FINDING RETIREMENT SECURITY AMID UNCERTAINTY

A Monograph of the Society of Actuaries

Introduction to the Papers

By Linda Koco

The economy that emerged from the recession of 2007-2009 has brought with it significant challenges in thinking and planning for retirement security in America.

It has also stirred up countless questions for individuals, such as: How can I build a reliable retirement income stream that will survive future economic swings? Where do Social Security, pension benefits and tax-qualified retirement savings plans fit into my retirement plan going forward? What investment approaches will help? What is the role of annuities and longevity insurance? Which financial experts to choose? How can I afford to retire?

The Society of Actuaries (SOA), which has long sponsored research to enhance understanding of the post-retirement period of life, decided to ask retirement experts to weigh in. This monograph of 10 authoritative papers is the result. Several of the papers were presented at the SOA's 2011 Annual Meeting in Chicago, Ill., and now the SOA is making all of them available online.

The monograph is the latest SOA study to probe pressing issues about retirement trends and issues in America. Earlier works have included a monograph on retirement housing plus publications on retirement risks and retirement solutions for middle-market individuals. Shortly, the SOA will also publish a set of 11 Decision Briefs on retirement; these briefs spotlight the many decisions people confront as they approach and enter retirement.

In this new monograph, the authors turn their attention to retirement issues facing individuals and families in the second decade of the 21st century.

The SOA asked me to review the papers and share my impressions in this introduction. The exercise has been something equivalent to entering a think tank of thought leaders from different countries. The experts share the same goal—to explore ways that Americans can achieve retirement security in view of economic, demographic and many other 21st century trends—but their research, findings and conclusions are alternately unique, accretive, unexpected and sometimes provocative.

The following pages highlight a few threads from each of the papers, the purpose being to whet the appetite, not to summarize or abridge. To read the original documents, just click on the author links in the body of the discussion and you will be taken to the author's entire article.

POWERFUL HEADWINDS

Throughout the first decade of the 21st century, retirement experts continually warned that powerful headwinds were gathering that would change retirement in America. They forecast changes that would impact individuals, employers and government, due in part to the high-tech, globalized New Economy that was emerging but also due to many societal and financial changes that were underway.

One of the biggest changes affecting retirement was the continued decline in traditional defined benefit (DB) pension plans, and the accompanying growth of defined contribution (DC) retirement plans such as 401(k)s, 403(b)s, and 457s. This decline set in motion a world in which people with DC plans would need to learn how to manage their retirement plan money on their own—something their forebears in DB plans did not have to do.

This shift was occurring just as the 77-million-strong baby boom generation was approaching retirement—the largest-ever generation in America to do so—and as older people were experiencing longer lifespans than their predecessors. Advances in health care and rising health care costs also loomed as major plusses and minuses on the retirement horizon.

The U.S. retirement industry did take steps to prepare for the new retirement world in the making.

For example, the insurance sector came out with new annuity features for guaranteeing a retirement income stream, modernized long term care policies, and income-focused planning strategies. Retirement plan providers introduced auto-enrollment, auto-increases and target date mutual funds with glide-paths set to the workers' retirement date; they also began exploring in-plan income options. Long-term care institutions developed housing arrangements that were more personal, convenient and suitable than the nursing homes of yesteryear. Governmental bodies debuted retirement initiatives ranging from information, support and benefits programs to curb-less sidewalks, larger fonts on street signs, and various transport services.

There was so much activity of this kind that it almost seemed as if the country would be largely ready to accommodate the stream of baby boomers expected to enter retirement in the second decade.

But the Great Recession of December 2007 to June 2009 hit Americans hard. In 2011, the U.S. Census Bureau reported that, from 2007 to 2010, real median household income declined for all age groups except 65 and older. Those who were nearing retirement age suffered the most. For instance, households with householders aged 35 to 44 had a 5.6 percent decline in income; those 45 to 54 had a 9.2 percent decline; and those 55 to 64 had a 6.2 percent decline.

Statistical averages on declining income don't tell the whole story. Families suffering job loss, bankruptcy and home foreclosure experienced far deeper cuts, even financial ruin.

