Society of Actuaries
Housing in Retirement
Round Table
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Transcript

Participants

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Chuck Epstein
Sheila Zedlewski
Tom Herzog
Don Redfoot
Steve Cooperstein

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STEVE SIEGEL: I just want to open and thank everyone on behalf of the SOA for attending this round table and participating in I think this very important subject. I'm really looking forward to the discussion and wanted to particularly thank everybody for all the pre-round table comments. I personally found them extremely helpful for the discussion today. Again, our sincere and significant appreciation for all of your participation and help so far. With that I'm going to turn it over to Anna to introduce everyone.

ANNA: I'm Anna Rappaport, Chair of the Committee on Post Retirement Needs and Risks and an actuary. Sheila.

SHEILA: I'm the Director of the Incoming and Benefits Policy Center at the Urban Institute. We do policy research on retirement issues, among other things.

ANNA: Chuck.

CHUCK: Chuck Epstein, I'm an independent financial writer.

ANNA: Steve.

STEVE COOPERSTEIN: I'm Steve Cooperstein. I'm an independent actuary focused on creating new products and services for the financial services industry.

ANNA: Don.

DON: Hi Don Redfoot, I'm a Senior Policy Advisor with AARP's Public Policy Institute.

ANNA: Joe.

JOE: I'm Joe Tomlinson, I'm an actuary and a financial planner and I occasionally write articles for financial planners.

ANNA: Tom.

TOM: I'm Tom Herzog, I'm the FHA Chief Actuary and I'm in the Office of Evaluation.

ANNA: Thank you. Our first question for today is what are the most important housing issues affecting retirees. I will make some comments and then go around the panel. It seems to me that we've discussed many issues but often we don’t mention that the housing choice is not only a huge economic decision, it’s an important choice for our lives. It helps determine what activities we have access to. And, the design of the house, for example, stairs or no stairs, may have some implications if we later become limited in what we can do. Will we be able to manage or not? It can also affect access to transportation. If we select an alternative form of housing, there may be a variety of services packaged with the housing, so it seems to me that there are a lot of life issues as well as all of the financial issues. Would somebody like to jump in now?

DON: I think Sheila made the comment in our online discussion that I think is a very important starting point which is the enormous heterogeneity among the older population and the differences that one sees there. I think your point is well taken about the non-economic issues that relate to lifestyle and the ability to live independently in old age and yet when we actually ask older people what the preferences are, they want to stay put, overwhelmingly. This means that they are basically living with choices they made often decades earlier about where to live and what kind of housing and what kind of neighborhood and what kind of access to services. Those choices they made decades earlier may not reflect their current needs, and so finding ways to frame the discussion about housing choices in old age both in terms of the economic as well as the non-economic issues I think is a real challenge, because for most people they're dedicated to staying put, which may greatly temper their ability to look at other possibilities.

ANNA: Don, do you know if people who have moved relatively frequently earlier in life are just as anxious to stay put as those who have not moved much or they're more willing to move? Is there a correlation between moving earlier and moving later?

DON: I don't know if I've seen research on that, though I think it's a reasonable presumption that there is probably more likely willingness to move later on, if you don't have the deep roots in one place. But for the majority of older people, they've really lived in one place for many decades usually. There may be important cohort differences that we will see coming along as we see more mobile cohorts come into old age.

TOM: Does some of it depend where your children are?

STEVE COOPERSTEIN: I do think it depends on cohorts quite a bit; distinguishing between those already retired from those about to retire and those that might be retiring in some years down the line, the baby boomers. What comes to mind with your suggestion about life objectives are continuing care retirement communities, which are a bundle that solves the problem of long term care, housing, and going from an adult community all the way through to a nursing home, if that becomes the reality.

CCR's, continued care retirement committees, haven't really been successful and I doubt that the next generation is going to want to stay as put as a continuing care retirement community requires - that you buy in that retirement location or thereabouts and set your future in place.

ANNA: One of the things I have noticed but have no data about is people I know who live in certain communities, which are in places where people have stayed put for years and years and years. They and many people they know live in the area where they grew up. Yet when I think about the people that I worked with in Chicago and knew in Chicago, most of those people have moved around and relatively few of them had grown up in Chicago. My impression is that there might also be a community difference, in peoples' life history, and there are clear differences in how much they identify with the place where they live.

DON: I'm sure that's correct that there are urban vs. rural differences and that you may find differences in different ethnic communities, for example. But in general, what you find is that today's older cohorts have generally stayed in one place for long periods of time. Mobility goes down as you age, in terms of moving from one place to another and so the question is whether one can change those norms so that people evaluate changing needs and look for different kinds of housing and communities that relate to those needs.

SHEILA: It's important we also remember that retirement isn't just one phase of life, but it's a continuing part of the life cycle. Needs at the very upper end of the age range are much different than those for early retirees, so I think we have to talk in terms of how needs change during retirement.

ANNA: Last year, the Society of Actuaries published a report on the phases of retirement examining exactly the situation Sheila described, how needs change over retirement and, of course, at retirement. It is absolutely true that people become more limited later on. I'd like to go back to the question of what are the most important housing issues affecting retirees. Chuck, I don't think we've heard from you, do you have something you'd like to add to the conversation?

