Home_Page/datafile/histretSP.html.



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Table 1
1970–90 Scenario with Small Buffer

BOY Age	BOY Principal	With-drawal Percentage	With-drawal (\$)	Return					Buffer BOY Balance	Buffer In/ (Out)	Buffer EOY Balance
				S&P 500	After Fee	To Acct	To Buffer	To Acct (\$)			
65	79,200	8.82%	6,987	3.56%	3.36%	3.36%	0.00%	2,426.36	8,800	144	8,944
66	74,640	9.04%	6,749	14.22%	14.02%	14.00%	0.02%	9,504.65	8,944	149	9,094
67	77,395	9.29%	7,191	18.76%	18.56%	14.00%	4.56%	9,828.61	9,094	3,342	12,436
68	80,033	9.57%	7,661	-14.31%	-14.51%	0.00%	-14.51%	-	12,436	(10,356)	2,079
69	72,372	9.89%	7,160	-25.90%	-26.10%	-22.71%	-3.39%	(14,810.78)	2,079	(2,079)	-
70	50,401	10.26%	5,172	37.00%	36.80%	14.00%	22.80%	6,332.11	-	10,403	10,403
71	51,561	10.69%	5,510	23.83%	23.63%	14.00%	9.63%	6,447.20	10,403	4,527	14,930
72	52,499	11.18%	5,871	-6.98%	-7.18%	0.00%	-7.18%	-	14,930	(3,255)	11,675
73	46,628	11.77%	5,487	6.51%	6.31%	6.31%	0.00%	2,596.03	11,675	82	11,757
74	43,738	12.46%	5,451	18.52%	18.32%	14.00%	4.32%	5,360.10	11,757	1,731	13,488
75	43,647	13.31%	5,808	31.74%	31.54%	14.00%	17.54%	5,297.43	13,488	6,713	20,200
76	43,136	14.34%	6,188	-4.70%	-4.90%	0.00%	-4.90%	-	20,200	(1,737)	18,464
77	36,949	15.65%	5,783	20.42%	20.22%	14.00%	6.22%	4,363.19	18,464	2,001	20,465
78	35,529	17.34%	6,161	22.34%	22.14%	14.00%	8.14%	4,111.47	20,465	2,449	22,914
79	33,479	19.61%	6,564	6.15%	5.95%	5.95%	0.00%	1,601.43	22,914	54	22,968
80	28,516	22.79%	6,500	31.24%	31.04%	14.00%	17.04%	3,082.30	22,968	3,796	26,763
81	25,099	27.59%	6,925	18.49%	18.29%	14.00%	4.29%	2,544.30	26,763	816	27,579
82	20,718	35.61%	7,378	5.81%	5.61%	5.61%	0.00%	748.36	27,579	27	27,606
83	14,088	51.69%	7,282	16.54%	16.34%	14.00%	2.34%	952.82	27,606	173	27,779
84	7,759	100.00%	7,759	31.48%	31.28%	n/a	n/a	-	27,779	-	27,779

Note: BOY indicates beginning of year; EOY indicates end of year.

Table 2
1970–90 Scenario with Larger Buffer

BOY Age	BOY Principal	With-drawal Percentage	With-drawal (\$)	Return					Buffer BOY Balance	Buffer In/(Out)	Buffer EOY Balance
				S&P 500	After Fee	To Acct	To Buffer	To Acct (\$)			
65	79,200	8.82%	6,987	3.56%	3.36%	3.36%	0.00%	2,426.36	26,400	144	26,544
66	74,640	9.04%	6,749	14.22%	14.02%	14.00%	0.02%	9,504.65	26,544	149	26,694
67	77,395	9.29%	7,191	18.76%	18.56%	14.00%	4.56%	9,828.61	26,694	3,342	30,036
68	80,033	9.57%	7,661	-14.31%	-14.51%	0.00%	-14.51%	-	30,036	(10,356)	19,679
69	72,372	9.89%	7,160	-25.90%	-26.10%	0.00%	-26.10%	-	19,679	(16,890)	2,789
70	65,212	10.26%	6,692	37.00%	36.80%	14.00%	22.80%	8,192.85	2,789	13,460	16,249
71	66,713	10.69%	7,129	23.83%	23.63%	14.00%	9.63%	8,341.76	16,249	5,857	22,106
72	67,926	11.18%	7,596	-6.98%	-7.18%	0.00%	-7.18%	-	22,106	(4,211)	17,895
73	60,330	11.77%	7,099	6.51%	6.31%	6.31%	0.00%	3,358.89	17,895	106	18,001
74	56,590	12.46%	7,053	18.52%	18.32%	14.00%	4.32%	6,935.21	18,001	2,239	20,241
75	56,472	13.31%	7,514	31.74%	31.54%	14.00%	17.54%	6,854.12	20,241	8,685	28,926
76	55,812	14.34%	8,006	-4.70%	-4.90%	0.00%	-4.90%	-	28,926	(2,247)	26,679
77	47,806	15.65%	7,482	20.42%	20.22%	14.00%	6.22%	5,645.35	26,679	2,589	29,268
78	45,969	17.34%	7,972	22.34%	22.14%	14.00%	8.14%	5,319.66	29,268	3,169	32,437
79	43,317	19.61%	8,493	6.15%	5.95%	5.95%	0.00%	2,072.03	32,437	70	32,506
80	36,896	22.79%	8,410	31.24%	31.04%	14.00%	17.04%	3,988.05	32,506	4,911	37,417
81	32,474	27.59%	8,960	18.49%	18.29%	14.00%	4.29%	3,291.97	37,417	1,056	38,473
82	26,806	35.61%	9,546	5.81%	5.61%	5.61%	0.00%	968.27	38,473	35	38,508
83	18,228	51.69%	9,422	16.54%	16.34%	14.00%	2.34%	1,232.82	38,508	224	38,731
84	10,039	100.00%	10,039	31.48%	31.28%	n/a	n/a	-	38,731	-	38,731

Note: BOY indicates beginning of year; EOY indicates end of year.

Table 3
All Scenarios with Small Buffer

Year	1930-50	1940-60	1950-70	1960-80	1970-90	1980-2000	1990-2010
1	6,987	6,987	6,987	6,987	6,987	6,987	6,987
2	5,685	6,530	7,444	6,539	6,749	7,444	6,530
3	2,984	5,425	7,931	6,967	7,191	6,957	6,957
4	2,548	5,780	8,450	6,511	7,661	7,412	6,976
5	2,714	6,158	7,897	6,937	7,160	7,897	7,156
6	2,537	6,561	8,414	7,391	5,172	7,819	6,764
7	2,703	6,990	8,964	7,750	5,510	8,331	7,206
8	2,880	6,533	8,984	7,243	5,871	8,876	7,678
9	2,691	6,411	8,396	7,717	5,487	8,761	8,180
10	2,867	6,321	8,946	7,977	5,451	9,334	8,715
11	2,680	6,734	9,352	7,455	5,808	9,945	9,285
12	2,504	7,175	8,752	7,202	6,188	9,294	8,678
13	2,341	7,644	9,325	7,673	5,783	9,902	8,110
14	2,494	8,144	8,715	8,175	6,161	9,929	7,580
15	2,657	7,612	9,285	7,640	6,564	10,186	8,075
16	2,831	8,110	9,893	7,140	6,500	9,627	8,343
17	3,016	8,640	10,373	7,607	6,925	10,257	8,158
18	2,819	8,659	9,695	8,105	7,378	10,928	8,691
19	2,766	8,093	10,329	7,575	7,282	11,643	8,552
20	2,727	8,622	10,677	7,526	7,759	12,404	7,992
Avg.	3,071	7,156	8,940	7,406	6,479	9,197	7,831

