

Lifetime Income: Risks and Solutions

**Presented by the American Academy of Actuaries
Lifetime Income Risk Task Force**

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Background on Today's Webinar

- Actuaries have an important role to play in encouraging lifetime income solutions, and the Academy Board, Public Interest Committee, and Life & Pension Practice Councils have identified lifetime income as a top policy issue.
- In August 2011, the Public Interest Committee sought input from the membership on a proposed statement advocating stronger public policy support for lifetime income solutions for Americans.
- The membership response was strong, encouraging, and helpful in determining Academy direction.
- Key conclusion: the actuarial profession has much more to say than can currently be captured in a single, brief position statement.



2012 Lifetime Income Initiative

- Expansion of lifetime income public interest statement to an initiative to:
 - Promote meaningful discussions both within and outside the profession;
 - Actively engage with the public policy community;
 - Host discussion symposia on longevity, longevity risk, and lifetime income;
 - Coordinate efforts of the life and pension practice councils; and
 - Develop actuarial policy statements.



Lifetime Income Risk Task Force

- Joint Lifetime Income Risk Task Force created in February 2011 by the Life Practice Council and Pension Practice Council.
- Task Force formed to address the risks and related issues of inadequate lifetime income among retirees.
- The goal of the task force is to educate the public, lawmakers, and regulators, financial advisors, employers, and the media on the risk of inadequate lifetime income.
- Preparing white paper examining the challenge of longevity risk: its causes and potential ways to manage/address it.
- Noel Abkemeier, Tonya Manning – Co-chairs



Lifetime Income

- Assured and adequate income throughout retirement is an important and growing issue in the United States for the following reasons:
 - Americans are living longer;
 - Migration from defined benefit plans to defined contribution plans has reduced the source of predictable retirement income; and
 - An increasing number of retirees as Baby Boomers reach retirement age.



Lifetime Income

- What is Lifetime Income?
 - Retirement income stream designed to last for the duration of one's lifetime
- Examples:
 - Social Security
 - Certain single or joint life insurance options from pension plans (e.g., annuities)
 - Other forms of structured income (and income management)



Sources of Lifetime Income Risk

- Accumulation Shortfall: Insufficient accumulation of asset /resources
- Poor ‘Decumulation’ Handling: Inadequate management of assets/sources of income, such as
 - Inadequate return on investments
 - Overly high withdrawals at early ages
- Longevity Risk: Simply, the uncertainty of how long one will live.
- Possible results of longevity risk:
 - Implications include: living beyond “life expectancy”, not planning on income past that point, losing ability to manage investments and income at an “old” age



Why is Longevity Risk a Challenge?

- Longevity risk is a challenge for those who do not understand it, plan for it, and take steps to mitigate its adverse effects.
 - Without careful planning, retirees risk running out of income to cover basic necessities.
 - If individuals outlive the income provided by their assets, they risk becoming a burden on family and/or society.
 - There may not be support mechanisms (e.g., social safety nets) for all those who failed or were unable to sufficiently plan and provide for adequate lifetime income.



Causes of Longevity Risk

- Longevity risk is the result of life expectancies not being fixed or predictable, but instead variable.
- We don't know in advance who will live short, medium or long lives.



Misconceptions about Longevity Risk

- Many people, even careful planners, only plan for 20-years of retirement.
- Focus is on the average, not the range of possibilities.
- Failure to address the probability of living longer than average.



Adverse Effects Stemming from Longevity Risk

- Inadequate retirement savings due to:
 - Lack of financial knowledge / education
 - Poor understanding of the risk / unpredictability of an individual's lifespan



Probability of Living to Certain Ages in Retirement

Probability of Living from Age 65 to Various Ages						
Age	Social Security Mortality			75% of Social Security Mortality		
	Male	Female	Survivor	Male	Female	Survivor
80	60.21%	70.80%	88.38%	68.48%	77.25%	92.83%
85	39.78%	52.73%	71.53%	50.35%	62.04%	81.15%
90	19.73%	31.25%	44.81%	30.05%	42.13%	59.52%
95	6.02%	12.37%	17.65%	12.68%	21.39%	31.36%
100	0.95%	2.76%	3.68%	3.39%	7.25%	10.40%

*(Data extracted from: Analysis of the 2007 period life table for the Social Security area population, <http://www.ssa.gov/oact/STATS/table4c6.html>, downloaded October 26, 2011.)



Adverse Effects from Longevity Risk

- Even when there is an understanding of longevity risk (lifespan), most people don't know how to determine how much money they will need.
- This can result in both overestimation or underestimation of retirement needs.