CHUCK: Yes, I wanted to add that some of the Boston College Research and University of Michigan research shows that there's pretty low mobility among single women, divorced women, the elderly and women with children because they don't have the option to move around as frequently for financial considerations. That's one thing that affects a huge percentage of the population which is often forgotten by the financial services community, those people are off the radar screen. Secondly, a lot of this is health driven and also employment opportunity driven. For example, some of the demographic shifts that we will be seeing show that the fastest growing states -- one of them was Alaska and elderly people are not going to move to Alaska -- so you might see a demographic shift of younger people in certain states and older people remaining in the sunbelt for example where there’s a lower cost of living and cheaper housing. You might see this new change in some of the new types of abandoned houses and low cost housing, which is going to be a suburban phenomenon.

ANNA: Does anybody have data or want to say anything about how much housing costs vary by area because you mentioned lower cost housing?

CHUCK: I think where the foreclosure rates are the highest in the United States certainly is affecting that. That's probably led by Arizona, Florida, California, and I'm sure the list goes on but I think the last number I saw was that the backlog of housing stock in Florida for example was about seven years and that's certainly going to be an overhang on more price decreases, so that's one opportunity. Then you have certain places like Michigan and some of the rural areas for example where you're going to see whole slots of urban downtown vacant and abandoned. So that's another factor which is probably going to also provide some opportunities if people wanted to create some really low cost elderly housing or convert some of these properties into low cost elderly.

ANNA: Does anybody else want to add to our first question?

JOE: One little point, based on some of my personal experiences with people, is that I do sense that people have a very strong preference to remain in their home but very often after they move to a new situation, they end up saying gee I wish I had not been so negative about this, and I've found that in a number of instances. The other thing sort of unrelated to that just to comment is I sense that we're facing, as we go forward, more of a squeeze in terms of people needing to use home equity, needing other financial products like income annuities and things like that whereas before it was sort of maybe being able to get by without tapping the home equity or annuities, that sort of thing.

ANNA: That change that's occurring, do you have any further comment on where that might be taking us?

JOE: I just think there's going to be more of a need for products certainly and you know I think it’s just going to be tougher on people to get by without either tapping the home equity, without buying products like annuities where they're just trying to sort of live off the savings and live what is increasingly long numbers of retirement years.

SHEILA: Don't we also think that the increase in interest in annuities is due to wanting to have a stable source of income during retirement, and at least to partially annuitize is becoming more popular. It isn't in other words, just driven by need but also a desire to have stability and income.

JOE: Right, it's the desire, but in terms of actual product sales, they still run at a pretty low level.

DON: I would concur.

CHUCK: Regarding product sales, I think there's a huge opportunity for the financial services community to create some low cost annuitized products and I believe they've been working on this. I think one of the things about financial regulation is that they're trying to keep their cost, their compensation structure the same while introducing an annuitized product, which traditionally has had some of the highest expenses. That's one reason why the personal finance people abhor annuities is because of all those up-front costs. This also gets to something I think I raised in my online comments was that I would still like to see the actuarial profession look into the demise of the U.S. pension system. I regard this as one of the biggest problems or failures of society in how the pension system failed because the majority of Americans prefer some sort of a stable retirement income, which is what the pension was originally designed for by I think it was Bismarck in 1880. I think that sets a huge untold story about the demise of the U.S. pension fund and the pension fund industry.

ANNA: Chuck, in the Society of Actuaries research, we have been very concerned, for a number of years, about the fact that when you ask people if they'd rather life income or a lump sum, they'll tell you life income is the most important and we have multiple studies that show that and at the same time we know that they select lump sums when they're given the choice. The same people who tell you that life income is the most important choose the lump sum. This is a puzzle that we've been dealing with for many years. This puzzle goes beyond the retail annuity market. When there is an option within a pension plan, where the pension plan doesn't have any sales loads, and the price is based on group mortality, the same situation holds. So, even though none of the factors that make the annuity expensive apply, people are overwhelmingly picking lump sums unless there is a cost of living index or medical tied to the continuation of the life income. That is a big puzzle to us but it's a good point that you've raised.

CHUCK: I think behavioral finance plays a huge role in that decision and I think that's the same type of thing of when people win the lottery. Do they want a lump sum or take those payments over time? I think unless they had expert tax advice, legal advice, they will choose to take the lump sum because it's the pot of gold.

STEVE COOPERSTEIN: I just want to say across the whole spectrum, whether it's 401(K)'s or choosing an annuity or choosing a lump sum in a pension, people really love to have control of their money; they feel more secure with that money being there at their beck and call, as opposed to having it tied up in some way that's beyond their control. I'm amazed that some people are now, even in their 60's, are saying that they don't trust social security and they'd be willing to cash in social security for a very small amount. I couldn't believe a recent survey along those lines.

SHEILA: We also know that employers have moved away from defined benefits pension plans in order to shed the risks that they entail and shift them onto the worker. This allows them to better control costs at the firm level.

ANNA: Risk is not the whole story. The regulatory environment has been quite chaotic and with the chaotic regulatory environment, employers do one thing and they think it will be fine and then the rules change when they find out later that the regulations are different from the proposed regulations. There are a number of factors that have caused employers to shift plans. Together with the risk the regulations have been a huge one.

SHEILA: Yes that is an important factor and I think there's a lot of research on this topic that could be brought to bear on why employers drop DB plans.

ANNA: That's a great subject but it's not really our subject for today.

SHEILA: Right.

ANNA: Let's move on to the next question. Is paying off a mortgage still an important strategy for retirees?