Table 4
All Scenarios with Large Buffer

Year	1930-50	1940-60	1950-70	1960-80	1970-90	1980-2000	1990-2010
1	6,987	6,987	6,987	6,987	6,987	6,987	6,987
2	6,530	6,530	7,444	6,539	6,749	7,444	6,530
3	4,195	6,103	7,931	6,967	7,191	6,957	6,957
4	3,582	6,502	8,450	6,511	7,661	7,412	6,976
5	3,816	6,927	7,897	6,937	7,160	7,897	7,156
6	3,566	7,380	8,414	7,391	6,692	7,819	6,764
7	3,799	7,863	8,964	7,750	7,129	8,331	7,206
8	4,048	7,349	8,984	7,243	7,596	8,876	7,678
9	3,783	7,211	8,396	7,717	7,099	8,761	8,180
10	4,031	7,110	8,946	7,977	7,053	9,334	8,715
11	3,767	7,575	9,352	7,455	7,514	9,945	9,285
12	3,521	8,071	8,752	7,202	8,006	9,294	8,678
13	3,290	8,599	9,325	7,673	7,482	9,902	8,110
14	3,506	9,162	8,715	8,175	7,972	9,929	7,580
15	3,735	8,562	9,285	7,640	8,493	10,186	8,075
16	3,979	9,122	9,893	7,140	8,410	9,627	8,343
17	4,240	9,719	10,373	7,607	8,960	10,257	8,158
18	3,962	9,741	9,695	8,105	9,546	10,928	8,691
19	3,888	9,104	10,329	7,575	9,422	11,643	8,552
20	3,834	9,699	10,677	7,526	10,039	12,404	7,992
Avg.	4,103	7,966	8,940	7,406	7,858	9,197	7,831

Figure 1
All Scenarios with Small Buffer

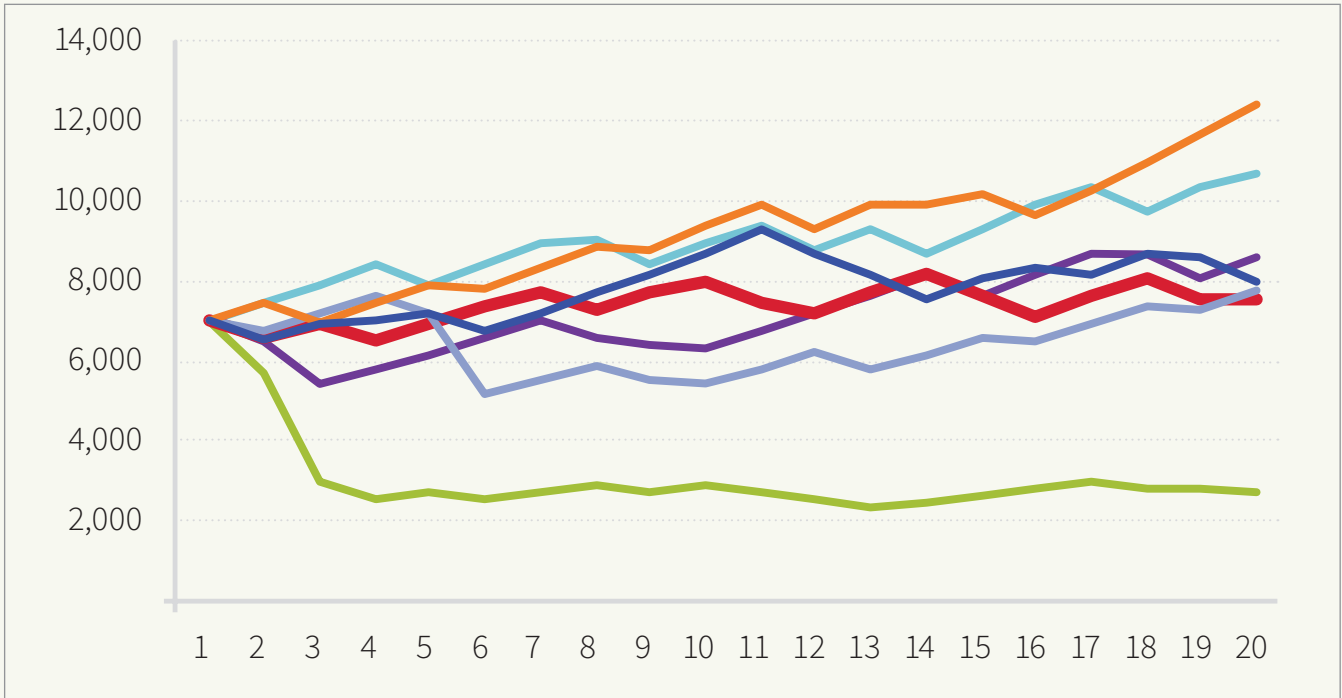
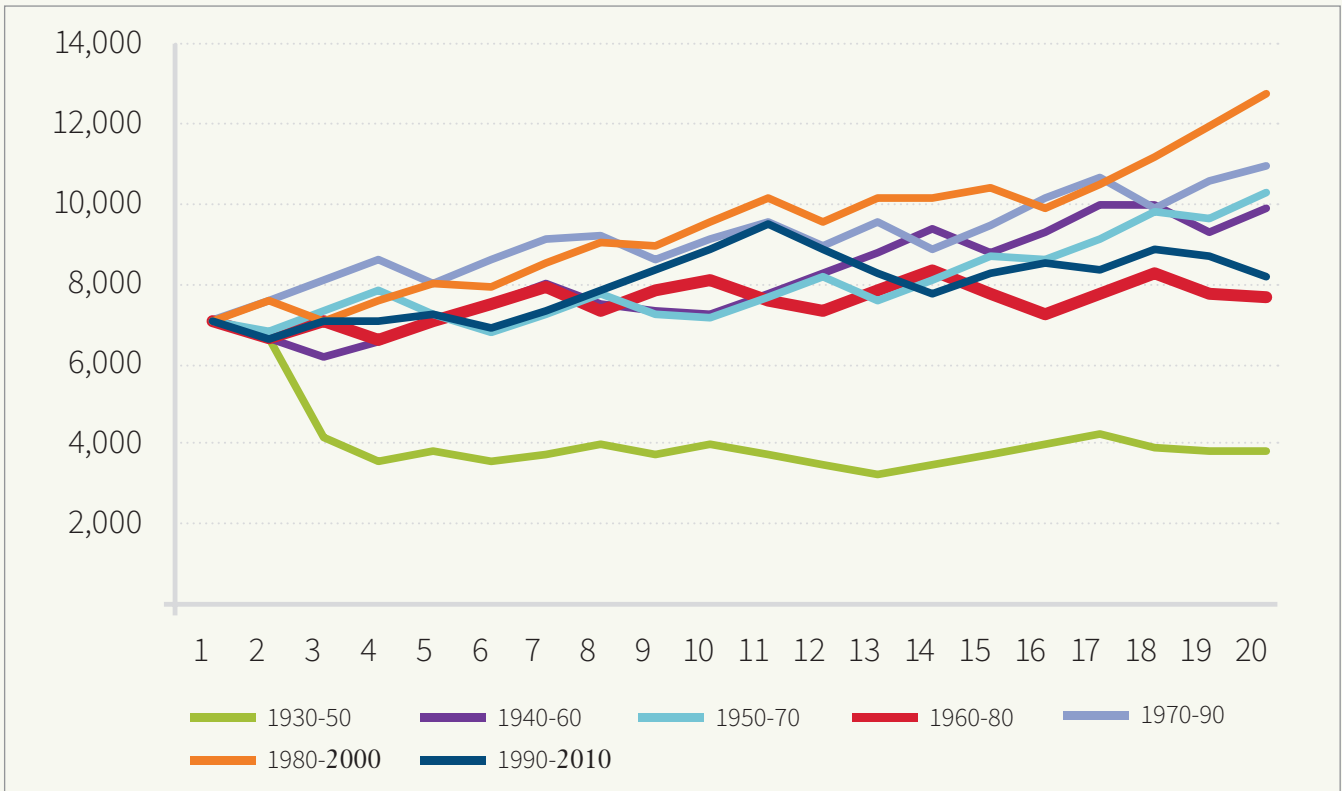


Figure 2
All Scenarios with Large Buffer



Interview with Charles S. Yanikowski

Tell us a little about yourself.

I first became interested in retirement in 1980, when my dad asked me at age 62 whether he could afford to retire then. I did what I could without benefit of software, and advised him to hang in there until he was 65. This worked out well for him, but the real lesson for me was that even most people who are smart and mathematically inclined (my dad was a mechanical engineer with numerous patents to his credit) are clueless about retirement finances. For that matter, so was the financial industry (and by the way, it pretty much still is). Eventually I reoriented my entire career toward contributing to solutions in this field.

What attracted you to the Essay Contest?

As I began to ease into my own semi-retirement last year, I realized that I had a couple potentially practical ideas that I had never done anything with in my own retirement software business. The essay contest presented a fine opportunity to put those ideas into the public arena, where perhaps someone else could use them—or maybe they would inspire even better ideas from someone else.

What steps, if any, would help make the ideas in your essay a reality?

