How Americans Manage Post-Retirement Needs and Risks

Research helps us understand how employees prepare for life after work.

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With the shift to a much greater emphasis on defined contribution plans and more individual responsibility, individuals are increasingly responsible for understanding and managing post-retirement risks. Employers can play a role in helping them in various ways. This article looks at results from the Society of Actuaries' 2005 Risks and Process of Retirement Survey. The objective of this survey was to expand on the earlier surveys conducted in 2001 and 2003, and further explore Americans' awareness of potential financial risks in retirement.

Methodology

The 2005 Risks and Process of Retirement Survey is conducted by telephone to Americans ages 45 to 80. Mathew Greenwald & Associates, Inc., and the Employee Benefit Research Institute (EBRI) are the firms responsible for the survey, which is done on behalf of the Society of Actuaries. The resulting survey report includes retirees and pre-retirees at all income levels.

The focus groups consisted of retirees who were two or more years after retirement and had lump sums of $100,000 to $500,000 to invest at retirement. In addition, the retirees did not have assets of more than $1,000,000 in total. The original intent was to recruit only retirees with no defined benefit income, but that proved difficult. Consequently, in order to find a suitable number of retirees for the focus groups, a number of them had both defined benefit and defined contribution resources. The focus groups were conducted separately for married and single retirees.

Highlights of Findings

Pre-retirees are much more concerned about post-retirement risk than retirees. The most important risks were health care, long-term care, and inflation. These are discussed in more detail below. There are remarkably few differences in responses between the 2001, 2003, and 2005 surveys. Differences that exist are found primarily among pre-retirees. Although concern about several retirement risks increased from 2001 to 2003 among pre-retirees, levels of concern measured in 2005 receded to those in 2001 (except for concern about having sufficient resources for adequate health care). Between the 2001 and 2003 surveys, the poor state of the economy and the events of 9/11 propelled many people to be more cognizant of retirement risk.

Both the surveys and the focus groups that were conducted tend to show there is little systematic long-term thinking about risk management. One of the primary conclusions of the focus groups is that much of the thought process for retirement risk is intuitive and emotional, rather than logical and methodical.

Health Care and Long-Term Care Risks

Of the various risks examined in the survey, both retirees and pre-retirees express more concern about health care needs and costs (together with inflation) than any other risks.

- Roughly half of retirees express concern about having enough money to pay for extended care at home or in a nursing home (52 percent *very* or *somewhat* concerned) or that they may not have enough money to pay for adequate health care (46 percent).
- Pre-retirees are even more likely to say they are concerned about these risks: Three-quarters report they are concerned about not having enough money to pay for adequate health care and six in 10 are concerned about having enough money to pay for long-term care.
- Health care and protecting against long term care risks were also the greatest concerns for the focus groups.
- Most retirees and pre-retirees purchase products to ensure that they can receive adequate health care.
- Three-quarters of retirees and pre-retirees indicate they have or plan to purchase coverage to supplement Medicare or participate

in an employer-sponsored retiree health plan.

- In contrast, retirees and pre-retirees are more likely to try to save for long-term care costs rather than obtain insurance for this risk.

Retirees are likely to have varying degrees of difficulty in securing health care coverage in retirement prior to Medicare eligibility. While a number of large employers still offer coverage, many retirees have no access to employer-sponsored retiree health coverage and the number of employers sponsoring plans is declining. Furthermore, coverage in the individual markets prior to Medicare eligibility is very expensive, and extremely difficult to obtain for those in poor health. It's no wonder that the surveys and focus groups confirm that access to affordable healthcare figures prominently on the minds of retirees and those near retirement.

Financial Risks

For participants with profit sharing plans, financial risk is a key consideration and is driven by participant's increased responsibility for managing investment fund returns. In the survey, inflation was also one of the top three concerns for both pre-retirees and retirees.

- Half of retirees (51 percent *very* or *somewhat* concerned) and two-thirds of pre-retirees express concern that the value of their savings and investments might not keep pace with inflation.
- More than half of pre-retirees also worry about being able to maintain a reasonable standard of living for the rest of their lives (59 percent) and the possibility of depleting all of their savings (55 percent).
- Retirees are less likely to say they are worried about maintaining a reasonable standard of living (43 percent) and depleting savings (38 percent).
- Roughly four in 10 married retirees and pre-retirees are concerned that their spouse might suffer a decline in standard of living if they should die first.

For the focus groups, after health and long-term care, the following risks were ranked in order of importance: inflation, investment risks, maintaining lifestyle, and outliving assets.

As indicated earlier, there is a seeming contradiction in the research on the approach to managing assets in retirement. In general, survey respondents

and focus group participants indicated a preference for guaranteed life income, but they actually employ other strategies. Results show that retirees and pre-retirees are most likely to try to protect themselves against financial risks by increasing savings, decreasing debt, and cutting back on spending.

