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Perspectives on Retirement Risks and the Individual

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Introduction

The U.S. retirement system is undergoing a transformation. There is a large increase in the number of people covered by defined contribution plans, and a corresponding decrease in the number covered by defined benefit plans. Approximately half of the adult population is not covered by a pension plan. People have been retiring earlier and living longer. While the trend to early retirement has turned around a little since 1985, the length of the retirement period continues to increase. This transformation means that an increasing number of Americans are more responsible for their own, increasingly expensive, security in retirement.

The traditional focus on retirement planning has been around accumulation of assets for retirement, and not on the distribution phase. Therefore retirement risk has not been well addressed. This paper will focus on retirement risk from the perspective of the individual with particular emphasis on public views on post-retirement risk and various plan features. It will identify major risks in retirement. It will provide data from two important studies: the SOA-AAA "Retirement Plan Preferences Survey" (2003) and the SOA "2003 Risks and Process of Retirement Survey." It will also focus on the importance of pre-retirement decisions not directly related to retirement and how they influence retirement security. It will reference *Life Defining Decisions*, a background paper prepared for the Actuarial Foundation for a partnership project with WISER (Women's Institute for a Secure Retirement – 2003).

In this paper, we will cover the following topics:

I. Individual perspectives on risk and retirement security – this section will define key post-retirement risks as defined in the Society of Actuaries study, and then it will focus on pre-retirement decisions that help drive retirement security. A case study in the form of a story is included to show how different risks are woven together. Then different programs are looked at to see how selected risks are allocated between individual and employer.

II. Key findings are presented from public attitude studies to show how the public views post-retirement risk and to provide examples of what people know and understand about retirement risk.

III. Recommendations and solutions. Gaps and misperceptions are discussed. In this era of increased individual responsibility, inadequate knowledge can have serious consequences.

The Retirement Preferences Survey serves to point out to us how much the retirement system is changing. The respondents are all people who are covered by retirement plans of some type. Eighty-eight percent of the retirees have benefits from a defined benefit plan compared to 49% of the workers. Only 9% of the retirees say that they received benefits from a defined contribution plan compared to 56% of the workers who say that they have such coverage.

Section I – Individual perspective on risk and retirement security

Retirement security is based on the fundamental idea that the individual will work for a number of years, build retirement assets and/or entitlement to benefits, and then retire and use the assets in their retirement years. Traditionally, retirement planning has focused much more heavily on the accumulation of assets rather than the use of assets. For some people, retirement is a single well-defined event, but for many it is a process extending over a period of time. The Society of Actuaries has published an inventory of post-retirement risks with key management strategies. Copies of this inventory are included with the conference materials. Risks can be viewed one at a time, qualitatively or quantitatively, or they can be considered by focusing on how they can interact for individuals or groups of people.

Stories as a way of illustrating risk

Case studies based on a single person provide a good way to explain some of the issues around post-retirement risk. For many audiences they are much easier to understand than statistics and probabilities of being faced with certain risks. Emily offers us an example. She moves from being healthy and married in retirement to widowhood, followed by progressively poorer health. She moves from her own home to independent living, to assisted living, and then to a nursing home. Each move includes a different environment, an increase in the service provided, and an increase in costs. She moves from complete independence to reduced ability to use the telephone to gradually being unable to communicate. She needs help with an increasing number of tasks including shopping, bill paying, managing her medications, and eventually, virtually all of the activities of daily living. The story shows the inter-relationship between various events, needs, and the economic situation. Appendix A provides a chronological detail of Emily's story, and shows how she is confronted with a series of risks, and progresses from healthy to various steps of disability and is then deceased. Such stories open the way to people thinking about risks and then considering the statistics and interactions.

The risks

As discussed above, the Society of Actuaries Committee on Postretirement Needs and Risks identified post-retirement risks and analyzed their variability. Some of these risks can be transferred through the use of financial products and others can not. Some of the risks identified were those traditionally identified, but others went beyond the traditional risks. It became clear in this process that not all of the risks can be managed easily. The following are some of the risks that were identified.

Longevity—outliving your retirement resources: Nobody knows how long their assets will last, especially since unexpected events might diminish those funds. Social Security provides a life income and the issue is really to have assets above and beyond what Social Security provides. Living off investment income only and preserving principal is one way to partially manage this risk. To totally manage it, one would need to live off investment income less the increase in value due to inflation. Annuitization is a method of risk transfer. Experts don't agree on the desirability of this solution, partly because of the tradeoff between a lifetime guarantee and loss of control plus loss of availability of funds for other needs. If annuities are not indexed for inflation, they offer partial risk protection only.

