Retirement Security: Public Perceptions and Misperceptions

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Context for Paper

• Variety of studies show misinformation, but no prior source unified data
• SOA Committee on Post-Retirement Needs and Risks led three partners to:
  – Identify documented areas of misinformation
  – Organize into unified paper
• Resulting paper titled *Public Misperceptions About Retirement Security*
  – Jointly authored by SOA, LIMRA, Mathew Greenwald & Associates
Context for Paper

• These results should be considered together with findings on behavioral finance

• Results reflect attitudes, knowledge
  – Unlike other studies that consider actual wealth
Retirement System Today

• Major decline in defined benefit (DB) plans
  – Face unlevel playing field
  – Uncertainty about funding rules

• Growth of defined contribution (DC) plans
  – Many of these plans dependent on employee action
  – Exceptions: Plans with automatic employer contributions and autopilot plans

• Social Security reform on policy agenda
Recommendations from the Academy

• Encourage good default options in DC plans and provide safe harbors for plans that are not dependent on employee action.

• Level the playing field and stabilize funding for Defined Benefit plans.

• Encourage regular income in all types of programs.

• Recognize the importance of Social Security

• Work to improve financial literacy
Ten Common Retirement Misperceptions

1. Saving too little
2. Not knowing when retirement will occur
3. Living longer than planned
4. Not facing facts about long-term care
5. Trying to self-insure against long life
6. Not understanding investments
7. Relying on poor advice
8. Not knowing sources of retirement income
9. Failing to deal with inflation
10. Not providing for a surviving spouse
1. Saving Too Little

- A majority have not tried to estimate how much money they will need for retirement.

- Many of those who have calculated this amount appear to underestimate how much money they will need to accumulate.
1. Retirees Who Live Longer Than Average Often at the End of Lives, in Deprivation

Non-Housing Assets of Families Headed By Someone Ages 85 and Over

<table>
<thead>
<tr>
<th>Range</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less than $2,000</td>
<td>17</td>
</tr>
<tr>
<td>$2,000 - $24,999</td>
<td>21</td>
</tr>
<tr>
<td>$25,000 - $99,999</td>
<td>28</td>
</tr>
<tr>
<td>$100,000 - $199,999</td>
<td>14</td>
</tr>
<tr>
<td>$200,000 and over</td>
<td>19</td>
</tr>
</tbody>
</table>

Source: Federal Reserve 2001 Survey of Consumer Finances and Employee Benefit Research Institute
1. Few Calculate Amount of Savings Needed for Retirement

Percentage of individuals who have done a retirement needs calculation

Source: EBRI/Greenwald, 2001-2005 Retirement Confidence Surveys
1. Savings Needed for Retirement

*Some respondents saying don’t know/don’t remember did not provide household income information.

Source: EBRI/Greenwald, 2005 Retirement Confidence Survey
## 1. Replacement Ratios

<table>
<thead>
<tr>
<th>Pre-Retirement Income</th>
<th>Replacement Ratio (%)</th>
<th>Replacement Ratio</th>
<th>% of Workers</th>
</tr>
</thead>
<tbody>
<tr>
<td>$20,000</td>
<td>89</td>
<td>Less than 50%</td>
<td>18</td>
</tr>
<tr>
<td>$40,000</td>
<td>80</td>
<td>50%–70%</td>
<td>41</td>
</tr>
<tr>
<td>$60,000</td>
<td>75</td>
<td>70%–85%</td>
<td>23</td>
</tr>
<tr>
<td>$80,000</td>
<td>77</td>
<td>85%–95%</td>
<td>3</td>
</tr>
<tr>
<td>$150,000</td>
<td>85</td>
<td>95%–105%</td>
<td>4</td>
</tr>
<tr>
<td>$200,000</td>
<td>88</td>
<td>105% or more</td>
<td>6</td>
</tr>
<tr>
<td>$250,000</td>
<td>88</td>
<td>Don't know</td>
<td>5</td>
</tr>
</tbody>
</table>

*Source: AON Consulting/Georgia State University, 2004 Replacement Ratio Study

**Source: EBRI/Greenwald, 2005 Retirement Confidence Survey
2. Not Knowing When Retirement Will Occur

- The chances are high that some workers will retire before they expect to.
- Many workers expect to supplement their retirement income with earned income.
2. Timing of Retirement Among Retirees