These very hard times ushered in widespread uncertainty about whether, if and how mid-Americans can achieve retirement security. Confidence in retirement declined so much that, by mid-2010, Towers Watson researchers were reporting that 40 percent of surveyed workers were planning to retire later than they had planned two years previous. Towers Watson also found that many workers were experiencing fear that they won't be able to afford retirement.

The concern continued through 2010 and on into 2011. For instance, near the end of 2010, AARP researchers were reporting that 40 percent of boomers who would be turning 65 in 2011 were planning to work until they "drop." And in March 2011, the Employee Benefit Research Institute (EBRI) and Mathew Greenwald & Associates, Inc., found that 27 percent of surveyed workers were "not at all confident" about retirement—up 5 percentage points from the level measured a year earlier.

In fact, the EBRI/Greenwald researchers found that workers were more pessimistic in 2011 than at any time during the two decades the two organizations have been conducting retirement surveys.

The authors of the monograph papers have assessed different aspects of the retirement future in light of all of this. Their conclusions are more hopeful than I had expected they would be, based on the ominous data that keeps coming out about the uncertain economy, the anemic recovery and the mounting retirement worries of many older people. Separately and collectively, the authors caution that many Americans will need to make critical adjustments in their retirement planning order to achieve retirement security, but the authors also present the changes as realistic, achievable goals.

TAKING A HOLISTIC APPROACH

Our review of the papers begins with a look at why at least two of the authors believe that advisors and consumers can benefit by taking holistic approaches to retirement planning in the retirement world that is unfolding. By holistic, they mean that retirement planning should take into consideration not only the financial issues that older people will encounter in retirement but also lifestyle, goals, relationships, housing, part-time work, hobbies and many other factors—in other words, the whole person.

These authors posit that retirement security hinges not just on money but on everything in the person's life. That is a lot different than the financial approach to retirement planning that has prevailed up to now. Consider:

Integrated (or Holistic) Financial Decision-Making: Chuck Yanikoski says there is "a mistaken impression that, when people actually do retire, accumulation simply becomes 'decumulation,' that we can just put a minus sign in front of the savings rate, and posit (or assume) that withdrawal rate and investment performance are now the two critical elements."

The reality is that the financial needs of retirees are much broader, and that investment return is no longer an overridingly critical variable, writes the founder of the Association for Integrative Financial and Life Planning and also founder and president of Still River Retirement Planning Software, Inc., Harvard, Mass.

In fact, Yanikoski maintains that retirement planning that focuses on withdrawal rate is "a highly inappropriate concept and "should simply be abandoned."

That statement will surely get the attention of financial advisors, many of whom take the withdrawal rate approach because they say it is simple and better for many retirees.

Yanikoski maintains that "a reality-based financial decision-making model" would be better. That's where the holistic thinking comes in. Such a model would focus on everything that affects the retiree's money, Yanikoski explains. It would include comprehensive data collection and analysis, too.

If the object is for the retiree to avoid running out of financial resources before death occurs and to provide a financial legacy, he reasons, "then everything that affects that outcome is relevant" In the retirement planning.

What is "everything?" Yanikoski presents the following list of issues as a starting point. He prioritizes them by impact, control and prevalence.

Table 1: Top 16 Financial Issues for Non-Wealthy Retirees and Near-Retirees, in Priority Order

	Impact	Control	Prevalence
Overall standard of living (expense management)	Very High	Very High	Universal
Moving to another residence	Very High	High	Very High
When to retire (or whether to go back to work)	High	High	Very High
Order in which assets are liquidated	Moderate	High	High
Planning for future mental incapacity	Modest	High	Very High
Planning for long-term care needs	High	Moderate	High
Annuitization	Moderate	High	High
Investment allocation / rate of return	Moderate	Moderate	High
Medical insurance options	Moderate	Moderate	High
Need for (or disposition of) life insurance policies	Moderate	High	Moderate
Debt management	Moderate	Moderate	Moderate
Optimal time to apply for Social Security benefits	Moderate	Moderate	High
Optimal retirement option to take from a DB plan	Moderate	Moderate	Moderate
Providing for dependent parents, children, siblings	High	Moderate	Modest
IRA Rollovers and Roth conversions	Modest	Moderate	Moderate
Trusts and estates	Moderate	Moderate	Rare

Source: Chuck Yanikoski, founder of the Association for Integrative Financial and Life Planning and founder and president of Still River Retirement Planning Software, Inc., Harvard, Mass.