Death of a spouse: The surviving spouse may need 75% of the couple's income to maintain the same standard of living. Poverty rates among widows are much higher than among married couples (15% compared to 4%). The associated risks can be transferred through use of survivor annuities or life insurance.

Inflation: This risk is a major concern for retirees. Except for inflation indexed bonds, most investment vehicles are not directly indexed for inflation, but different strategies provide different levels of inflation matching. Social Security benefits are inflation indexed, but few private annuities are.

Interest rate risk: For retirees with assets invested in fixed investments, declines in interest rates mean less investment income. Annuities also become more expensive as interest rates drop.

Stock market risk: Traditionally, it is expected that those with a longer time horizon will want to take more risk. There are very different risks between a single stock and a diversified portfolio. Retirement assets may also be invested in company stock which carries an additional risk since it is not diversified, and since the employee has a job related risk as well.

Unexpected health care needs and costs: This is a major concern and an especially difficult issue for retirees not yet Medicare eligible. When they do not have employer sponsored coverage, it is very difficult and costly to get any coverage. Prescription drugs and long term care have not been covered by Medicare to any significant degree, but Medicare will begin to cover a significant portion of drugs in 2006 and later.

Loss of ability to live independently: This is a major financial and life risk. Long term care insurance offers a means to partial risk transfer. Continuing care retirement communities also offer partial risk transfer.

Change in housing needs: Housing is often an important asset in retirement, and a house can be converted to income without moving through a reverse annuity mortgage. Housing is often integrated with care and as people have limitations in what they can do, these can be solved through moving into specialized housing. Specialized housing is generally more expensive than housing without the added services.

Change in marital status: Marital status can affect benefit entitlement in both Social Security and private benefits. Retirement assets can be modified or transferred at marriage, divorce, and remarriage.

Unforeseen needs of family members: Many retirees find themselves helping other family members including parents, children, and grandchildren.

Business risk: Benefits from a defined benefit plan in excess of federally guaranteed amounts can be lost on business failure. Federal insurance of defined benefit plans does not cover all benefit features in insured plans, and no insurance is provided for public sector employee plans or church plans. Defined contribution plan benefits depend on the value of underlying investments, and there are special risks when assets are invested in company stock.

Employment risk: Personal retirement expectations may include continued income from a bridge job, but it might be difficult or impossible to find the desired employment. This is becoming increasingly important because many people want and/or need to continue working in retirement. Health status can also change, making doing such a job impossible.

Other risks identified include:

- Lack of available facilities or caregivers
- Lack of appropriate consumer information for decision-making
- Public policy risk including changes in taxes and public benefits

Life defining decisions and retirement security

Decisions made before retirement have a big impact on financial security in retirement. It is clear that decisions about saving and investment retirement assets are very important. Other decisions have a much less obvious link to retirement security, at least for many people. The choice of employment is very important because of its link to retirement benefits, and decisions are important both when taking a job and leaving job. Decisions about marriage and divorce and the allocation of assets and paid work can also be important. A paper from the Actuarial Foundation identifies Life Defining Decisions and discusses their implication for retirement security. No research was done to determine to what extent the public focuses on retirement security at the time of these events. It is the opinion of the authors that most of the public does not focus much on retirement prior to age 40, and that the amount of focus increases starting at age 40. This is a good topic for further research.

How different retirement programs treat different risks

Different types of retirement plans distribute risk differently between different stakeholders. We assume here that risk is distributed between government programs, the employee, and the plan sponsor. We do not focus on shifting risk to the community at large. This happens if the individual is impoverished and effectively becomes a ward of the state. The chart below shows the distribution.

Treatment of Risks Under Different Types of Retirement Plans

Type of Risk	**Social Security Current System**	**Traditional DB Final Average Pay Formula**	**Traditional DB Career Average Pay Formula**	**Hybrid DB Cash Balance**	**Defined Contribution Plan**
Investment Risk	Plan, but largely NA	Plan Sponsor	Plan Sponsor	Plan Sponsor	Participant
Pre-retirement Inflation Risk	System	Plan Sponsor, to the extent that pay changes track inflation	Participant (but Plan Sponsor may absorb part through updates)	Participant	Participant
Post-retirement Inflation Risk	System	Usually participant, except in public sector plans	Usually participant, except in public sector plans	Participant	Participant
Post-retirement mortality risk	System – for individual and spouse	Sponsor if benefit paid out as life income, Participant if benefit paid as lump sum	Sponsor if benefit paid out as life income, Participant if benefit paid as lump sum	Usually participant (because benefits often are paid as lump sum)	Participant

How retirement risk is allocated in the family

Assets are accumulated during working years and spent during retirement years. Where the family stays together during the entire period, there is no problem of allocation by individual.