Source: EBRI/Greenwald, 2001-2005 Retirement Confidence Surveys
2. Working in Retirement

- Workers planning to work for pay
- Retirees who worked for pay

<table>
<thead>
<tr>
<th>Year</th>
<th>2001</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>61%</td>
<td>66%</td>
<td>70%</td>
<td>68%</td>
<td>66%</td>
<td></td>
</tr>
<tr>
<td>26%</td>
<td>24%</td>
<td>28%</td>
<td>32%</td>
<td>26%</td>
<td></td>
</tr>
</tbody>
</table>

Source: EBRI/Greenwald, 2001-2005 Retirement Confidence Surveys
3. Living Longer than Planned

- A confluence of trends is placing longevity risk squarely on the shoulders of retirees.

- Many people plan to live to average life expectancy yet do not understand they could live much longer.
3. DB on the Decline:
Percent of Workers Participating in a Plan

Defined benefit
Defined contribution

*Interpolated
Figures represent private industry only. Source: U.S. Department Of Labor, Bureau of Labor Statistics
3. Employer-Sponsored Retiree Health Benefits Disappearing

% of large employers sponsoring

Before age 65
Age 65+

Additional information not covered in oral presentation

Source: Mercer Human Resource Consulting
3. Retiree’s Understanding of Life Expectancy at Age 65

- Male Retirees: 63% underestimate, 48% overestimate, 28% on target, 8% don’t know
- Male Pre-retirees: 67% underestimate, 54% overestimate, 30% on target, 3% don’t know
- Female Retirees: 63% underestimate, 54% overestimate, 30% on target, 4% don’t know
- Female Pre-retirees: 54% underestimate, 46% overestimate, 43% on target, 7% don’t know

3. Survival Rates of 65-year Olds

Source: Human Mortality Database, University of California, Berkeley (USA), and Max Planck Institute for Demographic Research (Germany). Mortality rates based on 1999 experience.
4. Not Facing Facts About Long-Term Care (LTC)

- Many people underestimate their chances of needing long-term care.

- The percent of people owning long-term care insurance or that could self-insure an extended long-term care situation is low.
4. Risks of Needing Long-Term Care

- 44% will require nursing home care
- Average duration is 2.5 years
- Average cost of institutional care is now $70,080 a year for a private room and $61,685 for a semi-private room
4. Why Don't Retirees Own LTC Insurance?

- Too expensive: 67% (Retirees) 54% (Pre-retirees)
- Don't need it: 25% (Retirees) 28% (Pre-retirees)
- Medicare will pay: 17% (Retirees) 19% (Pre-retirees)
- Have enough assets: 17% (Retirees) 19% (Pre-retirees)
- Don't know enough: 29% (Retirees) 16% (Pre-retirees)
- Medicaid will pay: 14% (Retirees)
- Don't want to think about: 14% (Retirees) 9% (Pre-retirees)
- Too complicated: 11% (Retirees) 9% (Pre-retirees)
- Don't qualify: 5% (Retirees) 9% (Pre-retirees)
- Not recommended: 5% (Retirees) 6% (Pre-retirees)

5. Trying to Self-Insure For a Long Life

- Guaranteed lifetime income has many positive effects
- A majority of people desire guaranteed lifetime income in retirement
- Retirement benefits increasingly available in lump sum form
- Election of lifetime income options is low.
5. Importance of Lifetime Guaranteed Income in Payout Decision

Source: SOA/Academy, Retirement Plan Preferences Survey
5. Demand for Annuitzation is Significant

Guaranteed income sources will NOT be enough

- Retired: 41%
- Not retired: 60%

Interest in annuity concept

- Retired: 36%
- Not retired: 55%


Note: Respondents have at least $50,000 in investable financial assets
6. Not Understanding Investments

- Workers have more responsibility than before for managing investments for retirement.