Most retirees and near-retirees need to deal with these issues in their planning, Yanikoski maintains. They should also have detailed retirement plans that incorporate scenario testing, offer specific integrated advice and bring in the non-financial issues in holistic manner. Most investment-oriented retirement models do not do all this, Yanikoski allows. But he insists they should, because the broader more all-inclusive approach not only can work, but it can also "improve results by orders of magnitude," he explains.

SOA member Steve Vernon, a columnist for CBS MoneyWatch and president of Rest-of-Life Communications, Oxnard, Calif., is also a strong advocate of holistic strategies. In fact, in his writing and his advisory work, he says they are "essential."

Due to the many economic shifts in the country, the traditional retirement approaches—drawing on a pension, Social Security and private savings—may no longer be sufficient to solve the retirement challenges of middle Americans, he says repeatedly.

Some mid-Americans who become aware of the challenges ahead may respond by planning to work during retirement, postpone retirement, save more and/or cut back, Vernon says. But people should put the focus on establishing holistic goals for retirement and then make their plans from there, he says.

For instance, instead of viewing retirement as a period of not working, he suggests a more suitable goal is to approach retirement as the "rest-of-life"—a period that is not just financially secure but also fulfilling and healthy. So, when assessing whether to work longer, cut back or other options, he recommends that people also assess whether the various options will jeopardize life fulfillment, health and financial security.

Such talk may not sit well with advisors who believe in the "build the finances and the retirement life will follow" approach to planning. Some have told me they are uncertain about how to help clients set up a suitable plan from the holistic perspective. Vernon seems to have anticipated those concerns, because he has developed the following 10 steps to help people do this very kind of planning.

10 Steps to Holistic Retirement Planning
1) Do a realistic assessment of circumstances and resources. 2) Stay healthy. 3) Protect against catastrophic health risks. 4) Work as long as possible. 5) Make social security income as large as possible. 6) Make employer-sponsored pensions as large as possible. 7) Be prudent when withdrawing retirement savings. 8) Adopt simple, effective investment strategies. 9) Be thoughtful about tapping home equity. 10) Adjust living expenses to match income.
Source: Steve Vernon, "Retirement Planning for the Middle Class: Holistic Strategies Will Be Essential," Journal of Financial Service Professionals, March 2009

To achieve retirement security, Vernon concludes, mid-Americans will need to integrate finances with their lifestyle and make the most effective use of available resources, too.

APPROACHES FOR BEFORE PEOPLE RETIRE

A number of the monograph authors have examined approaches that people and their advisors can take before retirement starts. These include new approaches to money management, investing, tax management, and long term care.

Money Management and Routes to Improving Security: Kenton Hoyem and Wei-Yin Hu, both of Financial Engines, Inc., Palo Alto, Calif., call for a new approach to money management.

Many people don't know what to do with the retirement funds they have left following a market crash, Hoyem and Hu explain. Some just panic and then move the money into cash or other instruments that they perceive to be safe. But going to a cash-only position "is likely to do more harm in the long term," they say, because "the lower forecast growth of such a portfolio significantly reduces forecast retirement income."

Other people try to cope with the after-effects of a market crash by spending less, choosing more risky investments in an effort to gain larger returns, saving more than before the downturn, or working longer before entering retirement.

Those strategies can work in certain situations, especially the last two strategies, according to Hoyem and Hu. But after testing hypothetical workers in many different scenarios, the two researchers arrived at an eye-opening conclusion. For many workers, they say, the most comfortable approach would be to "save more" *and also* to "work longer" before entering retirement.

Liability-Driven Investing: Where retiree finances are concerned, Michael Ashton, managing principal at Enduring Investments LLC, Morristown, N.J., urges advisors to consider using a liability-driven investing (LDI) approach.

When determining the optimal portfolio asset allocation strategy and the maximum sustainable withdrawal rate for retirees, some advisors focus on using "very simple algorithms," Ashton points out. But some of those approaches rely on historical data sets, even though what happened in the past may not occur again in the future, he says.

Instead, he suggests that advisors use the LDI approach he outlines in his monograph paper. The approach is comparable to the LDI model that pension funds use—i.e., invest today "in such a way as to ensure that future liabilities can be covered." When assets and liabilities are more closely matched, he writes, the sensitivity of the strategy to unexpected returns, risks, and correlations decreases greatly.