However, in the event of family break-up, this is a matter for the family to decide. Under domestic relations law, pension assets are assets to be considered during divorce, but often this does not happen. One member of a couple may also have much greater capability to build retirement assets after divorce than the other. Social Security includes provisions that work well for some people and not others.

There are also distributional issues in the post-retirement period. Depending on the method of allocating assets over time and the distribution strategy used, there may be continued income to the survivor after the first person in a couple dies or there may not be such income. Economic status declines at time of widowhood.

The studies cited here did not look at the way families view the allocation of retirement risk and resources within the family, and this is a topic for further investigation.

Public attitudes and knowledge about retirement and related risks

A number of studies have focused on what the individual knows about retirement, how well people plan for retirement, and what they know about retirement related risk. This paper will consider two studies completed in 2003, and two annual series extending over a period of years. These studies are:

Study	**Methodology**	**Sponsors and Partners**	**Sample**
Retirement Plan Preference Survey (2003)	Two stage mail panel First survey stage used to determine those members of the Synovate mail panel that qualified based on participation in a pension or retirement plan. 10,356 of 15,000 panel members responded to the first stage, and a stratified random sample was selected.	Sponsors: Society of Actuaries American Academy of Actuaries Research Firm: Mathew Greenwald & Associates	Second stage surveys were sent to 1,088 workers and 1,889 retirees. The response rate for the second stage was 75% for workers and 33% for retirees. After discarding incomplete responses, a total of 790 worker responses and 600 for retirees were analyzed.
2003 Risks and Process of Retirement Survey (2003)	Telephone Interviews Households were selected from a nationwide targeted list sample	Society of Actuaries Mathew Greenwald & Associates EBRI	Americans age 45 to 80 split between retirees and pre-retirees – total of 604 interviews.
Retirement Confidence Survey (2003)	Telephone interviews Series starting in 1993	EBRI ASEC Mathew Greenwald & Associates	1000 individuals were interviewed, 782 workers aged 25 and older, and 218 retirees
Insight into Participant Investment Knowledge and Behavior (2002)	Eight in a series starting in 1991	John Hancock Research Firm: Mathew Greenwald & Associates	801 respondents between the ages of 25 and 65 Respondents were people who contributed to 401(k) plan and had a choice of funds to invest

Another paper that provides important background to this topic is “An Outsider’s Look at Retirement Plan Design” by Gary W. Selnow presented at the 2003 Pension Research Council Symposium. This paper looks at pension saving and planning decisions from the perspective of decision theory. Selnow points out that retirement planning is difficult because the payoffs are in the distant future, and the promise of pleasure tomorrow can mean pain today. In contrast, the wrong decision yields an instant gain and the decision to save can be postponed without immediate penalty.

Section II – Key findings about public perceptions

Concerns about retirement risks

The retirement risk survey provides insight into how the public views different types of risks. Retirees are most concerned about keeping up with inflation. The next concerns are that they might exhaust savings and be left only with Social Security, that they might not be able to pay for good health care, and that they may not have adequate funds to pay for nursing home care. The items selected by retirees as being the most concern were:

Risk	Top Priority: % Indicating Most Concerned (2003)	% Very Concerned or Somewhat Concerned	
		2003	**2001**
Inflation	17%	57%	55%
Health care	12%	46%	43%
Deplete savings and have only Social Security	11%	41%	n/a
Not have enough to pay for long term care	9%	47%	48%

Five other risks are also surveyed including the risk of not being able to maintain a reasonable living standard, the risk of not being able to stay in your own home, of not being able to rely on family members, and of not having money to leave to heirs. Not having money to leave to heirs was the lowest concern.