My essay describes a manual approach to a difficult subject. Software could be developed that would do the same thing in a way that was simultaneously more sophisticated in its decision-making process and less difficult for the individual consumer to use. I am beyond the point in my own career where I want to develop this kind of product on spec, but I would be happy to consult with anyone who wanted to pursue it—or equally happy to see them run with it on their own.

What groups would need to be involved?

There are four kinds of groups that have a big stake in sound re-retirement planning by consumers: financial companies that want to sell financial products, financial advisers who want to sell financial services, employers and employment-related groups (such as pension funds, professional organizations and unions) that are interested in the welfare of their employees or members, and organizations of consumers that consider the financial welfare of their members to be part of their mission. Any or all of these could justifiably pursue such a project.

What else would you like to tell us?

I wish to state clearly, for the record, that I consider the ideas in my essays to be in the public domain once they are published by the Society of Actuaries, and I disclaim any ownership or other entitlement if some other person or entity chooses to use them either in their current form or in some other form. ■

Dealing with Multiple Post-Retirement Risks in the Middle Market

By Charles S. Yanikoski

Retirees face many financial risks, some of them related to the intrinsic uncertainty of investment, others to health, economic or family issues that are largely unpredictable, still others to financial and lifestyle choices whose consequences cannot be clearly foreseen. Dealing with any one of these can be daunting, but the larger problem is that most older Americans currently lack a clear path for dealing with all of them as a totality.

NARROWING THE FOCUS

This is not a problem for everyone. Retirees who are wealthy—or merely “affluent” but wise enough to manage their resources at all prudently—rarely need to worry about impoverishment from retirement risks. Nonetheless, many of them choose to insure against some such risks because they want to reduce the odds of substantial financial losses to themselves or their dependents or heirs, or to assure peace of mind among that circle of potential beneficiaries. But these are usually nice-to-haves, not must-haves, for the affluent/wealthy.

At the opposite end of the spectrum, low and low-middle income folks generally can’t afford to insure against *any* of these risks. In that respect, sadly, their lack of options makes their strategy fairly simple: Be smart consumers and take advantage of whatever benefits or other revenue opportunities they might have. Meanwhile, they may be able to ameliorate their financial risks by other means—usually by relying on family, friends, churches, charities and/or government agencies.

The hardest decisions, therefore, generally apply to the middle and upper middle financial classes, who are the focus of this essay. They have, or could have (if they can be economical) enough resources either to insure against only *some* risks or to insure *in part* against *all* risks.

THREE WAYS TO ADDRESS RISK

But let’s take a step back before investigating that particular choice. People can address risk in three ways: by purchasing insurance products, by self-insuring and by reducing

their exposure. (They can also ignore risk, but that isn’t exactly “addressing” it, though it can be a rational response sometimes.)

Purchasing Insurance Products

Purchasing products such as life insurance, annuities, health insurance, long-term care insurance, investment return guarantees of various kinds, or products that offer some combination of these benefits is generally *not* a plausible stand-alone solution for people in our middle-income group, for two reasons. First, some risks are not insurable, such as, for example, the loss of pension or Social Security benefits, or financial stress caused by a divorce. Second, even where insurance or guarantees are available, middle income people generally cannot afford to buy into all of them.

Given these limitations, furthermore, it is necessarily the case that for any given risk for which they do purchase insurance, they are expending assets that could instead be used to help cover other contingencies. That is, *every choice for a middle or upper-middle income person or household to purchase a financial product to reduce a specific retirement risk entails a trade off: reducing exposure to that risk at the cost of increasing exposure to other risks.*

Self-Insurance

Self-insurance is one way to eliminate that problem. This strategy involves a conscious decision to “insure” against risks by applying most or all of one’s financial resources on the universal risk reducer we call “wealth.” Wealth (whether in the form of cash, savings, investments, home equity or other assets), especially wealth that is fungible (liquid, or able to be liquidated without risk of significant loss), can be used to deal with, or at least help deal with, any financial adversity. Having wealth rather than individual insurance arrangements against one or more risks means that you are insured (in this case, self-insured) against all risks, not just one or a few risks. You are even “insured” against risks that you cannot buy financial products to cover.

This is a tremendous advantage, but it also comes with disadvantages: (1) it is less effective against many individual risks than financial products designed to defend specifically against those risks; and (2) for a middle income family, a particularly bad outcome in even one of the 15 risk categories could wipe out the household’s wealth, and therefore leave them completely exposed to future contingencies of all kinds.

Reducing Exposure to Risk

This approach can help defend against specific risks, and often also can increase wealth, and therefore directly or indirectly help defend against all risks. Reducing exposure is achieved in a number of ways, most prominently, by

- Being more economical in one’s lifestyle, which, for example, reduces the risk of living too long because it becomes less

expensive to do so, and enhances one’s ability to increase or at least preserve wealth already accumulated.

- Looking for opportunities for additional income.
- Making shrewd trade-offs in forced decisions (such as Social Security claiming, or the choice of a defined benefit plan retirement option).
- Making prudent financial decisions in other areas.
- Choosing a healthier lifestyle, which can have a mixed effect: reducing medical expenses and perhaps extending one’s ability to earn money, but also increasing the risk of “living too long.”
- Strengthening social relationships, thereby providing personal or community networks that can provide help in times of need and reduce out-of-pocket costs when adversity does arise.
- Adjusting attitudes—mainly accepting certain “adverse” outcomes as tolerable: for example, agreeing to end up in a Medicaid-paid nursing home, if the need arises, even if it means you have to share a room with someone you don’t know.

Such choices, as already noted, are often the only options for the poor or near-poor, but they can be of financial benefit to everyone. Still, on their own they can rarely reduce every risk to an acceptable level.

These three strategies—insurance products, self-insurance through personal wealth and risk reduction—complement one another, and together they should be able to make a significant difference in improving the lives of people of retirement age.

OPTIMIZING THESE STRATEGIES

But how, exactly, can this work? Specifically, in any given personal or family situation, how can the combination of these strategies be optimized (or, to use a more appropriate term, managed most prudently)?

Clearly, a sophisticated decision-making model would be desirable. A model that enabled people to make the most prudent possible decisions would need to take into account both detailed financial calculations and the emotional impact of choosing to leave certain risks uncovered or only partly covered. No such tool exists.

However, we can put together a high-level template for creating such a model—or a non-automated and simplified version of such a model—by identifying the key questions to be asked and the order in which this should be done. This would give retirees a basis for better decision-making, which would not only help them financially but also improve their peace of mind (as well as that of their children, or others who worry about them).

People who are permanent living companions should, of course, pursue such a process together, or else separately but with a follow-up discussion. Where choices have financial or caregiving

implications for children or other heirs, it can be sensitive and sensible to bring them into the discussion as well.

Step 1. Assessment of Financial Risk Exposure

What risks do you *not* have to worry about because

- They don’t apply to you?
- Their likelihood is negligibly small in your case?
- Their financial impact would be negligible (either very small, or offset by other financial consequences)?
- You would not care (or care much) about the consequences?

For each risk you *do* have to worry about,

- What nonfinancial steps can be taken to reduce the risk (or reduce the impact of the consequences)?
- What is the remaining range of financial or other personal consequences (best case to worst case)?
- How high is the risk of consequences at the top, middle and bottom of that range?
- How important is it for you to find a solution for each level of the range of consequences?

Step 2. Financial Risk Abatement Capacity

What portion of your wealth do you need to set aside to cover your normal expenses?

- Start by estimating future income from all sources other than liquidating your wealth, and subtracting the projected expenses until life expectancy, or ideally at least five years beyond that. Assume a normal conservative rate of return on savings.
- Include inflation on expenses but also expected decreases in many expenses in old age.
- Important: Consider different levels of lifestyle, and costs associated with them: ideal, current, reduced but still doable without high levels of sacrifice, and minimal acceptable.

Make a preliminary decision on how much wealth to set aside for financial risk abatement.

- At each of the four levels of lifestyle listed immediately above, how much (if any) wealth do you have left over for risk abatement?
- At each level of lifestyle, how does the level of pain (if any) suggested by that standard of living compare to the level of pain that arises from the risks still present after Step 2 above? Take into account,
 - The probability of future risks, which by definition is less than 100 percent, compared to a reduction in lifestyle, which is virtually 100 percent certain, if you opt for it.
 - The possibility of more than one risk turning into a reality.

- What ability you have to adapt comfortably to a simpler lifestyle, or maybe even prefer it, once you get accustomed to it.
- Decide what living standard represents the best balance between reduction in lifestyle and reduced exposure to future harm. This is an important preliminary pointer to your most prudent risk strategy.