Impact of Longevity Risk

- Longevity risk affects segments of the population differently based on their economic circumstances:
 - Sufficient accumulation of retirement assets
 - Inability to accumulate retirement assets
 - Somewhere in-between



Impact of Longevity Risk

- **Sufficient Accumulation:**
 - Retirees able to accumulate sufficient assets to meet lifetime income needs under most circumstances
 - Retirees still face lifetime income risk, but have the ability to mitigate longevity risk under reasonable circumstances
- **Inability to Accumulate:**
 - Retirees unable to accumulate any significant amount of assets
 - Not in a position to implement lifetime income solution
 - Must rely on Social Security and financial support from others, and in some cases, social safety net programs
- **Somewhere In-between:**
 - Largest segment of population that needs to take direct action to assure its lifetime income is sufficient to meet basic needs



Addressing Longevity Risk

- Education:
 - Federal government
 - Employers
 - Others

- Potential changes to retirement plans:
 - During accumulation:
 - Plan design
 - Tax incentives
 - Notifications / statements
 - When leaving a retirement plan:
 - Restrictions on distribution (form, timing, etc.)
 - Education about payout options



Addressing Longevity Risk

- Other Approaches:
 - Changes in Social Security (e.g., retirement age)
 - Tax treatment of debt and savings
 - Changes in regulation of retirement plans
 - Health care and disability income insurance options



Value of Policy Guidance to Create Change

- Most changes in regulation require policy guidance.
- Existing pension regulation shaped by:
 - Tax treatment
 - Tax deferral
 - Required minimum distribution
 - ERISA rules and creation of safe harbors
 - Deductibility of contributions to retirement plans



Challenges of Using Public Policy to Mitigate Longevity Risk

- Individual needs vary
 - Wealth levels
 - Retirement income needs
- Health status varies and changes over time
- Entrenchment of current policy



Areas Where Policy Guidance Could Mitigate Longevity Risk

- Broad scope guidance
- Approaches within retirement plans
- Approaches when leaving a retirement plan
- Approaches outside of an employer retirement plan



Broad Scope Guidance

- Everyone needs improved education about lifetime income needs and how to prepare.
- Employers may be best positioned to be a primary source of this education.
- The U.S. Department of Labor and other entities that provide retirement information could expand their efforts.
- Actions to better assure retirees of the certainty of receipt of lifetime income from insurers and pension plans could increase use of lifetime income options.



Approaches within Retirement Plans

- Changes to annual retirement plan statements could express benefits in terms of lifetime income and bring the issue to the attention of employees.
- Narrowing the scope of ERISA “protected benefits” could lead to innovation, encourage continued provision of DB programs, and facilitate greater use of lifetime income approaches.



Approaches within Retirement Plans

- Changes in allowable designs could make it easier to offer annuity options as accumulation choices within DC plans, or even requiring annuity options be offered and by making them the default option.
- Tax policy could steer individuals towards allocating assets to lifetime income, (e.g., eliminating taxation on interest earnings upon lifetime annuitization).



Approaches to When Leaving a Retirement Plan

- Education about and attractive access to lifetime income options at the time of termination from a contribution-oriented plan would increase awareness of and use of lifetime income solutions.
- Education about the value of lifetime income at the time of termination from a defined benefit plan could increase awareness of and use of lifetime income solutions.



Approaches Outside of an Employer Retirement Plan

- In IRA rollovers or personal savings, tax policy can encourage use of a lifetime income solution, such as, eliminating taxation on interest earnings upon lifetime annuitization.
- Required minimum distribution (RMD) requirements create a hurdle for use of deferred income annuities (DIA) with qualified funds because they require premature distribution of funds already annuitized.
 - An IRS proposal to relax RMD requirements could facilitate the use of DIAs to address lifetime income challenges.



Approaches Outside of an Employer-Sponsored Retirement Plan

- The Social Security maximum retirement age could be increased beyond age 70 to introduce more flexibility into addressing longevity risk.



Time to Act

- Workers and retirees need to be better prepared to manage their lifetime income needs in retirement.
- A number of actions need to be taken to change the dynamics and provide much needed financial education.
- The problem cannot be solved with a single solution, but rather with a number of approaches that address lifetime income from different directions.
- The support and efforts of employers, lawmakers, and financial product providers will be necessary.



Academy Initiatives—Phase 1

- White paper on the “*Challenges of Creating Lifetime Income*” to be published this spring
- Pension Symposium during the Enrolled Actuaries Meeting
- Comments on proposed IRS regulations:
 - RMD allowance for longevity annuity contracts
 - Partial annuity distribution options
- More activity to come



Questions?



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