For pre-retirees, the top priorities were much more concentrated, the top five issues included the four issues which were top for retirees, and the order of them switched. The priority issues were:

Risk	Top Priority: % Indicating Most Concerned (2003)	% Very Concerned or Somewhat Concerned	
		2003	2001
Health care	24%	79%	58%
Not be able to maintain reasonable living standard	15%	71%	55%
Inflation	14%	78%	63%
Deplete savings and have only Social Security	12%	65%	n/a
Not have enough to pay for long term care	10%	65%	52%/57%

The pre-retirees are much more focused on risk than the retirees. While there was not much change from 2001 to 2003 in the reported concerns of retirees, there were big increases in the reported concerns of pre-retirees. It should be noted that this was a period when health care costs were increasing rapidly, employers were dropping retiree health coverage, and there were poor returns in equity markets. The authors are not surprised by the increased focus on risk by pre-retirees and would have expected a greater increase from pre-retirees. The exhibits summarizing retiree and pre-retiree concerns with retirement risks are shown as an Appendix at the end of this paper. The survey did not focus on whether some of the pre-retirees have decided to retire later, but other studies have looked at that issue. In the 2003 Retirement Confidence Survey found that workers overall were expecting to work longer than current retirees have worked. One-fourth of workers in that study say they will retire at age 65 (25%), and another quarter intends to retire at age 66 or later (24%, up from 18% in the 2002 study). That study shows that the average worker today plans to retire at age 65, while the average retiree reports leaving the workforce at age 62.

The definition of retirement

Many people do not leave employment all at once, but rather retire gradually. This has been studied extensively with significant focus on the move to bridge jobs. In the 2003 Retirement Risk and Process of Retirement Survey, respondents were asked about the process of retirement from their primary occupation and also were asked about how much work they were doing. Some people say they are retired, but in fact, are still working.

The prevalence of work and dependence on earned income during a transition period that often extends beyond “retirement” is important to understanding retirement security and risk. This is also important for the future as more people say that they expect to continue working in retirement.

A new study "Staying Ahead of the Curve 2003: The AARP Working in Retirement Study" states that 70% of workers who have not retired plan to work into retirement or never retire and almost half indicate that they envision working into their 70s and beyond.

Retirement process

Looking at the retirement process is important in our focus on risk because work and income after retirement are a part of many retirement expectations. Twenty-eight percent of the retirees indicated that they had retired gradually from their primary occupation and 67% of pre-retirees indicated that they expected to retire gradually. This would be a huge shift, and even if the prevalence of gradual retirement is not as great as expected, an increase still appears to be very likely. In the author's work with employers, we have identified a number of areas of skill that are likely to be in short supply as the baby boomers retire.

	Retirees Actions in Retiring From Primary Occupation	**Pre-retirees Expectations With Regard to Retirement From Primary Occupation**
Stopped working all at once	71%	41%
Continued to work for pay part time or periodically	16%	32%
Gradually reduced the number of hours worked before stopping completely	7%	16%
Continued to work for pay full time	5%	9%
Don't know	1%	2%

Working in retirement

Retirees who reported that they had worked after retirement were asked about how they had worked and pre-retirees who said that they planned to continue working were asked about their expectations. The group who continued working was split between 25% who became self employed, 40% who continued to work for the same firm, and 33% who went to a different organization. More of the pre-retirees expect to become self-employed.

	Actions of Retirees Who Reported Working in Retirement	Expectations of Pre-retirees About How They Will Continue Working
Worked for a different company	33%	30%
Worked for the same company at the same job	32%	} 37%*
Worked for the same company at a different job	8%	
Became self-employed	25%	39%
Don't know	4%	2%

*For pre-retirees, does not distinguish between the same job or a different job.

Understanding of mortality risk

One of the findings of these studies and other studies is that there is not a clear understanding of mortality risk. Some people will live to a very high age while others die early. The typical financial planning process focuses on average life expectancy, and there is not a good understanding of average life expectancy. By definition, about half the population will outlive the average life expectancy assigned to them.

Many people are not aware of the potential to use an annuity to secure a guaranteed lifetime income, and many financial advisors feel it is more advisable for people to manage their own money. The Retirement Plan Preferences Survey focused on preferred distribution options and showed a strong preference for lifetime income when people were asked what is important to them. This was puzzling to actuaries working with retirement plans because practitioners observe that lump sums are chosen most often in defined benefit plans that offer a choice. The Retirement Plan Preference Survey indicated that the following payout options are preferred by workers:

	Workers
A series of regular payments for the rest of your life and continued payments to your spouse for the rest of her life, if spouse outlives you	51%
A combination of regular payments and a lump sum withdrawal	18%
A series of regular payments guaranteed for the rest of your life regardless of how long you live, with no further payments after death to a spouse or other heir	15%
Withdraw the entire amount as a lump sum	12%
Don't know/no answer	4%

The groups that would prefer a lump sum versus a stream of payments included younger respondents and those with household incomes over $50,000.