- Three-quarters of retirees and more than eight in 10 pre-retirees say they save or intend to save as much as they can.
- Large majorities also say that they have or intend to completely pay off their mortgage (83 percent of retiree homeowners, 88 percent of pre-retiree homeowners) and eliminate all of their consumer debt (81 percent of retirees, 88 percent of pre-retirees).
- Two-thirds of retirees and eight in 10 pre-retirees have already or plan to cut back on expenses. Others try to manage these risks through asset allocation strategies.
- More than half of retirees and six in 10 pre-retirees say they invest money in stocks or stock mutual funds. Roughly similar proportions say they plan to or have moved their assets to increasingly conservative investments as they age (52 percent of retirees, 56 percent of pre-retirees).
- Others use or intend to use real estate investments as a hedge against financial risk (27 percent, 44 percent). Yet, although they say they have a preference for guaranteed life income, comparatively few ensure this by purchasing an annuity or choosing the lifetime income option from an employer retirement plan (33 percent of retirees, 39 percent of pre-retirees).

The focus groups reinforced the finding that retirees tended to prefer managing their assets by themselves. A number of them made little or no strategy changes in their self-management of assets at the time of retirement, but those who hired financial counselors frequently made changes based on the view of the counselor. As with the survey results, reducing spending was a favored risk management strategy of focus group participants.

Life Expectancy

Overall, understanding of life expectancy appears inconsistent, with respondents more likely to underestimate rather than overestimate life expectancy.

- Both retirees and pre-retirees are most likely to say they would manage a longer-than-expected lifespan by significantly reducing expenses (53 percent of retirees, 70 percent of pre-retirees).
- Liquidating other assets, such as funds earmarked for inheritances (42 percent, 54 percent) or home equity (36 percent, 43 percent), are other

likely strategies used for maintaining their standard of living.

- More than one-third of retirees and more than four in 10 pre-retirees believe they would completely use up all of their assets and be left only with Social Security in the event of living longer than expected.

Related to low awareness of the likelihood of outliving assets is lack of planning for needs of a surviving spouse in the event of widowhood. The sobering ramification of this lack of planning is that there are many more widows than married couples living in poverty or near poverty. This is clearly compounded by the fact that economic status tends to decline at retirement.

The Retirement Process and Phased Retirement

The process of retirement is changing with the shift into retirement no longer predicated solely on an all-or-nothing decision to stop working.

- Although most retirees indicate that when they retired they did so by stopping work all at once (69 percent), less than four in 10 pre-retirees think they will stop work all at once.
- Instead, three in 10 plan to continue working part time, two in 10 think they will gradually reduce the number of hours they work, and one in 10 expect to continue working full time.
- Meanwhile, the percentage of pre-retirees saying they will never retire has gradually increased, from 4 percent in 2001 and 8 percent in 2003 to its current level of 13 percent.

Although it is commendable that more and more pre-retirees would like to never stop working, it can be dangerous to rely only on this as primary source of funds, rather than having in place a formal plan for saving earlier on. An unexpected disability or change in economic conditions can make working in later years no longer feasible.

Results Differ By Group

The survey results were analyzed to examine critical differences by demographic characteristics. Differences in responses by economic status reveal few surprises. As in previous years, both retirees and pre-retirees with lower household incomes are more likely than those with higher incomes to be concerned about retirement risks. Nevertheless, retirees of all income and wealth levels continue to appear equally likely to be concerned about inflation risk. Fuel, heating, and medical costs are all subject to inflation fluctuation and can be a significant burden for retirees with fixed incomes.

Retirees and pre-retirees with higher net worth use different risk management strategies than those who are less affluent.

- Reducing spending is a preferred strategy among those with lower net worth, while the probability of eliminating consumer debt is positively correlated with income and net worth.

- In addition, as net worth increases, the likelihood of having invested in stocks or stock mutual funds and purchasing real estate to boost retirement resources increases.
- Those with higher household incomes are also more likely to save or intend to save for the possibility of having large health expenses or needing long-term care.

While there are significant differences in life spans and work history by gender, and in economic status by marital status and gender within the population, there continue to be relatively few differences in risk perceptions by gender. Among the differences in pre-retirees, women are more likely than men to express concern about: inflation, the affordability of long-term care, maintaining a reasonable standard of living, reliance on only Social Security and lack of family financial assistance. In addition, pre-retiree women are more likely than men to say that a likely consequence of living five years longer than expected would be to exhaust all of their savings.

The Role of Employers Is Key

The gaps in personal knowledge about retirement reinforce the importance of employer sponsored retirement programs, education and advice. Employers should seriously consider making employees more aware of risk management strategies through tailored education programs, applicable benefit offerings and group financial product options. In addition, investment counseling to the extent permissible under current regulation can be very helpful for employees. Automatic enrollment and modern default investment options have played a major role in making plans work well for those who do not take affirmative actions to manage their 401(k) plans. It is hoped that in the future employers will explore a new range of distribution and post-retirement default options and that the legal climate will be modernized to facilitate new distribution and default options that will better help employees and retirees manage post retirement risks.

For the special needs of women, employers should address risk management in light of work histories impacted by time off spent for family responsibilities and other typical differences. In addition, as mentioned earlier, the possibility of widowhood has a much greater impact on women.

Finally, for employers unable to offer their early retirees health coverage, it would be very helpful for them if the employer could help in securing other coverage by virtue of its reputation and bargaining power. For, although, as this article indicates, the nature of retirement and individual responsibility is changing, workers and retirees will always look to their present and former employers as a source of information and support in a rapidly evolving world.

To locate the Risk and Process of Retirement Surveys online, please visit: http://www.soa.org/ccm/content/?categoryID=341001.

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