People can address risk in three ways: by purchasing insurance products, by self-insuring and by reducing their exposure.

Step 3. Assessing Financial Products for Risk Abatement

For which risks that concern you could you obtain insurance?

- For which risks does some kind of insurance exist?
- Can you qualify for it?
- What does it cost?

Is a financial risk abatement product a good choice?

- What is the most important risk you are exposed to for which you could purchase complete or partial insurance?
- If you made that purchase, how much would it cost in terms of wealth reduction (short term and long term)?
- How much would that wealth reduction reduce your ability to cover other risks?
- If reducing the exposure to this one risk is more important to you than any resulting reduction in ability to cope with other risks, then such a purchase is a sensible choice for you. Otherwise, it probably is not.
- Make a similar assessment for other risks that you care about and that you could also purchase insurance against. It might be worth paying to insure even a minor risk if the cost is small enough.
- If more than one insurance product or guarantee passes this test, then assume a commitment to the product that seems the most compelling. Then repeat Step 3 to evaluate whether any additional purchases still make sense. If so, pursue as many of these as continue to make sense.

Step 4. Reality Test

- Are you comfortable with the implications of this plan, taking into account,
- The possible financial consequences of any risks you are still exposed to?
- The possibility of multiple risks turning into reality for you or your family?
- Any ongoing stress that exposure to these risks might involve?
- Any reduction in standard of living you will experience?

If not, return to the beginning and re-evaluate, taking the sources of this discomfort into account.

ADVANTAGES OF THIS APPROACH

A Holistic Approach

Most discussions of (and most tools and products for) dealing with post-retirement risks address only one risk, and rarely more than two or three. Single-risk approaches are valuable in determining how to alleviate a given risk but do not provide prudent advice about whether alleviating that risk is actually a good idea. Such an evaluation is possible only in the context of weighing the relative importance of all risks and the consumer's financial ability to cope with them.

Mind over Math

Risk management has important mathematical components, but fundamentally it is about something that is not mathematical at all: an individual's happiness. Risk matters to us because, if certain events occur, we expect them to make us unhappy (or to make others whom we care about unhappy). There is no mathematical way to measure the unhappiness that future contingencies might create, or to weigh those against the present and future unhappiness created by the costs of protecting oneself against those contingencies. People's attitudes toward death, illness, financial security, uncertainty, deferred gratification, the welfare of dependents and toward money itself, are complex, amorphous, highly individual and changeable over time. Risk abatement that ignores these issues produces results that may be mathematically defensible, but that are in no way truly adequate to the problem.

Preserving Wealth as "Universal Insurance"

While single-risk approaches, when competently devised and presented, do help people cope with individual risks, they also can encourage people of modest means to leave themselves overly exposed to a variety of other risks. As noted earlier, for many people, retaining assets that can be turned into cash protects against virtually all risks simultaneously. The proposed methodology respects this reality, while leaving open the possibility or even likelihood that action against certain specific risks is warranted.

ENHANCING THE MODEL

A fully developed and at least partially automated version of this model might include

A mathematical evaluation of the magnitude (financial impact and likelihood) of each significant risk as it applies to a particular individual or family, and of the cost of ameliorating it, as well as combinations of risks that tend to offset one another (most obviously, but not exclusively, the risk of dying too young vs. the risk of living too long).

Additional help for consumers trying to understand what the

risks mean, their likelihood, their consequences and potential nonfinancial ways of ameliorating them.

Perhaps some weighting strategy to help balance the immediate financial costs, the long-term financial costs, and the psychological pluses and minuses of each alternative—supplemented by an easy way for the consumer to override any such evaluations. ■



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Understanding Reverse Mortgages: An Interview with Shelley Giordano

SOA research has shown that non-financial assets are the biggest part of retirement assets for many middle American families. The largest part of non-financial assets by far are home values. Housing is the largest item of spending for older Americans, and housing costs vary greatly by geographic area and type of housing. Reverse mortgages offer a way to use some of the value of the home while still living in it. The SOA post-retirement risk research has indicated that few retirees are taking into account home values in their retirement planning. The 2015 focus groups indicated low interest in reverse mortgages. People thinking about planning have been asking the question: how do we take housing values into account in retirement planning? What are the options? How do we evaluate them? This interview with Shelley Giordano provides information about reverse mortgages and how they are being used today.

Can you tell us a little bit about yourself and the Funding Longevity Task Force?

Yes, thank you, I always welcome the chance to brag a little about the task force. After 15 years of experience in various aspects of reverse mortgage lending, and thanks to Torrey Larsen, CEO of Synergy1 Lending, I had the chance to invite a group of distinguished academicians to meet together to see what could be done about improving understanding of reverse mortgages. So in 2012, they took the leap, flew to San Diego, and just sat around a table to discuss their emerging interest in the role of housing wealth in retirement. It was becoming clear that in a DC world, where many people are poised to be underfunded in retirement, cash flow was going to be a problem. While just about every retiree has a home, there was a dearth of serious research on how the home could be monetized. This group of respected thinkers catalyzed an accelerating interest in research that measures how the home asset can positively impact a retirement plan. The members and I volunteer our time. Our core group includes Marguerita Cheng, CFP®, Thomas C. B. Davison MA, PhD, CFP, Wade D. Pfau, PhD, CFA, Barry H. Sacks, PhD, JD, John Salter, PhD, CFP®, AIFA®, and Sandra Timmermann, Ed.D.

Recently, the task force aligned with the American College of Financial Services. Associate Professor of Retirement Income and Co-Director of the New York Life Center for Retirement Income

Jamie Hopkins, JD, MBA, and I were privileged to hold our first joint meeting at MIT with Dr. Deborah Lucas, Sloan Distinguished Professor at the Golub Center for Finance and Policy.

Our stated mission is to develop and advance, for retirees and their financial advisors, a “rational and objective understanding of the role that housing wealth can play in prudent planning for retirement income.” Before 2012, the comments in the financial press, and even the pronouncements of the Financial Industry Regulatory Authority (FINRA), about the use of housing wealth as part of retirement income were not based on any serious quantitative analysis. Instead, these comments were rather “off-hand,” and consistently propagated a conventional wisdom that the use of housing wealth as part of retirement income planning should only be a “last resort.”

In 2012, two significant research papers were published and a well-respected blog was written, all demonstrating *quantitatively* that, for a sizable number of retirees, the conventional wisdom was incorrect. Indeed, for many of those retirees, their financial well-being would potentially be adversely affected by treating housing wealth as a last resort. An objective and rational approach, i.e., the quantitative analysis, used in the research revealed that housing wealth should be considered early in their retirement years and not as a last resort.

The potential to help improve retirements affects a significant number of people. We estimate that those most likely to benefit from this approach, known in the financial planning community as the “mass affluent,” total between 10 million and 15 million households, of the approximately 75 million “Baby Boomers.”

How important is home equity as a retirement resource? Why is it often invisible in the retirement planning process?

Well, first of all, as Dr. Robert C. Merton, Nobel Laureate in Economics and Distinguished Professor at MIT, is fond of saying, the house is an EXISTING asset. Nothing new needs to be created, people have spent their lives building wealth by paying down their mortgages but now have a financial asset that is only realized at their death.

Retirees have built a retirement pie of Social Security, qualified plans, savings, perhaps long term insurance, but when it comes time to retire, 65 percent of their wealth, which is bound up in their homes, is just flat out ignored. For some, it is like trying to retire on 35 percent of their wealth. That may be okay for wealthy people but leaves most retirees dangerously short.

We have to admit that the reluctance to use home equity has some cultural basis, but is probably more influenced by the bad reputation reverse mortgage lending suffers. Although much has been done to improve consumer safeguards, most recently with the Reverse Mortgage Stabilization Act of 2013, there is

Generally, a reverse mortgage is appropriate for those who are fairly certain they will stay in the home for as long as possible.

widespread misinformation that hampers greater uptake. Sadly, financial advisors are often times even less aware of the features of reverse mortgages than their clients who see TV commercials. Financial advisors do not get paid on initiating a reverse mortgage, their compliance officers often forbid a conversation about home equity at all, and financial planning software does not yet include reverse mortgage payments, much less illustrate sophisticated strategies. A homeowner cannot expect an enthusiastic, or even particularly informed, reception from most advisers when seeking advice on how to release equity from the home.

What are the key features of common reverse mortgages? What are the common differences in products?