SHEILA: The data from the health and retirement survey show that it's really only less than half who own their homes without a mortgage above age 55. I guess I worry when I hear these statements that people shouldn't retire until they own their homes outright, when people may have planned to have this mortgage and to be able to finance that cost in their retirement. Again I don't think one size fits all, you can't make one recommendation that works for everybody.

STEVE COOPERSTEIN: I think it depends on how that mortgage came into being. For instance, if the mortgage came into being when the interest rates were high in the 80's and then there were repeated refinancing opportunities to bring down that monthly mortgage and that mortgage amount became part of one's budget, and was then looked on as part of one's realistic budget for retirement, and don't really have funds to pay it off, it doesn't seem like an ineffective way of proceeding.

ANNA: Joe, do you have any perspective on this topic?

JOE: I think it kind of depends on what the other sources of income are. Certainly if somebody has Social Security and a defined benefit pension, they're in much better shape to pay a mortgage on a regular basis and the other thing it depends on sort of the overall picture for the person's assets like for instance, if somebody has a significant amount of their portfolio invested in bonds and they also have a mortgage, unless that mortgage is at some kind of a below market rate, then I would question why they're doing that, because they're probably just losing on the spread between the mortgage and their bond investment. I think you have to look at each individual case.

DON: I would agree that there is some variance but if you look at some of the research that's been done, in terms of under what circumstances and with what kind of mix of investments and income, it can make sense to continue to carry a mortgage. In general, you're going to be much better off, in most cases by paying off a mortgage before retirement. Sheila may be correct, I suspect that between 55 and 65 a lot of people do pay off mortgages so that the rates for the actual retirees may be lower. But there's no doubt that we're seeing more and more people entering old age with debt and I think that's considerable debt and considerable mortgage debt, then I think people need to evaluate that.

I think the other thing to note is that the calculation may change upon retirement. When you have, in your working years and making considerable income and you're relatively early in the mortgage where the interest segment is higher, the tax advantages may make having a mortgage attractive compared to paying it off. But when you reach retirement and you're near the end and the tax advantages are lower and the income is lower and as you said, if your investments go to the more conservative mix, this may be a good time to pay it off.

JOE: And it does depend on the individual circumstance like for instance if you had a person that just doesn't have a lot in savings and they find themselves needing to buy a house but they've got a big defined pension plan and social security coming in, then they can probably afford to carry a mortgage rather than just sort of renting or living on sort of a kind of minimalist situation.

DON: That's true though, one really does have to again look at the long term and that mortgage that you can afford right now, will you be able to afford it in 15 years? Thinking ahead do you want to continue to carry that mortgage as the value of your assets goes down?

JOE: Right, but what I'm saying is if you have a big defined benefit pension plan and no savings, you want to have a house, you don't have a choice.

DON: Then many people find themselves not having a choice, that's acknowledged, but what is the optimal, clearly it’s better not to have a mortgage for most people.

JOE: I'd agree with that, in the ideal world.

ANNA: Joe, when you do an analysis for your clients, what are some of the key factors that you would look at to see whether this is a situation where it pays to have a mortgage?

JOE: I think in terms of the fine tuning, it makes a slight difference in terms of whether you're holding your assets in taxable accounts versus where you have some tax advantage like 401K’s and things like that, in terms of whether you pay off the mortgage, there's a slight difference there. The other thing is that in terms of people taking their investments, for younger people, we're not talking about the pre-retired now but for the very young people, they very often need to have mortgages and it may make sense for them to have a mortgage even if they have a lot in savings because they can invest more heavily in the stock market and they have more years in front of them in which to handle the ups and downs of the stock market. But for people in their retirement years, I would agree that if you don't have to have a mortgage, I'd say probably for at least 90% of the people, you're probably better off not having the mortgage or trying to pay down a mortgage that you do have.

TOM: I have a problem here. I sort of would hope that people would be paying off the mortgage because then they don't get subject to potential fraud and I've been involved with at least one case where an 80 year-old couple basically got forced into refinancing multiple times ending up with close to a 30-year mortgage at age 80 and it was just a huge mess.

ANNA: Let’s talk about question three, what options are available for using housing equity in retirement and how effective are they and I don't know, Joe, would you like to start us off?

JOE: In terms of the options, I may not be the best person there, I only know a little bit about reverse mortgages for instance and my reaction to reverse mortgages is they look awfully expensive and they look very sort of restrictive in terms of, I don't know what's the best word for it, but not flexible, put it that way. One of the things that I wonder about going forward is whether or not this is really the best we can do in terms of financial products to help people be able to make use of their home equity in their retirement years and I think there's probably a huge opportunity to come up with things that might be better than this.

ANNA: Do you consider with your clients or do you encourage them to look at downsizing and moving to a smaller home as a way of using some housing equity?

JOE: We certainly talk about that but fortunately, some of my clients seem to figure this out for themselves and so there doesn't have to be much of a discussion or much convincing going on. I guess I've been lucky in that regard. For some reason, I don't seem to have clients that were the type that just wanted to really stay in their own home forever. I had that with my parents but not with my clients.

SHEILA: Somebody in the group probably has some good numbers on this, but before the huge housing problem, home equity lines of credit were the most popular way of tapping into equity among retirees, much more so than reverse mortgages. My understanding is that option is pretty much off the table now for most people. New home equity lines of credit aren't being issued and even some old ones are being retracted. The other option was some people would take out second mortgages on their home to get out some of the equity, and that's also restricted now. It seems to me logically that it's going to push, if this continues, more people into the reverse mortgage market as one of the few ways to get at this equity, without moving.

