

Retirement Risks and Solutions in the Middle Market

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Context: Society of Actuaries Post-Retirement Risk Research

Focuses on post-retirement period

Committee on Post-Retirement Needs and Risks

- Bi-annual risk survey
- Managing Post-Retirement Risks
- Ongoing project on decisions
- Software research
- Segmenting the Middle Market

All work is available online

Context for Study

- Lot done to identify problems, but no general agreement on solutions
- Believe that middle market not well served and facing increasing challenges in light of DB decline
- Requests made to focus on middle market solutions
- Some plan sponsors/employers hire planners to help employees retiring or leaving for 1-2 hours; they need guidance
- Hope that “mass customization” could be applied to setting up solutions – but ended in disagreement

Middle Market Retirement Research

Segmenting the Middle Market:

RETIREMENT RISKS AND SOLUTIONS

- Phase I: Profiling the market
- Phase II: Identifying needs and solutions

Phase I: Profiling the Middle Market

- Identifying the market
- Profiling the segments
- Retirement issues and risks

Composition of the Middle Market

- Middle Mass 25th – 75th percentiles
- Middle Affluent 75th – 85th percentiles

- Segments Studied
 - Ages 55 – 64
 - Ages 65 - 74

Profile of Middle Mass Segments

		Median Income	Median Net Worth	Financial Assets
<u>Age 55 - 64</u>				
Married	(29%)	\$75,000	\$348,000	\$108,000
Female	(14%)	28,000	111,000	36,000
Male	(8%)	41,000	125,000	36,000
<u>Age 65 - 74</u>				
Married	(17%)	45,000	285,000	100,000
Female	(11%)	18,000	130,000	45,000
Male	(5%)	25,000	130,000	42,000

Profile of Middle Affluent Segments

		Median Income	Median Net Worth	Financial Assets
<u>Age 55 - 64</u>				
Married	(6%)	\$132,000	\$1,300,000	\$416,000
Female	(3%)	58,000	415,000	116,000
Male	(2%)	79,000	465,000	116,000
<u>Age 65 - 74</u>				
Married	(3%)	93,000	1,100,000	410,000
Female	(2%)	43,000	480,000	160,000
Male	(1%)	54,000	490,000	150,000

Significant Characteristics of Middle-Market Finances

- Net assets of the middle-mass market are very limited and provide little retirement support
- Generally, approximately two-thirds of assets are non-financial, usually a home but sometimes a business
 - Most middle-market retirees will have to extract value from their home for retirement living purposes

Phase II: Identifying Needs and Solutions

- Key decisions
- Process overview
- Core flow of financial planning
- Key issues
- Profiling the needs of the middle market
- Profiling the twelve segments

Key Decisions Affecting Retirement Plans

- When to retire
- Work part-time during retirement?
- Timing of claiming Social Security
- Long-term care insurance purchase?
- Immediate annuity purchase?
- Individual health insurance purchase?
- Participate in retiree health insurance benefits?
- Life insurance purchase?

Key Decisions Affecting Retirement Plans

- Investment of retirement assets
- Hiring a financial advisor?
- Home equity loan?
- Reverse mortgage?
- Sell house/downsize?
- Move to continuing care retirement community?
- How to receive pension benefits (lump/annuity)
- Method of distribution from 401(k)
- Use of required minimum distributions

Core Flow of Financial Planning

- I. Quantify assets and net worth
- II. Quantify risk coverage
- III. Compare expenditure needs against anticipated income
- IV. Compare amount needed for retirement against total assets
- V. Categorize assets
- VI. Relate investments to investing capabilities and portfolio size
- VII. Keep the plan current

I. Quantify Assets and Net Worth

- Financial
 - Tax-qualified
 - Other
- Non-financial
 - Home
 - Business

II. Quantify Risk Coverage

- Casualty (recognize deductibles)
 - Life insurance
 - Medical
 - Long-term care
-
- Affects need for emergency funds

III. Compare Expenditure Needs Against Anticipated Income

- Essential spending
- Discretionary spending
- Unpredictable expenses (emergencies)

- Social Security
- Pension income
- Other annuities
- Part-time employment
- Rental income

IV. Compare Amount Needed for Retirement Against Total Assets

- Present value of net needs
- Investment return / income tax / inflation
- Life expectancy / health status

- Special bequests?
- Need to revise plan?