Around 95 percent of all reverse mortgages in the United States are Home Equity Conversion Mortgages, or HECMs, and are insured by FHA. There is a small market for jumbo mortgages for very expensive homes. But what all reverse mortgages share is a nonrecourse feature. This means that regardless of what the loan balances become, the house stands as the sole collateral. Even if the house is underwater, no deficiency judgment may ever be taken against the borrower or his heirs. This is the crucial safeguard for retirees but shockingly, even some financial advisers continue to believe that the “bank gets the house.” This is simply not true, and has not been true since President Reagan and the 100th Congress provided for modern reverse mortgage lending with the 1987 Housing and Community Development Act. Clients can choose between fixed or variable rates, trade higher interest rate margins for lender credits on closing costs (resulting in a somewhat lower initial credit capacity), or choose in some cases to limit their first year distribution in order to reduce the FHA mortgage insurance premium from 2.5 percent to .5 percent. Regardless of what structure they choose, these safeguards are inviolate:

1. The borrower never relinquishes title. The bank does not “get the house.” Just like any mortgaged home, the house will pass to the heirs. The heirs can pay off the mortgage or sell the house and keep the remaining equity.

2. The borrower never owes more than the house is worth. Every borrower is assessed FHA mortgage insurance premiums (MIP) that protect the borrower, as well as the lender, if the house value is underwater at loan’s end. In fact, no deficiency judgment may be taken against the borrower or his or her heirs.

3. The borrower never has to move even if he or she no longer has access to more credit. Even if the HECM loan balance exceeds the home value and/or there is no remaining new credit available, the loan is in effect as long as one member of the couple remains in the home as a principal residence and homeowner obligations such as tax and insurance are met.

4. The borrower never has to make a payment on the principal or the interest until the last one remaining dies, moves or sells. Voluntary payments are accepted but never required. Some reverse mortgage strategies include paying down the loan balance when the portfolio regains value. It may be advisable to make voluntary payments on the interest early in retirement, if convenient, in order to restrain the buildup on the load balance from tacked-on interest. Compounding interest accumulation may not have as much impact later in retirement when life expectancy is shorter and home values are likely to be higher, but managing interest in early retirement years may be a prudent strategy. FHA does not impose a prepayment penalty.

Note that all homeowner obligations must be met, such as tax, insurance and maintenance, during the life of the loan, as will any other mortgage.
Source: The 4 Nevers. (2000). Giordano

The initial credit capacity is based on the younger borrower’s age, the current interest rate environment, and the housing value. A rough guide is 50 percent (for the minimum age of 62) and reaches as high as 75 percent of home value at today’s rates, but only to the current FHA lending limit of \$636, 150. Higher home values are accepted but for purposes of calculating credit the lending limit represents the highest initial credit calculation possible. Current mortgages are allowed at time of application as long as the reverse mortgage (plus other funds if needed) extinguishes the lien/s at closing. Borrowers must attend third party independent counseling before a loan may be originated.

Normally, interest accumulates and for the HECM is based on the one year or one month Libor. Upfront insurance (MIP) is either .5 percent for 60 percent or less initial utilization, or 2.5

percent if greater amounts are drawn at closing. The ongoing MIP accrues at the annual rate of 1.25 percent and is assessed on current loan balance monthly. The loan may be prepaid at any time without a prepayment penalty.

How can reverse mortgages be used? What are the principal strategies? Are reverse mortgages used much to generate more regular monthly income?

Reverse mortgages can be set up as an annuity on the house, known as a tenure payment option. This provides a monthly paycheck that will continue until the last borrower dies, moves or sells. The advantage to this payment, besides meeting cash flow needs, is that since funds from a reverse mortgage are not taxable, the tax equivalent withdrawal from a qualified account is avoided. In other words, not having to draw from an account that needs to accommodate taxes can significantly reduce early depletion of precious portfolio assets.

The HECM can be used to convert a traditional mortgage with monthly principal and interest payments into a mortgage without mandatory debt service. In addition, very few people are aware that a HECM can be used to actually purchase a new home. This allows retirees to move to a more appropriate

housing without the need for monthly payments or dipping into savings in order to avoid a monthly mortgage payments.

Recently we discovered that the HECM product could be used in two different scenarios to restore equivalent housing to both sides in a gray divorce! This is an option divorce lawyers need to learn.

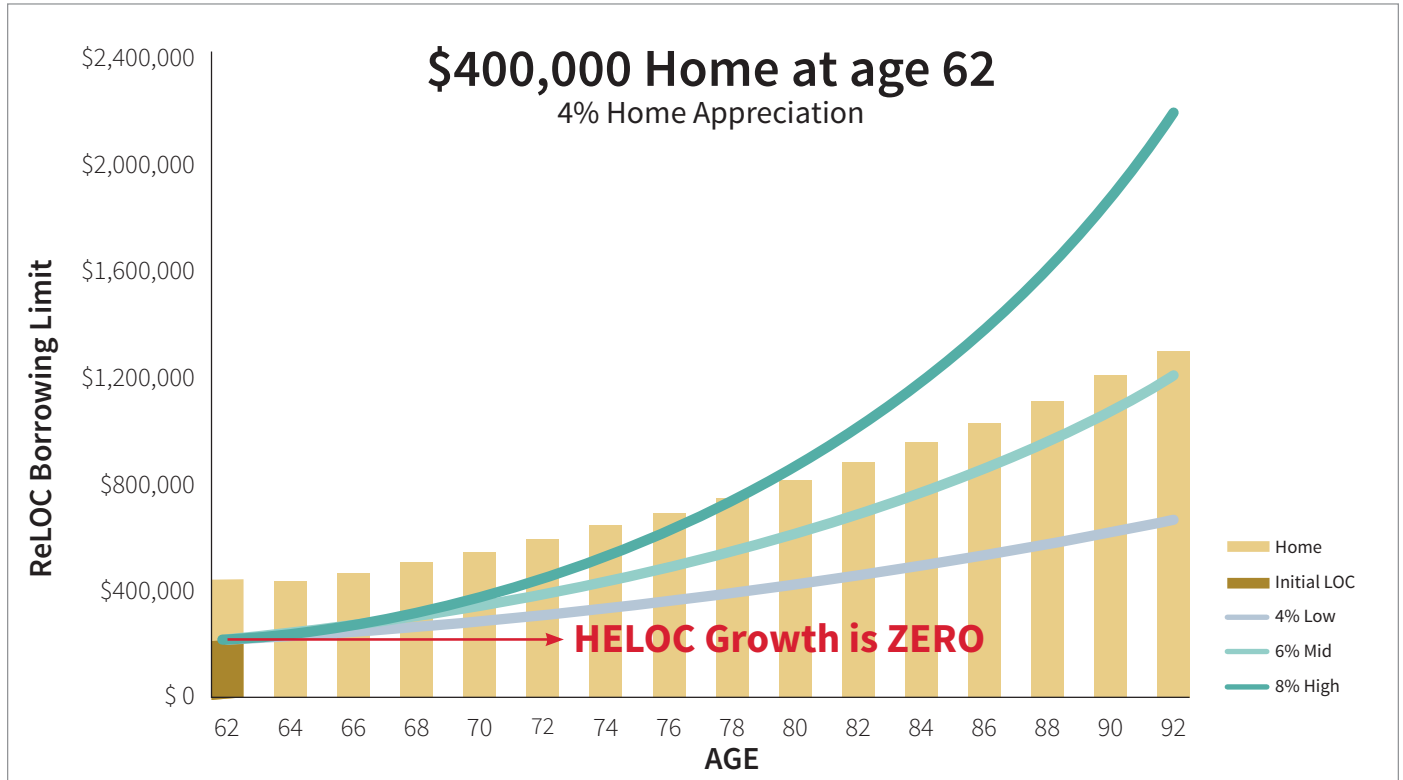
The most conservative and popular use of a reverse mortgage is to set it up as a standby line of credit to meet future unexpected spending shocks. Interest does not accumulate on the unused credit, just like a traditional HELOC. However, unlike a HELOC, the line of credit grows every month at the exact same rate the borrowed funds are compounding. For example, if the monies borrowed are compounding at the annual rate of 4 percent in any given month, the remaining line of credit will compound at the same 4 percent rate. This increase happens regardless of the value of the underlying asset, the home. Over many years, it is possible the LOC can exceed the home value, which provides valuable diversification for an asset that has idiosyncratic risk.

In addition, a HECM line of credit cannot be frozen, cancelled or reduced. The client is free to make any payments he wishes, or no payments at all.