CHUCK: I think one of the people on the panel supplied information from HUD, which said that the number of reverse mortgages remained stable over the last few years. I think one of the other panel members pointed out that reverse mortgages should be used only in an emergency situation. I would concur with that but traditionally or in the last I guess 10 years or so, home equity has been the major source of retirement wealth and I think that now that that's evaporated, I think that's one of the crucial problems. What are people going to do if they are locked into their current homeownership and that's affecting mobility and whether they can even retire.

DON: Unfortunately, other sources of wealth have also evaporated, relatively speaking.

SHEILA: Remember that reverse mortgages increased between ’07 and ’08 from 100 to 112, thousand -- new ones being taken out --and the new data that was submitted for ’09 so far shows mortgages of those at about 95,000, it may end up at about the same level as ’08.

TOM: My employer, FHA, is insuring the bulk of the reverse mortgages and my read on this is that we're running about 10,000 a month and as pointed out, we've sort of been running more or less there for the last 3 years or so. You may see a little bit of a blip here in the last few weeks of this fiscal year because unfortunately HUD will be reducing the maximum amount of the loans by 10% in 2 days at the start of the new fiscal year, and so we're seeing a rush to close here in the last couple days of the fiscal year. That may artificially bump up those numbers a bit, but in a couple of days what has been a very expensive proposition is going to become even worse, in that it’s going to cost the same but you may get 10% less of a loan amount, because of Congressional Budget Office scoring that has determined that the insurance fund is inadequately funded, given the recent decline in home values. It makes it a very difficult sale and one of the things, Joe you mentioned the need for some product development in this area, is it the best we can do, HUD has discussed the possibility of offering what we sometimes call a reverse mortgage light product. Right now a person taking out a reverse mortgage must pay 2% of the home value for the upfront mortgage insurance premium, irrespective of what they borrow, so for people who want to borrow relatively small amounts of money or for short periods of time, this is extremely expensive, but by offering a product where you had lower loan limits and in exchange lower costs related to the mortgage insurance, this may make it a somewhat more attractive product and more competitive with some of the home equity lines of credit products for example, which typically cost a great deal less than a reverse mortgage and are preferable for most people, if they have the income to support the monthly payments that would be required.

SHEILA: What would it take to get the HUD light started?

DON: HUD has been looking at this for a couple of years and certainly at AARP we've been encouraging this. What they have to do, since we're talking to actuaries here, a lot of the issues are actuarial. Right now the insurance fund relies on those folks who are paying premiums that are very low risk because they're not borrowing that much, so if you change the mix here and you take out of the pool of those who borrow low amounts and you have them paying lesser premiums, what does that do? To what extent does that expand your market rather than detract from it? These are the calculations they have to figure out in order to offer the product.

STEVE COOPERSTEIN: What is a reverse mortgage? A reverse mortgage is allowing one to get at the equity in their home without paying money out of their budget. People are at different stages at different times. A lot of risk contingencies cost could be removed from different types of reverse mortgages. For instance, you could have a 10-year reverse mortgage and take a certain amount of money out of one’s home not deplete it beyond a certain amount, and do so at a reduced risk premium.

DON: I would add one addendum to that, Steve. There are what we call split term instruments right now. That is you can receive payments for 10 years under the federal insurance program for example, but the split term meaning that's the term of the payments but you can continue to live in the house for as long as you live. Unfortunately, of course the interest continues to accrue so it doesn't mean that you can protect a certain amount of your equity by doing that necessarily.

STEVE COOPERSTEIN: Yes, I understand.

DON: So it’s one of the difficulties of a reverse mortgage because it is an asset based loan entirely and secured entirely by the asset and there are no monthly payments. That's its attraction, particularly to people with low incomes, but it also means that the compounding of interest works against you over time and so they're inherently very expensive in terms of the long term impact on your assets.

STEVE COOPERSTEIN: It all has to be integrated into a financial plan as to what one can afford. Certainly the hidden loan interest rates, loan interest, etc., need to be transparent to the buyer so that they can really understand what their financial situation is, and the taxability of the deferred interest payments - that they're not tax deductible until paid. Isn't that true?

DON: That's correct, so there's no interest deduction until you actually pay off the loan.

STEVE COOPERSTEIN: Whereas when you have deferred interest that you don't access, for instance, in a bank, the IRS still requires the payment of taxes on interest that's accrued but not paid.

ANNA: We've talked about home equity loans and reverse mortgages. Let's shift our discussion to think about what other ways are there to integrate the way we think about our housing wealth as part of our financial and other planning for retirement and how effective are they? So do people have some different ideas to add going beyond thinking about reverse mortgages and the home equity loan?

DON: I think the most common way that people use their home equity often is when they reach a point that they need to move for care. They sell the home and that becomes a significant way of financing assisted living or even skilled nursing care, so that may be the most common way that home equity is actually tapped and used especially in late life.

ANNA: Of course, it's not really tapping the home equity but people live in their house, in a paid for house, to help keep their monthly expenses down, which is an important part of the planning for retirement.

SHEILA: This also relates to the question that Anna raised in her E-mail about the questions that we didn't raise.

One was Medicaid and the fact that you can keep your house and be on Medicaid and receive long term care services although some states tap into that equity after you pass away. A lot of people don't sell their homes and instead go onto Medicaid and often can leave their home equity for their heirs.