V. Categorize Assets

- Liquidity for short-term needs
 - Insurance coverage and health condition influence emergency fund needs

VI. Relate Investments to Investing Capabilities and Portfolio Size

- Don't invest beyond your skills or those of your investment advisor
- Invest within your risk tolerance
- Appropriate assets vary by skill & tolerance profile

VII. Keep the Plan Current

- Health status and greater healthcare costs
- Living longer or shorter than expected
- Poor planning and unrealistic expectations
- Inflation
- Long-term care costs
- Loss of employment/forced early retirement
- Inability to find post-retirement job
- Unrealized pension benefits
- Public policy change

VII. Keep the Plan Current (cont'd)

- Death of a spouse
- Other change in marital status
- Loss of ability to live independently
- Unexpected needs of dependents
- Change in housing needs
- Financial literacy
- Liquidity needs
- Bequest goals and objectives

Key Issues

- Planning process
 - Investment and other scenario analysis is important
 - Provide for variability
 - Planning choices involve tradeoffs
 - Irrevocable decisions vs. those that can be changed
 - Planning horizon should be long
 - Critical analysis of spending

Key Issues

- Retirement decisions
 - Choice of retirement age is important
 - Choice of Social Security start age is important
 - Working after retirement may be needed
 - Retirement planning is a continuous process
- Investing
 - Risk tolerance and investing skills dictate choices
 - Planning depends upon risk tolerance
 - Investment choices should be well understood and suited to circumstances

Key Issues

- Personal situation influences decisions
 - Health status influences retirement needs
 - Uncertainty of longevity is a risk
 - Discretionary expenditures must be recognized
 - Need for flexibility in the use of housing assets
 - Family members may become dependent
- Risk management
 - Annuities can provide longevity risk protection
 - Insurance coverage mitigates the volume of needs

Profile of Middle Market Retirement Status

- Middle-mass pre-retirees and retirees have inadequate savings in the absence of significant pension or employment retirement income
- Middle-affluent single pre-retirees have inadequate savings in the absence of moderate pension or employment retirement income

Profile of Middle Market Retirement Status

- Middle-affluent female retirees have adequate retirement savings
- Middle-affluent male retirees have inadequate savings in the absence of moderate pension or employment retirement income
- Middle-affluent married pre-retirees and retirees have adequate retirement savings

Challenges for Middle Market

- Middle-mass and single middle-affluent
 - Financial assets are limited - suggests personal assets/Medicaid for LTC
- Middle-mass
 - Deferred retirement may be necessary
 - Employment during retirement may be needed
 - Home value will need to be turned into income
 - Social Security is not enough
- Middle-affluent male pre-retirees and retirees and female pre-retirees
 - May need income outside of Social Security

Challenges for Middle Market

- All middle-market households have bulk of assets in non-financial assets, generally a home
 - Many will need to convert to cash via sale, forward mortgage, or reverse mortgage
- In most cases, recommended conservative investing will limit upside potential but is needed due to limited assets
- Deferring retirement, possibly to age 70, can mitigate, but not necessarily eliminate, some of the challenges

Example 1 – Middle-Mass, Pre-retired, Married

- Age 60; retire at 66
- After-tax assets \$370K (\$240K non-financial)
- Income need: \$60K “essential”, \$5K discretionary
- Social Security: \$38K
- Need at retirement: \$521K without pension or earned income; \$318K if \$15K income; \$115K if \$30K income.
- Retire later? Part-time work?
- Will need to extract value from home.
- Medicaid for LTC?
- Stay with low or medium risk assets.

Example 2 – Middle-Mass, Pre-retired, Single Female

- Age 60; retire at 66
- After-tax assets \$116K (\$75K non-financial)
- Income need: \$25K “essential”, \$5K discretionary
- Social Security: \$15K
- Need at retirement: \$236K without pension or earned income; \$166K if \$6K income; \$108K if \$11K income
- Retire later? Part-time work?
- Will need to extract value from home.
- Medicaid for LTC?
- Stay with low or medium risk assets.

Example 3 – Middle-Affluent, Pre-retired, Married

- Age 60; retire at 66
- After-tax assets \$1,306K (\$884K non-financial)
- Income need: \$60K “essential”, \$46K discretionary
- Social Security: \$42K
- Need at retirement: \$1,258K without pension or earned income; \$991K if \$26K income; \$714K if \$53K income.
- Will need to extract value from home or business.
- LTC insurance may be appropriate to protect assets.
- Medium risk assets with some risk exposure possible.

Perspectives on Work

- Oversight group – lacked full consensus on results
- Reflects fact that there is no agreement about the right post-retirement solution
- Research report provides platform on which to build solutions/recommendations
- Original project goals were partly but not fully met – RIIA members can use for dialogue on solutions and maybe develop them further
- Still need way to find solutions for individuals with modest time investment

Perspectives on Work

- Many middle class people have very little financial assets. Their biggest decisions are;
 - When to retire and claim Social Security
 - What to do about housing/housing wealth
- Concerned that traditionally planning and software may not address relevant issues
 - Investment strategy not relevant for people without assets
 - Need more thinking about how to integrate housing and retirement planning

What Else is in the Report

- Identification of a range of products to help solution
- Framework for matching products to situations
- Twelve scenarios

Publicity on the Report

- Marketwatch – Bob Powell interviewed Noel Abkemeier
- US News & World Report
- CBS Moneywatch
- Philadelphia Inquirer
- Yahoo.finance

19.4 million media impressions

What is Next

- Updating data/profiles? – exploring what can be done and costs
- Bringing results to planning community and dialogue about them
- More work on solutions for middle Americans