- Many workers misunderstand investment returns and how investment vehicles work.
6. Misunderstand Expected 5-Year Average Annual Return

<table>
<thead>
<tr>
<th>Anticipated 5-Year Average Annual Return (mean %)</th>
<th>Historical returns 1926-2003</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2002 survey</td>
</tr>
<tr>
<td>Stocks on the New York Stock Exchange</td>
<td>10.9</td>
</tr>
<tr>
<td>Bonds issued by large corporate entities</td>
<td>8.1</td>
</tr>
<tr>
<td>Money market funds</td>
<td>7.7</td>
</tr>
</tbody>
</table>

Sources: John Hancock, 2002 & 2004 Defined Contribution Survey
### 6. Misunderstand Investment Risk

<table>
<thead>
<tr>
<th>Consumers’ Average Rating of Investment Risk (5-point scale)</th>
</tr>
</thead>
<tbody>
<tr>
<td>International/global stock funds</td>
</tr>
<tr>
<td>Domestic, diversified stock funds</td>
</tr>
<tr>
<td>Company stock</td>
</tr>
<tr>
<td>Money market fund</td>
</tr>
<tr>
<td>Domestic bond fund</td>
</tr>
</tbody>
</table>

Note: Company stock is generally more risky than a stock fund; Money market funds are less risky than domestic bond funds

Source: John Hancock, 2002 Defined Contribution Survey
7. Relying on Poor Advice

• A significant portion of retirees and pre-retirees do not seek the help of a “qualified professional.”

• There are no standards for “qualified professional.”

• Yet, there is strong desire to work with a financial professional.

Supporting documentation is in your handout
7. Individuals Retirees Consulted for Rollover Decision


- Family/friend: 42%
- Fin'l Planner: 36%
- Inv. Advisor: 24%
- Employer: 22%
- Accountant: 16%
- Banker: 9%
- Full-service broker: 14%
- MF Co. Rep.: 7%
- Ins. Agent: 5%
- Discount broker: 1%
- Outplacement counselor: 3%
- Lawyer: 5%
- Other: 3%
7. Advisors Used by Retirees to Plan Retirement

- Employer: 70% Extensive, 43% Some, 65% Little/none
- Financial planner: 63% Extensive, 46% Some, 24% Little/none
- Accountant: 36% Extensive, 30% Some, 16% Little/none
- Stockbroker: 35% Extensive, 32% Some, 14% Little/none
- Lawyer: 33% Extensive, 27% Some, 13% Little/none
- Insurance agent: 24% Extensive, 21% Some, 12% Little/none
- None of the above: 5% Extensive, 5% Some, 30% Little/none

Additional information not covered in oral presentation

Note: Respondents have at least $50,000 in investable financial assets
7. Exclusive Preference for Planning Sponsorship

- Professionals preferred overall, especially for financial risks
- DB plan income recipients prefer employer-sponsored planning

Additional information not covered in oral presentation

Base = Respondents with exclusive preference for one type of sponsor
Note: Respondents have at least $50,000 in investable financial assets
8. Not Knowing Sources of Retirement Income

• Workers misunderstand what their primary sources of income will be in retirement.
8. Expected and Actual Major Sources of Retirement Income

Source: EBRI/Greenwald, 2005 Retirement Confidence Survey
8. Process of Retirement

- **Stop working all at once**: 71% (Pre-retirees), 41% (Retirees)
- **Continue to work for pay part time or periodically**: 32% (Pre-retirees), 16% (Retirees)
- **Gradually reduce the number of hours you work before stopping completely**: 16% (Pre-retirees), 7% (Retirees)
- **Continue to work for pay full time**: 9% (Pre-retirees), 5% (Retirees)

9. Failing to Deal with Inflation

- Inflation has become a fact of life that for most has been managed through pay increases.

- While many pre-retirees and retirees are concerned about inflation, few have adequate means of managing their incomes on an inflation-adjusted basis.

Supporting documentation is in your handout
9. Inflation Facts – Last 60 years

Additional information not covered in oral presentation

Source: U.S. Bureau of Labor Statistics, CPI-U (all urban consumers), derived from July index values
9. Income Required to Keep Pace With Inflation

<table>
<thead>
<tr>
<th>Years</th>
<th>Income Required (in $)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Today</td>
<td>$1,000</td>
</tr>
<tr>
<td>5 Years</td>
<td>$1,188</td>
</tr>
<tr>
<td>10 Years</td>
<td>$1,411</td>
</tr>
<tr>
<td>15 Years</td>
<td>$1,675</td>
</tr>
<tr>
<td>20 Years</td>
<td>$1,990</td>
</tr>
<tr>
<td>25 Years</td>
<td>$2,363</td>
</tr>
<tr>
<td>30 Years</td>
<td>$2,807</td>
</tr>
</tbody>
</table>

Source: MetLife estimates
10. Not Providing for a Surviving Spouse

- Many married couples fail to plan for the eventuality that one spouse will die before the other.