DON: Medicaid is a very complicated question, in effect, Medicaid is running a poorly run reverse mortgage program where in exchange for a lien on the house, you get the money fronted for the services, and on great terms. There's no origination fees, no mortgage insurance, no interest rates and states are even notoriously bad at collecting the debt but they have onerous use restrictions in terms of basically the state then dictates what you will get in terms of services and how much. One question that has arisen is could we rationalize that system a little bit better and have a public reverse mortgage program geared for those who have disabilities, that would have a more rational face where the terms are clear but the uses would be more under the consumer’s control.

ANNA: Let’s move on. Are reverse mortgages a viable product for the future, why or why not and how can they be improved?

CHUCK: I would think that they, in theory, are a viable product. For the future, I think is the key term here because given the current housing debacle and the decline in portfolio assets, people are going to need money and they still need shelter, home shelters. I would like to see more competition in the financial services industry, more innovative products, a lower cost structure, maybe some tax benefits and I think that might be the new method of funding retirement wealth in the future.

ANNA: As we answer this question, I'm curious as to whether there's a well established reverse mortgage market that anybody is aware of in any country that we might want to mention, so who else would like to add to question four?

DON: There are several other countries that offer reverse mortgages. The British have had some recent and unhappy experiences with them, Australia has a market though frankly even though it’s still a fairly small market in the United States we're probably further along than most. I think the key clearly is getting the cost down and that's going to have to be through some combination of product development and greater competition as we have already noted. Certainly, also right now the credit markets just have to get back to some kind of normalized state. A couple of years ago, we were seeing just the beginnings of a secondary market, for example for reverse mortgages, and that had the affect of driving the cost down by 50 basis points, the interest rates. Fannie Mae was charging a premium of 150 basis points over a 10 year treasury and that drove it down to 100 basis points. Now we're seeing margins of closer to 300 basis points so that gives you a sense of where we've come, in terms of the margins there.

Until we get the costs down and see some innovative products, I think we're going to be stuck as kind of a niche market.

TOM: I thought Ginnie Mae had some sort of securitized product here, do you know are they doing...

DON: They are but it's only for a fixed rate product with the buyers that you take out the full amount up front, so it's a very limited market. I have a note that part of the driver for looking at this what I call the reverse mortgage light product has been Ginnie Mae's interest. By having a fixed rate product that has a lower loan limit, more people might be willing to borrow the full amount, but you don't want to encourage people to take out these loans, borrow the full amount and then have it sit in the bank. That's a real negative arbitrage and that's essentially what Ginnie Mae kind of forces you into unless you want to use the full amount up front.

TOM: And that goes back to what somebody was saying earlier that, instead of a home equity loan, you could use these to get a lump sum, if that's actually what you want to do.

DON: And we are seeing some greater amount of that right now, frankly because there are so many people who are in foreclosure. So, reverse mortgages are being used in some circumstances to undo sometimes predatory loans, but also other loans that weren't necessarily predatory. Some people were in trouble with regular forward mortgages and so the large lump sums become very handy for that.

ANNA: Does anybody have more ideas about what features they think might be viable in products that would appeal to the market?

JOE: I think of this not so much in terms of features, but I first think of the kinds of things that would put me off taking a look at the product as it exists today. I think one of the things is certainly the costs and I'm hearing costs that can come up to figures like 8 or 10% of the loan value that you have to part with up front.

DON: It can be much higher than that.

JOE: Yeah and that's just to me you know it just seems crazy, why would I want a product like that and then the other part that relates to that, the inflexibility, I mean the worst of all possible worlds and this can certainly happen when you're retired, is you go through all the reverse mortgage thing and you pay this 10% or more of the loan value up front and then you have some kind of health situation come up, you have to change your housing situation, you pay off the small amount of the loan, but that upfront cost is entirely lost at that point, so in terms of things to overcome, it would seem to me that the cost and this inflexibility are really the things that would kind of put me off and I assume would put a lot of others off as well.

DON: You raise a very important point and I hate to monopolize this but the fact is that one of the disturbing things that we're finding is that among borrowers who take out the mortgages in their mid 60’s and we are seeing the average age go down substantially, those borrowers typically keep out the loans only 6 or 7 years and yet their actuarial life expectancy may be more like 18 years at age 65.

TOM: Do you know why that's happening?

DON: We don't know exactly, frankly, it’s one of the things that I'm in the midst of trying to convince AARP to fund the research to do because I think it’s an extremely important question and especially for the long term financial security of people who take out these loans for whatever reason early in retirement. Whether it’s because they want to buy that new boat and take that dream vacation or whatever they're in serious debt problems early in retirement so whatever the cause, after six or seven years, on average, what the HUD data tells us is they're paying them off and they may be leaving with relatively low equity. So what these people are doing to meet their housing needs and their other financial needs I think is an important question.

TOM: Is it possible that they're about to come into a big inheritance or something and they're just using it as a short term loan to tide them over until they get this pot of money?

DON: Not very many people are in line for a significant inheritance, I don't think that will explain a very big sliver of it.

TOM: Okay.

CHUCK: I think the average inheritance in the United States is about $40,000.00.

DON: I know, but you want to look at medians and you want to look at the whole distribution because those are a little deceptive.

ANNA: I'm going to move us on to question five. What is the impact of fraud and improper loans on retirees? Tom, maybe you'd like to start us off on that one, because I know you've done a lot of writing here.

