Spending Lump Sums: Why Do Retirees Do What They Do?

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Agenda

1. Decision to retire
2. Why they retired
3. How they knew they could afford to retire
4. Sources of income
5. How they calculate ability to retire
6. Did their lifestyle change?
7. Did their investments change?
8. Key concerns
9. Concerns about longevity
10. Viewpoints towards annuities
11. Attitudes towards advisors
12. Managing retirement
13. Advice for tomorrow

Methodology

- Six focus groups (Hartford, Chicago, Phoenix)
- Retired 2-10 years
- Ages 60-72
- Financial decision maker
- Had investments of $50,000 to $500,000 in 401(k) or other employer-sponsored plan
- Had total retirement savings of $100,000 to $500,000 at retirement
  Now have $100,000 to $2 million in all investable assets, including investment real estate

1-2. The Decision to Retire

- Most retired before age 62
- Many had a target age
- A number were burned out
- Some were offered packages
- Many retired before they planned to

3. How They Knew They Could Afford to Retire

- The Main approach
  - Most had a good sense of their living expenses
  - They determined that their Social Security, pension (if available) and income from investments could provide for their monthly expenses
- A Minority Use Financial Advisor to Calculate Need
- Most Often the Decision is Made Right Before Retirement
  - None Had Targets for How Much to Accumulate for A Target Retirement Date

4. Sources of Income

- Most have diverse sources of retirement
  - Most have traditional pension plan
  - All have Social Security
  - Almost all have equities, bonds and cash
  - Few have long term care insurance
  - Just a couple have immediate annuities

5. How They Calculate Ability To Retire

- Scenario Testing Revealed the Typical Process
  1. Calculate monthly expenses
  2. Add up monthly benefits from Social Security and pension plan
  3. Derive shortfall
  4. Add up investable assets
  5. Multiply investable assets by approximately 6% to derive expected investment income
  6. Retirement feasible if expected income fills shortfall

6. Did Their Lifestyles Change?

- Many report higher expenses
  - Have more time to fill, do more entertaining and sports
  - None live on an exact budget or have hard targets for how much to spend each year, if they want it they buy it
  - There are always extra expenses, e.g. vacations, cars

7. Did Their Investments Change?

- Most made minor adjustments
- Many, especially those with advisors, rolled money out of their 401(k) plan
- More moved away from equities
- A small number became more heavily invested in equities

7. Investing

- Participants try to live on earnings on investments, at least until their early or mid 70s, in addition to Social Security and traditional pension plans
- None have a target for level of assets in five years or any other time period
- Participants take money out of non-qualified investments first, to retain the tax deferrals in qualified money

8. Key Concerns

- Participants were asked to rank six issues in order of level of concern
  - Health care costs
  - Need for long term care
  - Investment risk
  - Inflation
  - Outliving resources
  - Maintaining lifestyle

Key Concerns (cont'd)

- Level of control
    - Low control
        - Health care
        - Long term care
        - Inflation
        - Investment risk
    - High control
        - Maintaining lifestyle
        - Outliving assets
  - Biggest impact
    - Long term care
    - Health care

9. Concerns About Longevity

- Most underestimate life expectancy significantly
- Few think they will reach 90s
- Most base life expectancy estimates on family history
- Low fear of outliving assets because of expectation that living expenses can be reduced if necessary
- Concern lowest for those with traditional pensions

10. Viewpoints Towards Annuities

- Few have annuities
- Understanding of annuities low, lower for immediate annuities
- Most think annuitization is a bet and they do not want to bet against insurance companies
- Many think they can get better investment returns than the payouts in immediate annuities
- There is resistance to use risk reducing mechanisms in retirement
  - Many like long term care insurance
  - Few have it
  - There is resistance to spending reasonable sums to protect against the risk of needing long term care or living longer than average

11. Attitudes Towards Advisors

- There is widespread distrust of financial advisors, although many have long standing relationships with advisors
- There is some interest in seminars
- The few who have been exposed to Monte Carlo analysis found it unconvincing and not helpful
- Many think that they can invest more effectively on their own

12. Managing Retirement

- Few have an emergency fund
- Most have one pot of money and manage as they go
- They don’t live on a budget; they “automatically” know what they *can* spend
- In some couples, one worries and the other doesn’t
- It’s hard not to spend a lot
- None have a goal of how much to have at a set point in time in the future
- Most track assets quarterly
- Need to periodically reevaluate situation
- They will “just know” if they have to make a change
- Many hope to maintain principal until early 70s

13. Advice for Tomorrow

- Be frugal
- Avoid debt
- Plan…and stick with it
- Have health insurance coverage
- Get good professional advice
- Save and save more and earlier
- Consider possibility of long life

Key Conclusions

- Transition to retirement marked by minimal change
  - lifestyle does not change much, in the beginning
  - investments tend to change gradually, if at all
  - people tend not to move
- Decisions about being able to afford to retire are not thought through clearly
  - almost no thought to long term impact of inflation
  - no goals for spending or asset retention
  - understanding of the risks in retirement, but no planning for them
  - no ability to do effective “spend downs”
  - assumptions of investment returns aggressive and do not take possibility of volatility into account
  - a lot of focus on “feeling way through”
  - little reliance or belief in risk reducing mechanisms
  - retirement often starts before planned with little understanding of consequence
  - home ownership an important potential cushion, but little plans to use home value or liquidity
  - need for better skills will become urgent as prevalence of traditional pension plans decline