Retirees were asked about the type of benefit they are receiving from their plans. There was no independent verification of this selection, but some work was done to check participants to be sure that they understood the questions.

	DC Plan (n = 57)	DB Plan (n = 526)
Withdraw the entire amount as a lump sum to invest, roll into an IRA, pay off debts, etc.	26%	6%
A series of regular payments for the rest of your life and continued payments to your spouse for the rest of her life, if spouse outlives you	29%	35%
A series of regular payments guaranteed for the rest of your life regardless of how long you live, with no further payments after death to a spouse or other heir	23%	52%
A combination of regular payments and a lump sum withdrawal	8%	4%
Don't know/ no answer	14%	4%

The survey respondents indicated a very frequent choice of regular income. Considerations rated as important by both workers and retirees included:

- receiving a guaranteed amount of monthly income

- ensuring that they do not outlive their money during retirement
- the ability of income to keep up with inflation
- being able to maintain control of their savings
- receiving guaranteed monthly payments for themselves and their spouse, if he or she outlives them
- protecting themselves against investment market
- protecting against loss of value from a pension or annuity investment should they die earlier than expected

When deciding on what payout option to choose from your retirement plan during retirement, how important is each of the following considerations?

Considerations in Payout Option Decision

% Saying Very Important	Workers	Retirees
Lifetime income	69%	86%
Not outliving one's money	69%	77%
Keep up with inflation	65%	75%
Control of savings	61%	54%
Protect against market downturns	53%	55%
Protection from loss of value if early death	49%	44%
Access to emergency money	38%	30%
Leave an inheritance	31%	19%

The Retirement Risk Survey shows a spread of expectations with regard to the average life expectancy at age 65:

	Male Preretirees	Female Preretirees	Male Retirees	Female Retirees
Less than 75	9%	12%	15%	5%
75 to 79	20%	16%	23%	13%
80	25%	18%	25%	22%
81-84	6%	4%	7%	7%
85	22%	17%	14%	27%
86 and older	14%	26%	7%	18%
Don't know/refused	3%	6%	11%	19%

Pre-retirees expected people to live longer, and both groups expected females to live longer than males. Depending on the mortality study used, women can be expected to live about 4-6 years longer than men. Retirees were also asked how long they expected their retirement to last. Those who retired before age 62 were more likely to expect their retirement to last at least 30 years (24% vs. 10%). People with poorer health and lower incomes (less than $25,000) were more likely to answer that they did not know.

Expected Length of Retirement (for retirees)

Less than 20 years	15%
20 to 24 years	20%
25 to 29 years	7%
30 years or more	17%
Don’t know/refuse	41%

When people were asked about the lifetime income stream that is equivalent to a $100,000 lump sum at 65, there was a wide range of answers. The correct answer will vary over time based on changes in interest rates, and will generally fall between $500 and $1,000.

	Workers	**Retirees**
About $500 a month	34%	33%
About $1,000 a month	27%	21%
About $3,500 a month	12%	9%
Don’t know/ no answer	27%	37%

Other work has shown that people prefer a lump sum to a future stream of income payments, even when the lump sum is not as valuable. The work of Gary Selnow, cited above also helps to explain a preference for lump sums. With lump sums, there is an immediate gain compared to taking a life annuity.

What people say and what they do does not always line up. This was a topic for discussion at the 2003 Pension Research Council Conference. Lori Lucas of Hewitt Associates cited data on intentions and actions. She indicated that after some financial seminars, while 100% of those not participating said that they planned to participate in their plan, only 14% actually did. Among people who did not attend, 7% started to participate. Twenty-eight percent indicated that they planned to increase their contribution rates but only 8% did. Another study focusing on actions compared to statements is included in a new book: *Play to Your Strengths, Managing Your Internal Labor Markets for Lasting Competitive Advantage* by Haig R. Nalbantian, Richard A. Guzzo, Dave Kieffer, and Jay Doherty, McGraw Hill, 2003. They define the “Say – Do” trap and in analyzing the internal labor markets in many companies find that what the companies say they do is not what they are actually doing in rewarding people. For example, they found one company rewarding seniority but saying they were rewarding performance. They also find that employees do the same thing. This paper focuses on responses of participants to surveys about what they believe and/or intend to do. It is important to recognize that the responses help us understand what people believe, but stated beliefs may not be a good guide to future action.