TOM: Yes, I've done a lot of stuff on this, but I thought Don had some really good comments there, particularly I agreed with the first paragraph of his remarks, but yes, the elderly have been victims of a lot of predatory loans and I guess as I said before this sort of goes back into the issue of paying off the mortgage early, you have 80 year-old people taking out 30-year mortgages, which is pretty upsetting there and you know I think the other thing is that there's just a dearth of financial education, there are just too many people out there that aren't very astute financially. I guess as a personal aside here, I'm trying to educate my 25 year-old daughter who is a drama major , but it’s not very easy.

ANNA: Do other people have comments on fraud and improper loans.

CHUCK: I just thought that the topic of fraud really is the engine behind the entire mortgage debacle in the first place because I think you did have from the financial engineering, which was inherent, was originally I think legitimate. The role of collateralized debt obligations for example did serve a legitimate purpose. But when it became a mass appeal type of thing, you had systemic fraud in the real estate industry, among appraisers, among real estate brokers, among mortgage originators, and I think that was what fueled the popularity of this thing. I think it’s very sad that nobody, that I haven't seen any prosecution at the lower level, there were thousands of people involved in every state. Plus one last thing, the state regulators I thought were sitting on their hands here too did have authority and a lot of these people even forget there is a state regulator for mortgage and states attorneys general, so they didn’t have to just rely on the federal government.

TOM: All I can tell you is one of my colleagues and I wrote a paper for this conference. She has done everything she can to get action through the courts and it has been extremely frustrating for her because she's not getting anywhere.

CHUCK: Wow.

DON: I think it’s important to note that one of the drivers here is that just looking at the situation of older homeowners why are they targeted? In part, they are targeted because they in fact have built up the home equity, they have the money to borrow against and they have a combination of high home values but low incomes often. That makes them vulnerable to the kinds of fraudulent practices and predatory practices that we saw, just because they don't qualify by income for regular loans, but for sub-prime and predatory loans. That then sets off the downward spiral of equity stripping that goes on and repeated refinancings that we saw driving some of the sub-prime debacle.

TOM: My read on this is that the elderly people tend to be pretty vulnerable and can easily be talked into these things and the other people that were preyed upon were minority groups, particular African Americans and Hispanics.

CHUCK: I would just say one thing about the suitability requirements which do exist when you open a mutual fund or a hedge fund for example, I don't know if there are any suitable requirements for a lot of the products.

DON: I think that's an important question there about, this has come up in a number of states that have wanted to institute suitability requirements for reverse mortgages. Governor Pawlenty vetoed a bill that would have required that in Minnesota for example. Another alternative way to look at this is some efforts to increase the fiduciary responsibility of mortgage brokers, to act on behalf of their clients rather than on behalf of the lenders.

CHUCK: On the fiduciary standards, there is a group that is proposing that for the brokerage industry which I think would, might go full circle with ERISA because one of the key elements of ERISA was the adoption of fiduciary standards which made some very, very significant penalties for fiduciary violations. The brokerage industry is, to my knowledge, fighting the adoption of these fiduciary standards, which would change the entire way they do business.

DON: But as we treat home equity more like a financial product, as other products, and tapping it, I think developing parallel standards here noting the differences of course in the products but that there really are parallel issues to be dealt with here.

CHUCK: But I think the fiduciary standard is a major element in the financial services business and if they would have had some sort of fiduciary standards and some regulation among a lot of these independent mortgage companies, I think we wouldn't have this problem today, we'd have a whole different discussion.

DON: And to answer Tom's earlier question and complaints may find a more sympathetic hearing in the courts.

CHUCK: I think the idea of adopting fiduciary standards among the brokerage industry is key to prevent this in the future. I think the mass fraud was probably because there was no fiduciary standard. It probably made it very easy to do the fraud on the elderly and I think that and some of the failure at the state level, some of the state level authorities who do consumer fraud protection, I think this would have been an ideal thing for them to investigate and prevent but I haven’t seen anybody being prosecuted for this.

JOE: Just another issue related to fraud and this affects both mortgages and other financial products is I think one of the choices we have to make is very often we've looked at products in terms of we want to offer people a lot of choice, so we come up with a lot of product variations and I wonder if sometimes the product variations really create more opportunities for fraud and there's an open question in my mind is if we would be better off sometimes with more standardized products.

ANNA: Joe, I think that's a really good point. What would be some suggestions for standardized analysis of the issues and how to think about them? Fraud is a separate issue from being encouraged to buy a house that's a stretch for them. The idea of buying a house that is a stretch often ends up with a bad result for a lot of retirees, particularly if they have incomes that aren't indexed. A house that might have been a stretch when a retiree bought may be totally unaffordable later on. I'm looking for evaluation tools and hoping to get people to think about this within the framework of the long term. One of the things that the Society of Actuaries’ research also shows is that for people who were fairly newly retired and had assets that a lot of them weren’t thinking very long term in their planning. Too short of a planning horizon is a big issue.

JOE: I think that the house being a stretch also relates to the whole thing in our society about a lot of push to consume but not nearly as much push to save and certainly for young people starting out and this may sort of continue into later life, it seems it very often comes down to well let’s see how much mortgage we can afford, you know based on our income and things like that. We just pushed this as far as we can, that's the mortgage you can afford, therefore, you can afford this much house. It’s not really a question of do you really need this much house.

ANNA: Many retirees I know are frugal and seeking to manage carefully what they spend. I see them thinking about spending in a very different way than younger people often do. Do we have any more comments on the fraud question, if not I'm going to move us on to the next.