In addition, rather than optimizing on the basis of volatility of the assets themselves, the LDI strategy seeks instead to maximize return for a given level of volatility of the portfolio surplus.

Individual investors and pension funds do differ in significant ways, Ashton allows. For instance, "a pension fund generally has contractual terms that make its liabilities relatively clear, while an individual investor generally does not." Still, he says, by reducing the mismatch between assets and liabilities, an advisor can reduce the importance of the assumption that the returns, variances, and correlations the client experiences will be like those of the historical data set.

The natural question is, how could this help the retiree? In scenarios conducted using this approach, Ashton writes, "an LDI-aware strategy is difficult to dominate." Furthermore, he says, the LDI-aware investor will likely be more comfortable (and therefore, perhaps, be able to invest surpluses in a more return-seeking than risk-minimizing fashion)."

In an era where many people are uncomfortable and uncertain about many things—including investing and retirement prospects—such an outcome could make a difference.

A Tax Diversification Strategy: In the years ahead, retirees will likely be facing some serious tax challenges. Taxes are likely to increase as the federal government seeks to repay the national debt, shore up Social Security and Medicare, launch the new health care reforms and fulfill many other responsibilities. This will be happening as more and more baby boomers retire and start withdrawing money from qualified and non-qualified accounts.

The question is therefore, what is the most advantageous tax strategy?

Gregory C. Freeman, a financial advisor and the president of Strategic Stewardship, Woodstock, Ga., has been looking into this. In his monograph paper, he concludes that higher income retirees could benefit from applying a "tax diversification" strategy.

This strategy focuses on maximizing "the diversification of investment portfolios based on creating multiple sources of income, each taxed in a different way," he says. The approach would, for instance, draw assets from different "tax buckets" such as bank certificates of deposit, money market funds, pensions, defined contribution accounts, annuities, stocks and bonds, cash value life insurance, and more. The idea is to blend after-tax income from different sources and to offer the increased ability to manage taxes, no matter which way the tax law changes.

That's quite a bit different from traditional tax strategies built around a tax law that is assumed to be static. These generally try to maximize tax-deductible savings today with the assumption that the client will enjoy lower tax rates in the retirement years.

Freeman's approach is an ideal example of how retirement experts are changing their thinking in view of today's economic uncertainty. Since the emerging tax environment is likely to be unpredictable, possibly characterized by increased tax rates and changes in fees, exemptions and deductions, he believes that traditional tax strategies will be less effective going forward. The tax-diversification strategy could, by comparison, be more tax efficient and therefore help position clients for a more financially secure retirement.

The strategy will, Freeman says, leverage current tax laws to help improve a client's retirement income, while still protecting investments and income from being over taxed.

To illustrate, he tells of an analysis he did of retirees putting retirement income assets into just a few tax qualified accounts versus those using a mix of accounts, each taxed in a different way. In one scenario, a client using the multiple tax bucket approach could end up paying $53,000 less in taxes compared to a client who had invested the same account value but in only one type of tax bucket, he says.

Diversified tax planning would not be as important for clients anticipating a modest retirement income of perhaps $60,000 a year or less, Freeman cautions. In fact, he says, those with a reasonable expectation of staying in the lower brackets during retirement could be adversely affected. But higher earners could benefit. That is a key point that retirement advisors may want to consider as they mull this over.

A New Approach to Long-Term Care Plans: Yet another pre-retirement issue has to do with preparing for long- term care funding, writes Yung-Ping Chen, a fellow in the Gerontology Institute and a professor emeritus at the University of Massachusetts Boston.

A perfect storm seems to be gathering in this area as the second decade unfolds. “Just as need for long-term care awaits some baby boomers as they age, both private and public funding for it is becoming less available,” he writes in his monograph paper. So, “how to avert a Katrina of long-term care?”

How indeed? In October 2011, the federal Department of Health and Human Services stopped implementation of a nationwide voluntary private insurance program for long-term care called the CLASS Act. The law had been enacted in 2010 but government analysts subsequently determined that it was not financially sustainable.