Knowledge about investment risk and returns

The Insight into Participant Investment Knowledge and Behavior Study provides some insight into knowledge of investments. The participants in this survey all participate in 401(k) or similar plans with investment choice, but many of them show significant gaps in investment knowledge.

Participants are confused about the relative riskiness of company stock. The 2002 Insight report states "Surprising enough, Enron has not affected participants' perception of risk of a single company's stock. The risk ranking for employer stock (as an investment) remained below diversified domestic stock funds and diversified global and international stock funds, and by margins consistent with previous surveys."

In this study, 42% of participants say they have little or no investment knowledge, up from 38% in 1997. Only 20% say that they are relatively knowledgeable, down from 24% in 1997. When asked what type of securities is found in a money market fund, in 2002, 49% said short-term investments, 47% said bonds, and 40% said stocks. Participants were asked to include all that applied so multiple responses are possible. Only 8% knew that money market funds included only short term securities.

Strategies for managing risk

In the survey on post-retirement risks, retirees were asked about risk management strategies. Reducing spending is the first strategy chosen. Considerable numbers also say it is a good idea to buy financial products, but then when asked what they have done, many fewer buy such products.

Retiree Strategies in the 2003 Survey	Describes Them Very Well	Describes Them Somewhat Well	Describes Them Not Too Well	Describes Them Not At All Well
Try to reduce unnecessary spending so that can set aside as much money as possible to keep the value of the savings growing	35%	41%	9%	14%
Think it is a good idea to buy insurance to protect financially against things like the possibility of needing extended nursing care	27%	24%	18%	29%
Try to invest a considerable portion of money in stocks and stock mutual funds, hoping that in the long run their value will rise enough to provide with comfortable lifestyle	22%	24%	16%	36%
Think it is a good idea to buy annuities, because they protect people by paying a guaranteed income for life, no matter how long.	13%	25%	17%	42%

Between 2001 and 2003, interest in reducing spending and buying long term care insurance increased, and interest in buying stocks and annuities was reduced. When asked what actions they had taken to protect against needing long term care, 17% said that they had purchased insurance and 9% indicated that they were saving for this need. The "Say-Do" issue becomes particularly important in focusing on issues like the use of financial products.

Sources of regular income for retirees

In the 2003 Retirement Risk survey, sources of income and their importance are reviewed and they are shown below. Forty-five percent of respondents said that they personally saved for retirement.

	Major Source	Minor Source	Not a Source	Don't Know
Social Security	54%	24%	21%	2%
Regular income from an employer's defined benefit pension plan	41%	19%	39%	1%
Money from an annuity or regular withdrawals from an employer's retirement savings plan, such as a 401(k), 403(b), or 457, or from funds rolled over from this type of plan	11%	25%	63%	1%
Regular withdrawals from a bank or investment account	8%	25%	67%	<.5%
Annuity payments from an annuity purchased on your own or through an IRA set up on your own	5%	25%	70%	<.5%

Importance of retirement plan features

In the Retirement Plan Preferences survey, participants in defined contribution plans liked this type of plan better and participants in defined benefit plans liked these plans better. Several theories were advanced to explain these preferences: people sought out jobs with the types of plans they wanted, people were influenced by employee communications, and companies design plans to attract the types of people that fit the roles they needed. This is an area for more research.

The Retirement Plan Preferences survey asked pre-retirees about what they thought was important in their plans. It is important to note that there are striking differences in the types of plans covering active workers and retirees. Retirees were very likely to be covered by defined benefit plans and current workers were not.

The features of retirement plans viewed as important (in decreasing order) by workers and retirees were:

Considerations in Payout Option Decision

% Saying Very Important	Workers	Retirees
Lifetime income	69%	86%
Not outliving one's money	69%	77%
Keep up with inflation	65%	75%
Protect against market downturns	53%	55%
Control of savings	61%	54%
Protections from loss of value if early death	49%	44%
Access to emergency money	38%	30%
Leave an inheritance	31%	19%

Conclusions

The retirement world of the future is challenging because of the decline in defined benefit plans, low savings rates in the United States, increased longevity, and the failure of many people to focus effectively on planning for retirement.