DON: I think there is one additional line of discussion there too, because with the reverse mortgage, except for relatively few recent products that allow a reverse mortgage for purchase, you're not buying a house, you're using it to fund consumption. So the question is, should certain products be prohibited or restricted from purchase, certain practices in sales. For example, we're seeing a fair amount of marketing to purchase annuities, or long term care insurance or other financial products or investment opportunities, etc., with a reverse mortgage, which almost never are in a consumer’s interest.

ANNA: Then, Don, would you say prohibit is one option and another option would be have some required disclosures and analysis at time of sale and a look back period?

DON: I mean these are the various options but in certain cases, it is just so unlikely that it would ever be in the consumer's interest that you simply prohibit some of the practices, others where there might be limited circumstances where they make sense. I think it's an important area for looking at just how restrictive do we want to go on the use side of these loans.

ANNA: Anybody have any follow up comments to Don's comment?

CHUCK: I guess one of the questions is how much you do it by restricting that way versus some stricter fiduciary type standards that could be applied in a more flexible way. I mean I've seen examples where for instance I think there was an example in the paper that Steve did of somebody basically taking equity out of their house and using the equity to buy what's known as a rated annuity product and that's actually what made sense in terms of this individual. I'm not sure that you want to just have a blanket prohibition that goes against this, even though it may be in the majority of instances it's not a good thing to do.

DON: There's always the potential of stifling of innovation versus some practices that have just been really unconscionable going on out there, but I think these are the options, you laid it out nicely, how much do you put on restricting particular products and sales versus how much you put a fiduciary responsibility that is enforceable.

STEVE COOPERSTEIN: Beyond the fiduciary responsibilities and restrictions, what concerns me is that seniors are so vulnerable. To retire one needs a significant amount of assets, albeit much, if not all, of such assets balance expected outlays during retirement. Replenishing any such assets that are unexpectedly depleted is difficult for someone with at best limited potential for earned income. These assets are open though, even beyond sales people, to fraudsters aware of the home equity of seniors. It comes to the next question, the policy that needs to be focused on the home equity and fraud against seniors, beyond the normal.

ANNA: Let's move to question six, but if there are other points that you all thought were important and that you haven't heard they can also be discussed at this point. Based on the recent events, what are the most important implications for policy makers, practitioners and related financial professionals as well as any other important issues not already covered? Would somebody like to start question six?

CHUCK: In my written comments, I mentioned about the real broad picture which is also I think of interest to actuaries about the whole concept of retirement in general. How, as a society, does America want to treat people who have retired and if you look at a snapshot 25 years ago, society did a good job of letting people build up retirement assets through either pension, 401(K) and housing wealth. However the current snapshot going 25 years forward, 25 years ahead is dramatically different so how are we going to fund social security, given the deficits, the very contentious debate over health care reform for example, regulatory reform, fiduciary responsibilities and I think we have this huge societal issue here over and above some of the nuts and bolts things when we discussed the first four questions.

ANNA: Chuck, I certainly agree and just recently testified at the ERISA Advisory Council that we need to be looking at the broad issues and I hope we'll have another round of real focus on the national retirement policy. It's been since Jimmy Carter's administration that there's been a real commission and study of national retirement policy. Who else would like to jump in?

DON: I think probably in the context there too is something that Sheila raised at the very beginning which Jacob Hacker has called the great risk shift and in general what we're seeing is a lot of shifting of risk of various sorts, including investing for old age, retirement, health care and other risks. These are being increasingly shifted to individuals from employers and from government programs even and I think the great policy question is are we going to shift further to individuals or what's going to be the continuing blend. Particularly, if employers are increasingly not going to be bearing the risks going forward in a global competitive world here and how do we treat various assets as part of a long term planning process that deals with some of life's risks in a very new economic context.

SHEILA: Related to those comments, you know I think we're going to be looking at potentially major tax reform in the near future. At least that's what the administration says to look forward to. Some of these issues such as treatment of homeownership and the tax code, treatment of retirement savings at different income levels and so on, I think are going to be really big issues.

ANNA: Does anybody else want to comment about taxes and whether tax policy, how its driving decisions people are making about homeownership and whether that's good or bad, from their personal perspective?

SHEILA: I just wanted to mention in case folks haven't seen it, there's some recent work by Bill Gale at Brookings. It's an interesting article on how the tax treatment of homeownership actually can be shown to increase the cost of housing. Also, the British slowly phased out their tax deductibility of mortgage interest and with no real harm to their housing market. Now this is before the crash, but nonetheless, I think there's more evidence behind changing how we treat housing on the tax code than we might think.

DON: In general, I would say it's clear that tax policy has encouraged homeownership and perhaps the over consumption of housing. Maybe part of what needs to be rethought through I think is part of what Sheila was saying about do we want to continue to encourage homeownership as a matter of policy? Is that part of what got us into this problem to begin with, by various tax and other incentives to encourage homeownership and what would be the consequence of moving away from that?

ANNA: I'm concerned not just about the basic concept of homeownership but also the balance between putting more money into housing versus money into financial investments and other savings. I'm also concerned that the tax policy encourages people not just to own homes but to put more money into homeownership and less into other forms of savings, but I don't know if that's really true.

SHEILA: I think, Anna, there is evidence that that does happen from some of this same research. Whether people would put it in retirement savings versus other kinds of financial assets is unknown, of course.