Retirees can purchase private long-term care insurance on their own, of course, but while some have done so, many others have not. Retirees also can, and do, self-pay for care, but they need to have funds available for that, and many do not. Those who are indigent can get some help from Medicaid, although that program may well be curtailed in the New Economy in ways that vary by state. A good many retirees rely on family and neighbors for assistance, but availability and ability may not always be present. So obtaining care will be a serious retirement issue in the retirement future.

In his monograph paper, Chen asks readers to consider another approach. That would be to set up a Social Security/Long-Term Care (SS/LTC) plan.

The SS/LTC plan would divert perhaps 5 percent of the retirees’ Social Security benefits to pay for their own care. It has met with objections and reservations, Chen allows. But he argues for its consideration on the grounds that SS/LTC is a method of paying for long-term care “by deploying the sources of funding currently in use differently, relying more on insurance, both social and private, and less on personal payments and public assistance.”

APPROACHES FOR AFTER PEOPLE RETIRE

Some of the monograph authors look further down the road, suggesting approaches that might help Americans in the period after they have entered retirement. The topics covered here range from new paradigms for post-retirement and the search for the optimal withdrawal rate to illiquidity as an option in the retirement plan and the timing of annuitization.

New Paradigms that Focus on the Post-Retirement Period. Anna M. Rappaport, an actuary and founder of Anna Rappaport Consulting in Chicago, writes that the period after labor force exit will be quite long for some people who may live to age 100 or beyond. Her view is that success during this period will require more than knowledge about managing financial resources.

Success will require “a combination of financial management including a focus on risk, health management, focus on relationships, focus on engagement, and activities that are meaningful to the individual,” she says.

That can be viewed in the same vein as taking a holistic approach to the post-retirement years.

This will not be easy. As Rappaport puts it, a lot of what people think they know about retirement is often “misguided or false.” For instance SOA research that has found that some retirees with moderate assets tend to deal with things as they occur and do no formal retirement planning, she notes. The research has also found that although many are aware of long-term care insurance, few buy it and a number think it is too expensive. As for annuities, the researchers found “very limited awareness” of these products.

Adding to the difficulties is that, employers, the financial services industry and governmental bodies are all encountering challenges in adjusting to their role in the new retirement landscape.

One example Rappaport cites is the current reluctance of employers to offer, and policymakers to mandate, lifetime income options inside of defined contribution (DC) retirement plans, such as 401(k) plans. She suggests that part of the reason for this reluctance is that employees tend not to choose these options (if offered). In addition, she says, “regulatory issues in the U.S.—such as joint and survivor annuity and spousal consent requirements, annuity provider selection responsibilities, and/or fiduciary responsibilities, etc.—create more work and uncertainty for plan sponsors.

Still, the situation is far from hopeless. For one thing, retirement plan participants are likely to be more concerned about a secure income stream in light of the recent economic crisis, writes Rappaport. “As a result, policy and practice are under study in many countries and change is likely,” she predicts.

Furthermore, Rappaport and other retirement experts are speaking and publishing extensively on retirement issues and solutions, and they are doing so with an intensity that I, as a reporter and editor, have not witnessed before in my 20-plus years of writing about retirement. Just as the squeaky wheel gets the grease, this intensity may be the lever that moves individuals to do more planning, and policymakers and industry players to respond with more effective products and strategies.

Optimum Withdrawal Rate: One of the most pressing concerns for many people today is how much they can safely withdraw from their retirement savings without fear of running out of money.

For the past five or so years, perhaps a little before, many retirement experts have been recommending a systematic withdrawal rate of 4 percent a year as a rule of thumb. That’s a substantial reduction from the 8 percent a year often bandied about in the 1980s when interest rates were in the double-digit range, and from the 5-6 percent often broached during the go-go 1990s when the stock market was skyrocketing (and again, in some quarters, in 2005). However, the depth and duration of the 2007-09 recession and its aftermath have caused experts to question even the 4 percent rate.

Chris O’Flinn and Felix Schirripa, FSA, decided to revisit the issue. The two researchers are co-founders of ELM Income Group, Inc., a Washington, D.C. insurance agency where O’Flinn is now president.

In their paper, O’Flinn and Schirripa detail the impact of different withdrawal rates on model portfolios based on the historical record and the latest available data.