Traditional HELOC vs. HECM Line of Credit Comparison

	Traditional HELOC	HECM Line of Credit
Line of credit (LOC) cannot be frozen, reduced or canceled if the ongoing terms of the loan are met.		✓
Line of credit grows each month, regardless of home's value.		✓
Allows homeowner to access the equity in their home for funds they can use for purpose while owning their home.	✓	✓
No monthly payments required.*		✓
Minimal credit requirements.		✓
Minimal income requirements.		✓
Age-based loan: Homeowners 62 and older.		✓
Government-insured loan.		✓
Non-recourse protection insures the borrower can never owe more on the HECM loan than what the house is worth.		✓
Draw period remains open during borrower's residency never recasts into a principal and interest payment.		✓
No time limit on access to cash.		✓

*Borrower must maintain home as primary residence and remain current on property taxes and insurance. Source: Retirement Funding Solutions



Source: www.toolsforretirementplanning.com

Homeowners can compare a HECM line of credit to a traditional HELOC. Although potentially useful in retirement, a HELOC requires monthly payments, can be altered, has no guaranteed credit growth feature, and often specifies time limits. A HECM line of credit, in comparison, is flexible and reliable in a way that is not possible with traditional lending.

The rate variables at which a HECM line of credit grows is determined at closing. Depending on interest rates, the line of credit can actually outstrip the home value over time. As interest in reverse mortgage has grown, several other uses have been unveiled. An excellent place to learn about these strategies is at www.toolsforretirementplanning.com, an independent blog authored by Task Force Charter Member Thomas C.B. Davison, PhD, CFP.

Can reverse mortgages be used as part of a withdrawal strategy to avoid or lessen the need to sell in down markets? How does this work?

If you think about a dip in portfolio value as a potential spending shock, it does not take long for you to see the HECM standby line of credit as a solution. This is exactly what Barry H. Sacks, PhD, JD, did when he constructed the first coordinated strategy to avoid spending from a losing portfolio.² His strategy is simple but powerful. In years following a downturn in portfolio value, the spending comes from draws on the house via the HECM line of credit. If the portfolio is in positive territory, draws the

following year come from the portfolio, as usual. This coordination of home equity with portfolio throughout retirement results in access to a better bank balance, which the *Wall Street Journal* refers to as the best path to happiness.³ Later research by John Salter, PhD, CFP, Harold Evensky, and Shaun Pfeiffer of Texas Tech University validated the Sacks findings, although their approach is slightly different.⁴

Just about anybody can appreciate that you don't want to sell your Bank of America stocks for a couple of dollars, when you paid \$30 for them. But this is exactly what happened to some retirees during the financial crisis, and what depleted their portfolios prematurely.

Of particular concern for retirees is a bear market early on. Under the stress of systematic withdrawals, an undervalued portfolio in early years, known as sequence of returns risk, can be quite dangerous. If the portfolio is under stress, taking draws will result in spending too large a percentage of that asset. So you can see from the start that the conventional advice to use your house as a "last resort" is wrong. Results are much better for cash flow survival if housing wealth is integrated into a retirement plan, especially if the early years of a retirement would subject your withdrawals to reverse dollar cost averaging, aka "buying high and selling low."

Dr. Sacks points out that reverse mortgage is different than the debt in the usual sense. Obviously the debt management is

discretionary. Payments of any combination can be made, or not, totally in the control of the homeowner. And yes, taking draws from the HECM is “spending” equity but wholly unlike spending equities. Once an equity is spent it is gone forever, and cannot participate in a recovery/increase in value. But in spending parts of the “home” the owner still is able to enjoy the entire home, and derive comfort and enjoyment despite borrowing against it.

Can reverse mortgages be used at time of purchase of a new home? How does this work?

Sometimes it makes sense to move to another part of the country, or into a different, perhaps more social, neighborhood. It could cost some money to move, and the retiree may be reluctant to do so if it would involve a mortgage payment. Actually mortgages are often tough to get once you are retired and have no income. So much cash is required in those cases, that the move might require a substantial draw on the portfolio. There is a way to finance a new house using a HECM for purchase. Basically the borrower provides a substantial down payment and the remaining financing is met by a reverse mortgage. Just like any reverse mortgage, there is no monthly debt service, and the loan is not due until the borrower dies, moves or sells.

How can reverse mortgages be used to help pay for long-term care?

There are no restrictions on how reverse mortgages can be used so it is possible to use proceeds to purchase long-term care

insurance. Another way to provide for long-term care is to set up a HECM growing line of credit early in retirement and use a reverse mortgage fund to pay for long term care. This line of credit will increase at a contractually determined rate and can easily grow to be hundreds of thousands of dollars. If the funds are never needed, the cost of maintaining the fund was small especially when you compare it to the cost of premium payments for years of long-term care coverage that you may or may not ever redeem.

Can people who are trying to maximize their Social Security benefits use reverse mortgages to help? How does this work?

It is important to calculate the cost of debt in evaluating whether or not to use a reverse mortgage to fund spending needs in the gap years between 62–70, in order to delay Social Security. But there are case studies that have shown that in combination with being able to avoid draws on an undervalued portfolio *and* delay Social Security benefits until 70, that there could be a substantial improvement in cash flow survival for later years. Strategies like this always have the best results when the client can avoid early negative sequence of returns.

How can someone tell if a reverse mortgage is a good deal?

As the saying goes, “when banks compete, you win.” There just is no substitute for comparison shopping. Do not allow yourself to be rushed. Get at least three quotes and make sure each quote shows a selection of margins on fixed rate options, as well as

How HECM Purchase Money is Calculated

It is difficult to envision how the HECM Purchase transaction unfolds unless you understand that the reverse mortgage financing attaches to the home being purchased, not to the home being left behind.

Illustration 8.1 Departure House Not Part of Transaction



Legacy Home The departure home is not used to calculate purchase money funds.



HECM Reverse Mortgage is placed on new home.
New Retirement Home This house is used to determine HECM purchase funds. The reverse mortgage attaches to the new principal residence.

Illustration 8.2 Formula for Determining Down Payment Needed to Purchase/Examples

(Purchase Price) minus (HECM Lump Sum)* equals Down Payment

A.	\$ 300,000	\$180,000	\$120,000
B.	\$1,000,000	\$340,000	\$660,000
C.	\$ 700,000	\$300,000	\$400,000

*The HECM Lump Sum draw is calculated using the HECM formula taking into account the age of the youngest borrower or Eligible Non-Borrowing Spouse, the current “Expected” interest rate and the FHA appraised value of the home or \$625,500.

Source: What’s the Deal with Reverse Mortgages? Shelley Giordano 2015. People-Tested Media.

both monthly adjusting and annually adjusting rates. You will get a sense of the right balance of margin to upfront costs if you do your homework, and through the discussion, learn what structure is right for your particular needs. A good place to start is <http://www.mtgprofessor.com/home.aspx>. All lenders will be happy to send you colorful, easily digested materials. Never work with a lender who is not patient about discussing the loan, if you wish, with your children, planner, accountant, lawyer, trusted friend, or minister.

What is the Reverse Mortgage Stabilization Act of 2013 and how did it change things?

During the housing bubble, some borrowers and lenders abused the reverse mortgage. People who may not have been realistic candidates for home ownership were able to borrow enormous sums of money through a reverse mortgage. Many were unable or unwilling to make their tax and insurance obligations, with homes underwater because of the crisis leaving no cushion, Congress acted to tighten the credit box for HECM going forward, as well as address some other shortcomings:

The Reverse Mortgage Stabilization Act of 2013

1. Brakes	Cannot use too much too soon
2. Qualifiers	Demonstrate willingness and capacity to meet tax and insurance obligations
3. Discounts	Slow early use, reduced FHA mortgage insurance premiums .5% vs. 2.5%
4. Protections	Non borrowing spouse cannot be displaced

Source: Benefits Magazine, October 2016. Giordano, "Could Employers Improve Retirement Outcomes with Reverse Mortgage Education?"

CAN A REVERSE MORTGAGE EVER BE FORECLOSED? WHAT IS THE RISK?

Just like any mortgage, the homeowner must meet his tax, insurance and maintenance obligations. Foreclosure is possible if these requirements are not met. The risk of not being able to meet these obligations has been reduced by the Stabilization Act of 2013. Borrowers must now demonstrate their ability to make these payments, and if they cannot, the payments are escrowed or in extreme cases, the loan is denied altogether. The homeowner must treat the house as his primary residence although snowbirds are allowed. Both Congress and HUD continue to refine the program to ensure that the reverse mortgage is a sustainable solution for homeowners.