DON: Of course, mortgages and buying a house is a form of forced savings. Until recently, savings have gone down and down so in some ways its forced savings and in some ways is saving people in the long run. So to discourage housing and that forced savings, aside from the tax question, seems to not be cognizant of the way people are consumptive. If you can hook consumption into savings, it seems like, I'm talking about pre-retirement to a large extent, it seems like a good policy to follow.

TOM: That is an implicit assumption that house prices don't go down.

DON: Or even if they stayed the same, they're still saving.

TOM: Yes, I said they don't go down, if they go down, there's a huge problem and that's what we've just been through.

DON: Of course.

TOM: This is not a risk free investment in the least and in my paper on experience of FHA loans insured during the early 1980s in Houston that showed like half of the FHA insured loans in Houston ended up as an insurance claim.

DON: Yes, but over time, I would think that housing is a less volatile investment than securities or even bonds.

TOM: The problem is that you're not diversified, you have one house in one place and it’s not impossible to lose close to 100% of your money and then if most of your money is in that one asset, that's a very bad situation.

DON: I agree.

ANNA: To get back to the general question, I think that the idea that there would be more interest in annuities if there were different kinds of products offered should be explored. There are a lot of different kinds of products being designed, some of which let you get some of the money back if you die early. The economy has focused us on loss of retirement accounts. More people may realize that they need to be able to count on a steady stream of income.

JOE: Another thing unfortunately is what I call the financial advice system in this country is a bit more predatory than providing good advice and one of the things you look at is it’s not just people making decisions, it’s people making decisions in conjunction with those people they take advice from. For instance, if you take the question of you go to some financial advisors and say should I just take the pension my company is going to give or should I take the lump sum? If you take the lump sum, then for that financial advisor, they can earn money on those assets under management. Very often questions about buying an annuity versus not buying an annuity or taking a lump sum, things like that they also get very much affected by the financial advice system.

CHUCK: I agree, I think there's an inherent conflict of interest in what was just described as well as something as vanilla as selling mutual funds where there are revenue sharing agreements and 12B1C’s which restrict the options that are even told to investors by the financial advisor, which gets us back to the fiduciary discussion. But as far as the housing goes, I think there are going to be a lot of economists who would say you should just consider a house as a roof over your head and not an investment. I think we've been sold the American dream idea that the house is going to be a good investment. That's only true if it’s going to earn a relatively low risk positive rate of return versus a portfolio asset.

ANNA: If nobody has a other specific comments, what I would like to do is just go around and ask every member of the panel if they'd like it make a wrap up comment from their perspective. Steve Cooperstein, would you like to start the wrap up comments?

STEVE COOPERSTEIN: I'm concerned about retirees in the current environment. Home equity isn’t going to affect seniors if they don't have to access their home equity and it comes back, but with stocks, if they're withdrawing money they are accessing it at a reduced amount, then they're going to be more constricted and they're going to need to tap their assets more. I'm concerned that they're going to tap themselves in ways that haven’t been fully thought out, so I would really like to see financial advisory programs, even software that helps financial planners focus on how to integrate housing.

ANNA: Great point, Steve. The Society of Actuaries is just completing its second study of financial planning software to understand how the software handles different risks and of the sample of programs we've looked at, there are vast differences in the way to handle housing and some of them not at all so that's a big issue is integration of housing into these programs.

SHEILA: I guess as I said in the remarks here, I think housing is a big piece of the retirement income puzzle. I agree that so much has changed in the past few years or even the past decade with the decline of defined benefit pensions and increases and then declines in home values that it’s time really to look at, take a fresh look at this whole retirement income system.

ANNA: Chuck?

CHUCK: I would agree that there should be a more holistic approach toward retirement planning, which does include portfolio assets as well as medical expenses, including Medicaid, as well as housing. I think that's been overlooked but I also think this whole discussion has been shaped by the financial services industry, which does have a vested interest in taking the discussion in a certain direction. I think the housing area has been intentionally left out of the equation, but I think that this current problem, which was 100% man made, can be solved, too, by some regulation and some product innovation accompanied by some significant financial reform.

ANNA: Joe?

JOE: I'd just like to say that I think there's a huge product development opportunity as far as helping people be able to access home equity on some kind of a reasonable cost and flexible basis and I'd like to see some more work get done there than has been done to date.

ANNA: Don?

DON: I think the juxtaposition of two things that were the larger trends of shifting more and more risks to individuals to make financial decisions and yet the ongoing data that you cited, Anna, that consumers don't think about long term very well and don't know how to assess long term risks, especially in retirement where those risks come not only in terms of finances but health and other things that really impact long term security. Coming up with new rules of the road and new products to address this new world we're entering I think is a huge challenge and new regulatory approaches and public policies as well as private sector products, I think these are the challenges we face.

ANNA: Tom.

TOM: Just briefly here I think the issue is to get more people financially educated and in particular they need to get into a diversified portfolio and then just to go study financial history. If you go to the history of the United States, starting with George Washington, there have been all sorts of panics and recessions and depressions and all these assets can go down and they can go down a lot and people need to be aware of all of that.

ANNA: For the middle Americans who don't have a lot of money besides their house, holistic thinking about retirement is a huge issue for them as is when they claim social security. As we think about new planning tools, I think it’s important to help people think about how much money they put in housing differently, what they do about the house, but also when they retire and when they take social security, as well as thinking about the balance of house and financial investments. I'm really encouraged to hear us talking about both regulatory changes, fiduciary responsibility for brokers, new products and the potential that we can do things that would work better. I think this has been a really good discussion. I want to thank you all.