Their conclusion is as revealing as it is disturbing: A retirement income plan based on a 4 percent withdrawal rate “carries an historical risk of failure for a long retirement that is much higher than generally acknowledged. For example, 15 percent of the historical 35-year retirements failed when funded with equal parts of stocks and bonds.”

The conclusion might be disturbing to some people, because many financial advisors continue to say that the 4 percent rule of thumb is the dominant—and widely accepted—withdrawal recommendation. If that is the case, then a good many retirement plans could be at risk, based on the O'Flinn/Schirripa analysis.

Of course, it is always possible that the 4 percent rate will work out satisfactorily to support a particular client's lifetime needs, or even many clients' needs. However, advisors and planners might want to review the O'Flinn/Schirripa findings and suggestions, just in case the material offers perspectives their own analyses had not considered.

Illiquid Vehicles*:* In some cases, old financial approaches may become new again as consumers and their advisors strive for retirement security. Illiquidity is one example.

Insurance companies have offered income annuities and annuitization (which converts a liquid lump sum into an income annuity) for decades. Both approaches are illiquid in the sense that they lock up the client's money in return for paying the client a guaranteed monthly income stream for life (or selected period).

Consumers have generally ignored both products, and researchers have generally found that the key reason consumers don't annuitize or take out income annuities is that they don't like illiquidity. Consumers want access to their money at all times, the researchers have said time and time again.

The last recession seems to have changed public perception on this, however. In second quarter 2011, income annuities reached an 11 percent share of the fixed annuity market, up from just 4 percent eight years prior, according to Beacon Research, Evanston, Ill. Another researcher, LIMRA, Windsor, Conn., says that income annuity sales in 2010 sales reached $7.6 billion, almost double the $4.6 billion sold eight years prior. That means more money is going into illiquid products.

As for annuitization, use is still pretty low, says Garth Bernard, president and CEO of the Sharper Financial Group LLC, Burlington, Iowa. However, Bernard predicts that "we may be witnessing the dawn of a new era where annuitization becomes a more commonly exercised option in retirement income solutions alongside other retirement vehicles that are more widely used today."

Why will this happen? Consumers will come to value what he calls the "utility of illiquidity," Bernard says. That is, they will value how annuitization will enable them to receive a "significantly higher" monthly income stream in retirement or to produce a given level of income with "substantially less assets" than would be possible with liquid vehicles, he says.

Other benefits of illiquidity may also come to light. For instance, owners of illiquid products will see that their other assets are now free for other purposes—if, say, the owner used the illiquid products to help cover the basic fixed expenses. In addition, Bernard says, the illiquid products function has hidden assets in the sense that they cannot be spent, lost, stolen, or shaken by the markets. "That may be a solid foundation for a retirement plan," he says.

The Right Time to Buy An Income Annuity: Jeffrey K. Dellinger, an actuary and CEO of Longevity Risk Management Corporation, Ft. Wayne, Ind., has challenged the popular notion that the right time to buy an income annuity is later in the retirement years. In his monograph paper, Dellinger calls that notion a "misconception" and one that could end up reducing a person's retirement income substantially, potentially forcing a person to adopt a lower standard of l living.

The misconception is not without supporters. After all, many financial advisors and retirement experts have been urging older people to delay purchase of an income annuity for 10 or more years after retirement, on grounds that the retirees will get a larger monthly payout by waiting.

But Dellinger ran the numbers on a variable annuity, looking at what happens to retirement income if the assets are annuitized (to a variable income annuity) at retirement versus after 10 years of taking systematic withdrawals.

His calculations came to a startling conclusion: A woman who retires at age 62 would receive 11.6 percent higher income every year after age 71 if she buys the variable income annuity at time of retirement rather than 10 years later. This assumes the premium is the same in both cases, that the woman takes the same level of income from the two programs during the first 10 years, and that the portfolio kept growing at a constant 7 percent investment account rate of return.

Readers can find the additional assumptions in the paper, including discussion of the impact of mortality credits. But for purposes here, the finding and the new thinking that fuels it represent a decided departure from traditional retirement planning concepts. It will be food for thought for advisors who have annuity clients who are asking the "when is the right time" question.