WHAT OTHER RISKS ARE THERE?

Generally, a reverse mortgage is appropriate for those who are fairly certain they will stay in the home for as long as possible. It only makes sense to use your home as carefully as you would any

other asset. This might mean making interest only payments early on in order to manage the compounding interest. As you age, and those payments become a burden, just stop them. Your life expectancy is shorter, and chances are your home value has increased.

In other words, don't consume your housing wealth recklessly. You may need to move and use that equity later in life for other living options.

How do we find the academic literature and economic analysis on reverse mortgages? Who are some of the most important authors?

My little book, *What's the Deal with Reverse Mortgages?* is fairly comprehensive and catalogues dozens of resources for getting started. Tom Davison's www.toolsforretirementplanning.com is the most up to date review of all of the research. Dr. Wade Pfau, PhD, CFA, has just published *Reverse Mortgages: How to use Reverse Mortgages to Secure Your Retirement (The Retirement Researcher's Guide Series)*. All of these publications will point you to the work done by Dr. Sacks, Dr. Davison, Dr. Pfau, Dr. Salter, and Dr. Gerald Wagner, as well as others.

If I want to find out what products and companies are in the market, is there a comparison service or data base available that is up-to-date? Where do I find it?

Again, a great place to start is at Jack Guttentag's site www.mtgprofessor.com. The National Reverse Mortgage Lenders Association has a large list of lenders at <http://www.reverse-mortgage.org/Find-a-Lender>. ■

ENDNOTES

- 1 <http://www.fool.com/investing/general/2015/05/17/americans-average-net-worth-by-age-how-do-you-comp.aspx>
- 2 Sacks, Barry H., and Stephen R. Sacks. 2012. "Reversing the Conventional Wisdom: Using Home Equity to Supplement Retirement Income." *Journal of Financial Planning* 25(2): 43-52.
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- 4 Pfeiffer, Shaun, John Salter, and Harold Evensky. 2013. "Increasing the Sustainable Withdrawal Rate Using the Standby Reverse Mortgage." *Journal of Financial Planning* 26(12): 55-62. And Pfeiffer, Shaun, C. Angus Schaal, and John Salter. 2014. "HECM Reverse Mortgages: Now or Last Resort?" *Journal of Financial Planning* 27(5): 44-51.



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Getting Employees to Improve Their Financial Management: An Interview with Liz Davidson

INTRODUCTION FROM ANNA RAPPAPORT

One of the featured topics at the 2016 Plan Sponsor Council of America annual meeting was Financial Wellness. This is also a topic being studied by the SOA Committee on Post-Retirement Needs and Risks. Liz Davidson, Founder and CEO of Financial Finesse was a featured speaker. She shared her book What Your Financial Advisor Isn't Telling You. The book ends with a Financial Independence Day Checklist. It is often not very difficult to figure out what people should do, but it can be extremely difficult to motivate them to do it. This article shares some of her insights.

Tell us a little about yourself.

I'm a California native, who's traveled the world, worked in the financial capital of the world, NYC, and found myself back home to push forward an issue that I think is hugely critical to our society: the need for every American to have access to unbiased financial guidance. I started Financial Finesse in 1999 after running a hedge fund for several years and finding that even high net worth individuals had very little knowledge around basic money management. I thought to myself, these individuals have access to all the financial planning guidance and advice they could desire. If they don't understand these concepts, how much worse off are people without access to this kind of guidance, which is so critical to making sound financial decisions?

It was an aha moment for me and I've been passionate about financial wellness since that day. My company, my book and my entire mission are to help everyday people from all walks of life have access to the kind of financial guidance that helps them achieve financial security.

It is commonly identified that people need to plan more and save more. What can be done to make that happen? What role can the employer play?

We often find in tracking employee financial wellness through our research think tank, that employees of all ages, ethnicities, income levels and generations are behind the curve in saving; only 19 percent, according to our research on employee retirement preparedness, said they were confident they could achieve their retirement goals. What's interesting when you pull back the curtain on the saving issue, however, is that the reason most employees aren't saving enough is actually related to money management problems—simple things like sticking to a budget, or managing how much credit card debt you carry, for example—are the core issues holding employees back from saving more.

Employers that have this understanding can better help employees save by first providing guidance or education that helps them get a handle on basic money management. The most effective workplace financial wellness programs focus on the total financial wellness of employees, offering different ways for employees to access guidance around their pressing financial questions and issues. This, coupled with good plan design that incorporates automatic features, is moving the needle much more in the direction of employees' savings rather than just retirement and investing advice alone.

What financial mistakes do you see average people making? What remedies are there for these mistakes?

The biggest mistake we see is not saving enough. The most effective programs start by encouraging employees to run a retirement calculator, so they can get a sense of how much they need to save in the first place to achieve a comfortable retirement.

The second biggest mistake we see is employees not understanding the impact that saving (or not) has on their retirement picture. It's amazing when you show an employee the effects of compound interest; saving as early as possible and making incremental increases to their contributions as they're able are small but powerful ways employees can be educated about the importance of saving. We often suggest that programs implement a contribution rate escalator, so employees can save what they can now, then slowly increases their contributions.

The third biggest mistake is not being properly diversified. The best way to remedy this is to choose an asset allocation fund such as a target date fund to make investing simpler.

The SOA Retirement Risk Research indicates little formal risk management by many people. Favored risk management strategies include reducing expenses and saving

more. Financial products other than health insurance are not favored. What risk management should be considered as part of retirement strategies? Do you have ideas for getting people more engaged with this topic?

The biggest risk management strategy we advocate at Financial Finesse, is ensuring employees have long term care insurance in place. An employee could plan perfectly and do everything right when it comes to saving, but without LTC insurance, one medical issue could wipe out their entire retirement savings!

These are the most tragic situations; we've seen it time and time again, and it can easily be avoided with help from employers, who are at the forefront of helping employees plan for retirement. The programs we see that have an impact on this particular issue educate on the need for LTC insurance; most employees simply don't think about it. They also educate employees on Medicare and the fact that they can't qualify for it unless they've spent down all of their retirement assets.

The second biggest risk is running out of money. With so many employees not on track for retirement, this is an issue nearly every employer can address to help employees save more for retirement. A well designed plan and good payout options for retirement income are key here—the best plans usually offer immediate income annuities for example, so employees have less risk of running out of money in retirement.

The SOA Committee on Post-Retirement Needs and Risks has identified debt as an increasing concern when we think about retirement security. What steps do you suggest to motivate employees to manage debt? Which are most effective?

The first step would be to identify how bad the situation is. Employers who are implementing successful financial wellness programs are making people aware of the huge impact debt has on their finances by showing them the cost of interest specifically. It's amazing how much of a lightbulb moment this is for people; seeing for example that interest alone will cost you another \$10,000 over the course of 10 years definitely acts as a wake up call for people carrying large amounts of debt.

The second step is seeing the impact that even a small amount of extra money toward one's debt can have on their budget and savings. A program might provide them with something like our 'debt blaster' calculator, which allows them to input different amounts paid toward interest and see its impact on the total amount.

The next is providing employees with a strong sense of accomplishment. They can do this by focusing on small steps they can take now to see impact. If an employee is having trouble with self-motivation, employers can help by providing education that encourages paying down their debt on the smallest card first,



rather than on the highest interest rate. This helps the employee see quicker results, and continue to stay motivated.

The SOA has identified the family as an important part of retirement security, but the wrong family actions can be a barrier to security. And many couples are no longer together by the time of retirement. What ideas do you have to encourage families to work together? What should people do to ensure that they will not have nasty surprises because of actions taken by other family members?

This is a big issue that I also cover in my book, which isn't often taken into account in planning for retirement. Families need to understand that retirement security isn't just the breadwinner's responsibility.

First and foremost, both spouses need to be on same page with the big-picture. A common problem we see is one member of the household managing all of the financial decisions, and not involving the other in decisions that have a major lifelong impact on the family. This can be detrimental when for example, the breadwinner of the family passes away with no will, or life insurance policy to sustain their family once they are gone. The family suffers greatly and had their spouse been involved in the financial decision making, this may have been avoided.

Employers can help by encouraging "money dates" once a month, or however often a couple can arrange for. This opens the line of communication around the household's money and encourages families to work together because everyone's actions and attitudes about money affect the outcome.

This also leads to your point about many couples not being together by the time of retirement. It's even more critical than ever for women, who face significantly higher health care costs in retirement due to increased longevity, to be an active participant in the retirement planning decisions.