- The consequences of not planning can have serious consequences, especially when the survivor is the wife.

Supporting documentation is in your handout
10. Importance of Guaranteed Income for Spouse in Payout Decision

Source: SOA/Academy of Actuaries, 2003 Retirement Plan Preferences Survey

Additional information not covered in oral presentation
## 10.2001 Poverty Rates Among the Elderly

<table>
<thead>
<tr>
<th>Additional information not covered in oral presentation</th>
<th>Poor (%)</th>
<th>Near Poor (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Married persons</td>
<td>4</td>
<td>4</td>
</tr>
<tr>
<td>Nonmarried men</td>
<td>14</td>
<td>9</td>
</tr>
<tr>
<td>Nonmarried women</td>
<td>18</td>
<td>10</td>
</tr>
</tbody>
</table>

Related Learning

- 10% - 20% of the population are “unbanked”
- A significant percentage of employees stay in default options
  - They do not save if they must act to do so
- Groups vary in their interest in and ability to plan

Additional information not covered in oral presentation
Conclusions

- Misperceptions still exist after 20+ years of experience with 401(k) plans and IRAs
  - Experience with 401(k) plans show many people choose and stay in defaults
- Route to a strong retirement system is multi-pronged, and must include programs that work for those who will not take initiative
- Actions must consider DB plans, DC plans and Social Security
- More and better education is important, but should not be the primary strategy
  - Different population segments respond well to different strategies
  - For some segments, education is not enough and will have little impact
Retirement System Today

- Major decline in defined benefit (DB) plans
  - Face unlevel playing field
  - Major uncertainty about funding rules
- Growth of defined contribution (DC) plans
  - Many of these plans dependent on employee action
  - Exception: Plans with automatic employer contributions and Autopilot plans
- Social Security reform on policy agenda

Based on what we know, what are our options to strengthen the retirement system?
People don’t plan well for retirement

• **Observation:** Most people don’t behave as “rational economists” and plan well for retirement

• **Implication:** Plans need to work without specific action by individuals (to accommodate people who do not act on their own)

• **Options**
  – Encourage DB plans
  – Strengthen DC autopilot options

• **Consequences:** Without strong defaults there will be more reliance on plans of last resort (Medicaid, SSI)
People don’t plan well for retirement

- **Observation**: People do better in employer plans than they do on their own
- **Implication**: Employer plans should be encouraged as the backbone of the system
- **Options**
  - Encourage DB plans
  - Strengthen DC plans
- **Consequences**: Without strong defaults, there will be more reliance on plans of last resort (Medicaid, SSI)
Longevity risk has shifted to individuals

- **Observation**: Responsibility for insuring against longevity risk has shifted to individuals
- **Implication**: Individuals need easily accessible, cost-effective annuities
- **Options**
  - Allow DB plans substitute 20-year certain & life for lump sum option
  - Allow annuitization in DC plans
  - Keep annuitization in Social Security
- **Consequences**: Without protection from longevity risk, will see more individuals, particularly single women, impoverished at older ages
All individuals are not savvy investors

- **Observation:** All individuals are not savvy investors
- **Implication:** Many individuals may need to be given fewer choices, better default options, and be exposed to less investment risk

- **Options**
  - Fiduciary protection for employers for limiting DC options, providing investment education
  - DB plans protect against investment risk
  - Carefully constructed investment choices on Social Security accounts

- **Consequences:** Poor choices will be more prevalent among the poor, poorly-educated and lead to more reliance on systems of last resort
Recommendations

• Recognize limitations of individuals
• Recognize value of DB
  – Stabilize funding
  – Level playing field
• For DC
  – Provide safe harbors for plans not dependent on employee action (i.e., autopilot plans)
  – Encourage good default options
• Support efforts to improve financial literacy
Recommendations

• Encourage regular income in all types of programs
• Recognize importance of Social Security
• Test outcomes of policies for groups with different situations (e.g. couples, widows, people with some time out of labor force, etc.)