THE IMPACT OF BEHAVIOR ON RETIREMENT SECURITY

A key question that has become more important in the wake of the recession of 2007-2009, has to do with financial decision-making among seniors. Specifically, given that investors are routinely encouraged to make a gradual shift to less risky investments as they approach retirement, why did older investors with more than $200,000 in retirement savings lose more than 25 percent of these funds by year-end end 2007? More broadly, why do people make the financial decisions they make?

Melissa A. Z. Knoll, an expert in the Office of Retirement Policy for Social Security Administration, Washington, suggests that behavioral factors are at work here, not just economic factors. She is among a new breed of retirement experts, who are incorporating findings from behavioral analysis into their retirement security thinking and proposals.

In her monograph paper, Knoll points out that a person might decide to save, or not to save, based on insufficient knowledge or information. Another person might rely on rules of thumb and biases more than financial facts or details. Still others might be swayed by personal issues such as self-control, procrastination, and emotions, or by the way that financial options are presented, considered, or arranged.

This wide variety of factors may help explain some of the unsatisfactory choices and decisions that retirees made before, during and after the 2007-09 recession, even retirees who were previously exposed to sound retirement plan options.

Behavioral economists have been studying such differing behaviors for many years, but Knoll goes a step further. In her paper, she presents some interventions that she says researchers, policymakers, and financial planners could offer "to aid individuals in their pursuit of future financial well-being." One such intervention involves changing a person's point of reference. Here is Knoll's explanation:

"Imagine an employee who earns $55,000 and finds it too difficult to save for retirement because of current financial needs. This individual may ask herself, 'would I have turned down my job if I was offered $52,500 instead?' More than likely, her answer would be 'no.' The difference in weekly earnings between a job with a $55,000 salary and a $52,500 salary amounts to only $50, which can accumulate to roughly $325,000 of savings over 40 years, assuming a 5 percent rate of return (SSA, 2009). Once an individual recognizes that she would have survived had she been given a different reference point initially (i.e., a different starting salary), she may recognize that she could adapt to a smaller income each week."

Knoll's belief is that interventions like this will help encourage savings across the lifespan. That should, in turn, help to ensure that people will be more financially secure in retirement. If there is a better time than now to explore these ideas, it is hard to know when that would be.

CONCLUSION

In their monograph papers, the authors have sketched out a hopeful, albeit cautionary, picture of retirement planning in the years ahead. They concede that serious challenges exist but say there are some things that mid-Americans and financial advisors can do to improve the likelihood of achieving a secure retirement.

These approaches may entail taking a holistic approach to retirement planning and retirement living. That could lead to decisions to work longer, save more, delay Social Security, and/or spend less or differently. Insurance and financial advisors who work with older clients may find themselves talking with clients as much about lifestyle, emotions, and housing preferences as about assets and income streams. Concern about finances will naturally continue, but several of the monograph authors suggest that retirement planners may increasingly decide to incorporate these considerations alongside other retirement considerations, not in place of them.

Going forward, advisors and clients may find themselves working with different tools and paradigms to for the pre- versus post-retirement years. Employers, retirement plan sponsors and government may be called upon to change their existing approaches to accommodate the new paradigms and the new needs of those in retirement.

Retirement planners might increasingly recommend not only income annuities and new-styled long term care plans, but also illiquid products right alongside the liquid products. Some advisors may employ tax diversification strategies, withdrawal percentages lower than 4 percent, new money management approaches, and applied liability-driven investing. Behavioral analytics might wend its way to the planning table too.

The monograph papers offer ideas and suggestions, not predictions and prescriptions. I also think they are invitations, in the sense that the authors are inviting financial professionals and other interested Americans to the table of engagement, inspiration and innovation regarding retirement in the United States. The hope is that readers will find something in the papers or the ensuing discussion that sparks a solution to a stubborn problem or opens a door to an opportunity not yet considered. For that reason alone, the SOA's monograph papers are well worth exploring.

About the Author:

Linda Koco, MBA, is a Cleveland, Ohio writer and editor who has written extensively on retirement income issues, planning, strategies and products. For a number of years, she has served on the Society of Actuaries' Committee on Post-Retirement Needs and Risks. Currently, she is a contributing editor for the *InsuranceNewsNet* magazine and website as well as the *AnnuityNews* e-newsletter and website. Previously, she was a senior editor of *National Underwriter Life & Health* magazine and managing editor of five of its e-newsletters, including the monthly *Income Planning* e-newsletter.