Research on what the public knows about retirement and retirement planning shows big gaps in knowledge and many misperceptions. Any system that relies too much on people providing for themselves is likely to leave some people out.

There are several different directions that can be taken to enhance the retirement futures of Americans. They include:

- Plan design that recognizes people need help in saving for retirement. Within the context of defined contribution plans features like automatic enrollment, good default investment options, and provisions to direct pay increases automatically to plans offer potential routes to more retirement savings.

- Increased education with research supporting it to make sure its design is effective.

- Maintaining a good level of employer contributions to retirement programs whether they be defined benefit or defined contribution.

- Being sure that Social Security provides a good base layer of benefit. The studies discussed here reinforce the importance of Social Security and not relying too heavily on individual efforts.

An analysis of the research indicates that there are significant gaps and perceptions that are disturbing to practitioners with regard to retirement planning. These concerns are intensified by the increase in personal responsibility for retirement.

As we think about these gaps, we need to remember that there are different segments of the population with regard to retirement security:

- People who in old age are relying on Social Security alone and have no financial assets.
- People who have substantial assets and for whom financial and retirement planning is heavily focused on minimizing estate taxes and maximizing the inheritance for their heirs
- And people in the middle. For this group, traditional planning for retirement is very important.

The impact of gaps is most important to the 50% - 60% of the population who are in the middle. Strategies for managing post-retirement risk are also mainly for the people in the middle. For the bottom group, retirement security could be enhanced with some financial assets, either by saving or through longer term employment in jobs that offer some types of pensions. However, without such assets, these strategies don't work.

Some of the gaps and issues with regard to perceptions that we found are:

- Pre-retirees misunderstand what their primary sources of income will be in retirement. They underestimate the importance of Social Security and overestimate the importance of personal savings.
- Respondents in surveys say that they prefer lifetime income, but when given a choice, plan participants in qualified plans tend to choose lump sums.
- There are different views on how much income is needed for a good retirement, and from a personal perspective, people make different choices in retirement. However, in spite of these differences in views, many people do not calculate what they need and/or appear to underestimate that amount.
- While many individuals are now heavily responsible for managing their own retirement assets and planning, many have basic misunderstandings about the financial market and investment products.
- Many people retire earlier than they plan to, some for reasons of health, some because of job loss, and some for other reasons.

- There is relatively little understanding of longevity risk, and outliving assets is not an issue recognized as very important by many retirees.

- People are more likely to think that others will need more long-term care than they will need. They tend to underestimate their own need for long-term care.

- More people think buying risk management products is a good idea than actually buying such products.

Appendix A

The Story of Emily

Emily's Age	Emily's Situation	Help Needed and Cost in Year 2000 Dollars
70	Emily and her husband, Robert, age 75, are both retired. They are happy, active, walk almost every day, but are phasing down activity level. Robert has heart disease, controlled by medication. They live in their own home with a yard in a suburb of a major northern city.	
73	Emily and Robert find it difficult to care for the house and yard and feel trapped in the winter. It's hard to get help with snow removal, and they don't like to drive in snow. They're exploring other options for living. They've slowed down activities further. Emily is in good health but concerned about meeting the demands placed on her.	
75	Robert dies. Emily relocates to an independent-living apartment complex. She keeps her car. She has dinner provided, has access to activities, transportation, etc. Her apartment is cleaned weekly.	Cost of apartment and services is about $2,500 per month.
76	Emily is diagnosed with Parkinson's disease. With medication, she can handle most of her needs. She needs five separate medications taken in different combinations four times a day to help control the Parkinson's and high blood pressure. Emily stops driving, and no longer keeps the car.	Same cost for apartment. Her health care costs are paid by a combination of Medicare and insurance provided by Robert's former employer.
77	Emily needs help paying her bills and managing her finances, plus help with shopping and errands. A family member is helping her about twice a week for a minimum of six hours per week with bill paying, errands and doctor's appointments. She can answer the phone and make calls only to preprogrammed numbers. She can get messages on her answering machine. She is able to take a short walk on her own.	Same as age 76.
78	Emily can no longer manage her own medication and can't use the answering machine. A paid helper comes in for about	$2,500 per month for the apartment plus

Emily's Age	Emily's Situation	Help Needed and Cost in Year 2000 Dollars
	three hours a day in addition to twice-a-week help from the family member.	$1,200 per month for the helper.
80	Emily can no longer manage without help in bathing, dressing and administering medication. She moves to an assisted living facility. She can feed herself if meals have been prepared and served, but she is no longer able to fix a cup of coffee or to pour coffee from a coffeepot. A family member helps her two to three times a week with errands, bill-paying and doctor's appointments.	$4,000 per month including all meals, administering medication, assistance in bathing and dressing.
82	Emily has extreme difficulty walking and trouble feeding herself. She has a great deal of difficulty speaking or hearing and often gets confused. She moves to a nursing home. She continues to get help from a family member three times a week.	$6,000 per month for the nursing home.
84	Emily dies.	