Lastly, families who compromise their retirement savings to fund their children's college education, for example, often find their retirement taking a huge hit. Our planners often tell people that "you can get a loan for college, you can't get a loan for retirement," so for one, parents can have this discussion early with their children, providing them with the circumstances whatever they may be—and allowing their children to make education decisions based on what the family can help with (if anything) and what they're willing to take on from a cost perspective. In general, when parents prioritize any of the family members' needs over their own, it leads to reverse situations in the future.

What tools and activities work for average people?

Plan design is the best place to start if employers want to help people save more for retirement. Setting up automatic enrollment leads to more people saving, and automatic escalation, even set at just 1 percent per year, helps employees make small progress toward saving more, without feeling a significant impact in their paychecks. Simplified investment options are also useful for hands-off investors.

Tools that show employees their retirement picture and make it easy for them to increase their deferral rate or change their allocations are taking away the stigma of having to go to HR for every minor retirement related decision.

Also, financial wellness tools and coaching can help employees make progress in all areas of their finances, and helps them grow more confident in their decisions. The employers we work with offer our Financial Wellness Assessment that helps employees start off on the right foot by determining areas of vulnerability and the steps they need to take to improve those areas. It also provides employers with valuable data around the state of their employees' retirement preparedness and most pressing financial issues so they can design programs to best meet their

needs. There are also some very useful tools out there that help employees manage their retirement benefits—assessments of whether they are saving enough, but then from there, making it easy for them to make a quick change to change their outcome.

Last, employers who create a culture of wellness seem to be having the most impact in helping employees save more and improve their financial picture. For example, one company we work with shut down all company operations for 30 minutes so that every single employee could take their Financial Wellness Assessment. Another houses a special room dedicated to financial one-on-one sessions which employees can book during work hours. Showing employees that you care about their financial wellbeing, and ability to retire the way they want to and when they want to, can play a major role in their success.

What else would you like to tell us?

Oftentimes, the biggest barrier people face to saving for retirement is that they get overwhelmed by the big picture. They read articles in the news or hear from coworkers that they'll need to save an outrageous amount of money to be able to afford retirement and think, "forget it!"

For employers, it's really all about offering guidance that helps employees take small steps that will add up over time, bringing them back to paying small amounts toward debt, making small increases to what they can save, and translating all that they do with their money into the day-to-day rather than big picture. ■



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Bringing Economics and Actuarial Science Together: An Interview with Joseph Goodman

INTRODUCTION FROM ANNA RAPPAPORT

For my fifty plus years as an actuary, there has been interest to new kinds of jobs and in new areas. I have served as a facilitator at about a half dozen Fellowship Admission Courses over the past decade. At each course, I have been interested to learn about the career paths and decisions made by the new Fellows. Usually there are some people who have made different choices and have different jobs. At the June, 2016 EAC, I met Joseph Goodman. Joseph has a Ph.D. in Economics from Northwestern university in Evanston, Illinois. He decided to add actuarial studies to his portfolio. He works in an economics consulting firm. Some of his work is connected to pensions. I think many pension actuaries will be interested in his work.

What kind of work do you do? What types of retirement plan issues do you encounter in your work?

I work for Compass Lexecon, one of the world's leading economic consulting firms. Compass Lexecon specializes in providing economic analysis for complex issues, often in a litigation context. I have worked on three cases involving pensions. Each focused on different retirement plan issues.

The first case revolved around actuarial assumptions. My team was hired to analyze the "true" level of underfunding for a group of public pensions plans. Each of the plans issued annual financial reports with purported funding levels, but unrealistic assumptions led to unreliable estimates. In particular, the discount rate assumptions were too high. My team researched which discount rates were sensible from both theoretical and market-oriented perspectives, and we translated those rates into funding levels.

The second case hinged on whether a private pension plan qualified as "Top Hat." Most private pension plans are regulated according to the Employee Retirement Income Security Act (ERISA) and are required to maintain certain funding levels. Top Hat plans, however, are exempt from many of these regulations. To qualify as Top Hat, a pension plan must be maintained exclusively for a select group of management or highly compensated employees. In this case, the pension plan covered numerous employees, but all of them had management responsibilities.

The plan sponsor believed that their plan qualified as Top Hat. Plaintiffs disagreed.

In the third case, a deferred compensation plan had its crediting rules amended. Most retirees ended up earning less under the amended system than they would have under the original system, so they moved to certify a class action. The key question in this case was whether all plan members were similarly affected by the rule change or whether retirees' individual investment decisions determined harm. The Court ruled that individual issues predominated and denied class certification.

What prompted you to pursue actuarial science? Does the combination help you find different solutions?

I have always been interested in real-world problem solving and in applications for economic reasoning. As a senior in college, I deliberated between studying for a Ph.D. in economics and pursuing actuarial science. I opted for economics. After graduation, I joined an economic consulting firm and realized that actuarial science could actually provide professional synergies. The Ph.D. requires deep learning on specific topics, and the FSA process provides basic exposure to a broad range of empirical concepts and techniques.

This combination is helpful in economic consulting because of the tremendous variability from case to case. Each project requires a different approach to modeling and problem solving. The heart of our analyses always uses an economic approach, but tools from other fields are often useful. Furthermore, opposing experts come from a wide array of backgrounds and employ a wider array of techniques. The actuarial background helps me understand their reports and develop appropriate responses.

What is different and what is similar about the approaches to problem solving by people with economics and actuarial backgrounds?

My impression is that there are more similarities than there are differences. Empirical economists and actuaries use overlapping toolsets to answer similar questions. The focus may be a little different—such as economists with fancy regression techniques or actuaries with fancy statistical distributions—but the tools are similar. Both fields use messy, real-world data to fit models and make predictions.

The bigger difference is between academic approaches and practical approaches. Academics in applied economics are primarily concerned with developing new techniques. The methodology used in problem solving is often more important than the quality of the solution. In contrast, practical approaches emphasize good solutions over cutting-edge techniques.

What else would you like to tell us?

Many people believe that Big Data will solve every empirical problem. I think that is naive. It's true that bigger datasets allow for more complex analyses and greater statistical power, but there are downsides as well. Being able to test many hypotheses at the press of a button encourages p-hacking as people test endless combinations in search of statistical significance. This leads to false positives and spurious results.

Conducting empirical analyses may be easier than ever, but quality solutions remain difficult. They require analysts who

can understand data accurately, interpret results, and distinguish between competing narratives. ■



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An Update from the Retirement Plans Experience Committee

PUBLIC PENSION MORTALITY STUDY

The Retirement Plans Experience Committee (RPEC) and the SOA are working on a study of mortality in public pension plans. The study will contain significantly more data than the private plan study that produced the RP-2014 Mortality Tables. Though the dataset has not yet been finalized, currently it contains over 40 million life years. There has been a delay in the study timing of approximately nine months due to data collection and verification issues. Currently, the plan is to issue an exposure draft report in the spring of 2018, with completion and publication of the final report in mid-late 2018 after a 3-4 month exposure period

PRIVATE PENSION MORTALITY STUDY

The SOA and RPEC have also kicked off a new study of mortality in private pension plans. Data has been collected for this study and industry participation in the data call has been strong. SOA and RPEC plan to study mortality by collar type and income quartile and will also attempt to study mortality by industry. Currently, the plan is for an exposure draft to be released by late 2018 with a 3-4 month exposure period. The expected publication date for the final report will be in the spring of 2019.

SOA and RPEC have decided that PBGC data will not be included in the private pension mortality study due to the

timing of its availability. The SOA intends to collect the PBGC data and study it separately when it becomes available.

MORTALITY IMPROVEMENT UPDATE

Mortality Improvement Scale MP-2016 was released in October, 2016. This new scale reduced year-over-year volatility by decreasing the horizontal convergence period to ten years and setting the initial slopes of the horizontal and diagonal projections to zero. RPEC plans to continue to issue annual updates to the scale as new data becomes available.

The SOA's Longevity Advisory Group has commissioned research by the University of Waterloo which will explicitly study age, period, and cohort effects in historical U.S. mortality improvement. This research should be finished in the next six months and depending on the findings, may impact the future of RPEC's work.

OTHER UPDATES

- Jim Berberian is now the chair of RPEC and will serve in that role for the next two years
- The Pension Section Council is developing a guide on credibility theory. Please contact Andy Peterson (apeterson@soa.org) if you have questions or comments on this guide. ■



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