Appendix B – Detailed Results from the 2003 Risks and Process of Retirement Survey
Retirement Risks as Viewed by Retirees

How concerned are you. . ? Which of these are you most concerned about?

Retirees (2003 n=273; 2001 n=282)

	Very Concerned	Somewhat Concerned	Not Too Concerned	Not at All Concerned	Most Concerned*
That you might not be able to keep the value of your savings and investments up with inflation					
2003	25%	32	21	21	17%
2001	21%	34	22	23	
That you might deplete all of your savings and be left only with Social Security					
2003	25%	15	23	36	11
2001	(not asked)				
*Not asked in 2001					

Figure 1 (continued)
Retirement Risks

How concerned are you . . ? Which of these are you most concerned about?

	Very Concerned	Somewhat Concerned	Not Too Concerned	Not at All Concerned	Most Concerned*
That you might not have enough money to pay for good health care					
2003	22%	24	26	27	12%
2001	22%	21	24	32	
That you might not have enough money to pay for a long stay in a nursing home or a long period of nursing care at home due to poor health or frailty					
2003	20%	27	27	25	9
2001 (in a nursing home)	20	28	24	28	
2001 (at home)	18	30	23	29	
That you might not be able to maintain a reasonable standard of living for the rest of your (and your spouse's) life					
2003	17%	29	24	30	7
2001	17%	29	27	26	
That your spouse may not be able to					

	Very Concerned	Somewhat Concerned	Not Too Concerned	Not at All Concerned	Most Concerned*
maintain the same standard of living after your death, if you should die first (if married)					
2003 (n=172)	15%	19	24	41	6
2001 (n=167)	16%	27	22	35	
That you might not be able to afford to stay in your current home for the rest of your life					
2003	15%	16	28	40	4
2001	(not asked)				
That you might not be able to rely on children or other family members to provide assistance					
2003	15%	16	21	47	4
2001	(not asked)				
That you might not be able to leave money to your children or other heirs					
2003	11%	16	27	46	3
2001	(not asked)				
*Not asked in 2001					

Figure 21
Retirement Risks as Viewed by Pre-Retirees
How concerned are you . . ? Which of these are you most concerned about?

Pre-retirees (2003 n=331; 2001 n=318)

	Very Concerned	Somewhat Concerned	Not Too Concerned	Not at All Concerned	Most Concerned*
That you might not have enough money to pay for good health care					
2003	49%	30	8	13	24%
2001	30%	28	19	23	
That you might not be able to keep the value of your savings and investments up with inflation					
2003	42%	36	13	8	14
2001	24%	39	19	17	
*Not asked in 2001					

Figure 21 (continued)
Retirement Risks
How concerned are you? Which of these are you most concerned about?

	Very Concerned	Somewhat Concerned	Not Too Concerned	Not at All Concerned	Most Concerned*
That you might deplete all of your savings and be left only with Social Security					
2003	36%	29	18	16	12
2001	(not asked)				
That you might not be able to maintain a reasonable standard of living for the rest of your (and your spouse's) life					
2003	34%	37	18	11	15
2001	20%	35	28	17	
That you might not have enough money to pay for a long stay in a nursing home or a long period of nursing care at home due to poor health or frailty					
2003	33%	32	16	18	10
2001 (at home)	24%	33	23	21	
2001 (in a nursing home)	24%	28	24	24	
That your spouse may not be able to maintain the same standard of living after your death, if you should die first (if married)					
2003 (n=207)	25%	22	26	27	4
2001 (n=211)	17%	23	29	31	
That you might not be able to afford to stay in your current home for the rest of your life					
2003	19%	25	23	33	6
2001	(not asked)				
That you might not be able to leave money to your children or other heirs					
2003	13%	25	29	32	5
2001	(not asked)				
That you might not be able to rely on children or other family members to provide assistance					
2003	13%	20	25	40	1
2001	(not asked)				
*Not asked in 2001					

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