Approaching the DECUMULATION PHASE OF RETIREMENT

THE PENTEGRA IDEA FORUM

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The Current Climate

"Asset Decumulation or Asset Preservation? What Guides Retirement Spending," a report published in April 2018 by the Employee Benefit Research Institute (EBRI)[1], studied the extent to which the non-housing assets of certain retirees changed during their first 20 years of retirement.

Somewhat surprisingly, it showed that retirees generally exhibit very slow decumulation of assets, even when those assets are abundant or when there is guaranteed income available from other sources—such as a second income being earned by the retiree and/or his or her spouse, stocks, and rental of property—to ensure that retirees will not "overspend"' those assets. "While some retirees do spend down most of their assets in the first 18 years following retirement," according to the report, "about one-third of all sampled retirees had increased their assets over that period."[2]

The study further found that retirees with a pension were much less likely to have spent down their assets than non-pensioners. During the first 18 years of retirement, the median non-housing assets of pensioners—who entered retirement with a significantly higher amount of assets—had gone down only 4 percent, compared to 34 percent for non-pensioners.

In addition, the EBRI study found that the median ratio of household spending to household income for retirees of all ages stood at roughly one, increasingly slowly as the person aged.

"This suggests that majority of retirees had limited their spending to their regular flow of income and had avoided drawing down assets, which explains why pensioners, who had higher levels of regular income, were able to avoid asset drawdowns better than others," according to the report.[3]

1 Sudipto Banerjee, "Asset Decumulation or Asset Preservation? What Guides Retirement Spending?," EBRI. Retrieved from https://www.ebri.org/pdf/briefspdf/EBRI_IB_447.pdf.
2 Ibid.
3 Ibid.

Executive Summary

This paper examines the trends in how retirees spend the funds ("decumulate") in their retirement accounts, as well as professional advice on options best practices and strategies to address how to decumulate in a prudent fashion. The paper analyzes the key factors driving the current decumulation landscape and how they are impacting the prevailing way that recent and current retirees are spending down their retirement savings, as well as potential future implications.

Retirees generally exhibit very slow decumulation of assets, even when those assets are abundant or when there is guaranteed income available from other sources

In the face of regular news reports on how Americans are not saving sufficiently for their retirement—including recent articles in Forbes[4], USA Today[5], and on CNBC.com[6]—the fact that today's retirees are arguably underspending their nest eggs could be seen as a positive. But not all experts agree.

In an interview conducted for this white paper with EBRI President and CEO Lori Lucas, we learned that common reasons for underspending include a more fiscally conservative attitude taken by most aging people; uncertainty as to how long one will live (and thus how much money will be needed to see them through); an intent to bequeath assets to heirs; and what she termed "irrational concerns" about health care costs.[7]

According to a survey of the Asset and Health Dynamics, out-of-pocket health care expenses are not as high as commonly believed. For those who die at age 95 or later, the median cumulative out-of-pocket expense after age 70 until death is slightly above $27,000.[8]

Nevertheless, according to the 2017 Retirement Health Care Costs Data Report released by HealthView Services, retiree health care expenses are expected to rise at an average annual rate of 5.47 percent "for the foreseeable future," almost triple the U.S. inflation rate from 2012-2016 of 1.9 percent. The report further stated that that a 66-year-old couple retiring in 2017 would require 59 percent of their Social Security benefits to cover total retirement health care costs; a 55-year-old couple would need 92 percent; and a 45-year-old couple would need 122 percent.[9]

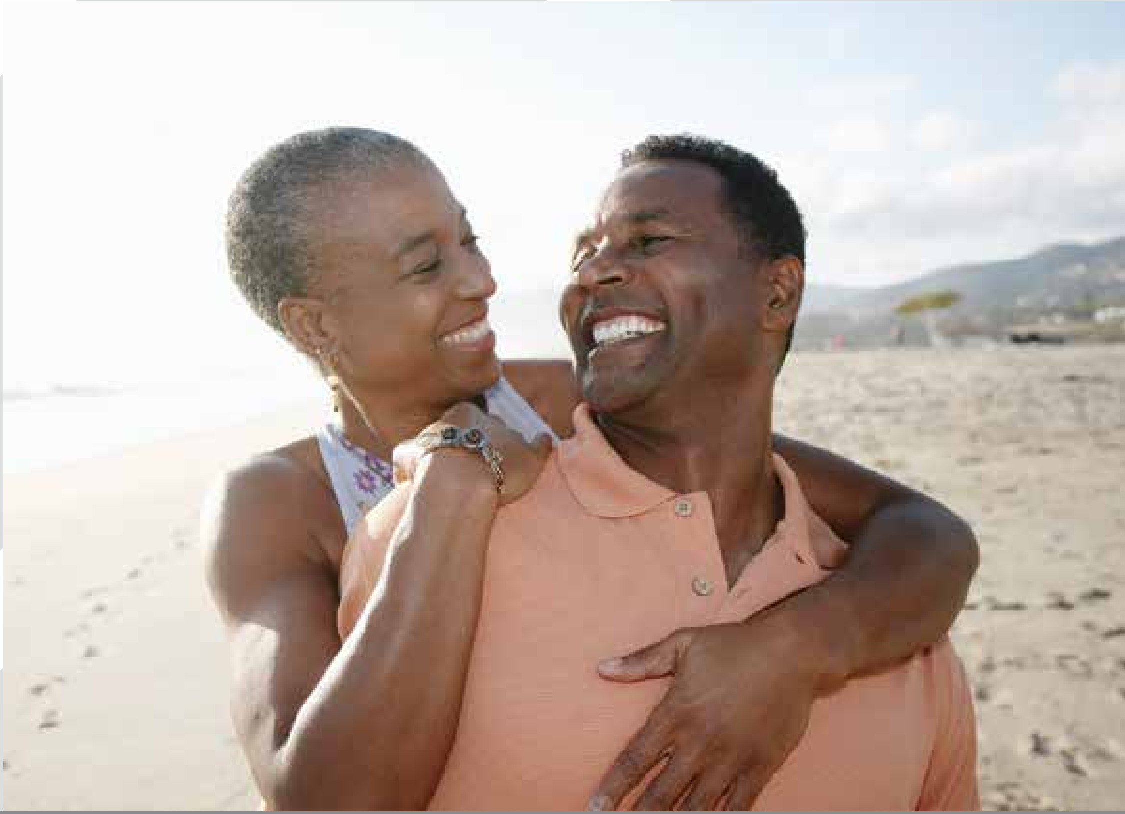
Regardless, Lucas said that the overriding factor – as demonstrated by the general uncertainty of how much retirees should spend during their retirement was "a lack of education. They don't know what a safe rate for spending down is, which in some cases is further exacerbated by the difficulty they have in changing their behavior," moving from the accumulation to the decumulation of their retirement funds.[10]

According to Pentegra's Richard Rausser, Senior Vice President of Client Services, "There's longevity vs. market returns vs. inflation." With respect to longevity: In 1935, when the Social Security program was introduced, age 65 – the traditional age of retirement – exceeded that of the average life expectancy of 61.7. In 2010 average life expectancy reached 78.7.11 As of December 2017, Americans could expect to live 78.6 years.[12]

4 Kate Ashford, "Americans Still Missing the Boat on Retirement Savings," Forbes, February 28, 2018.
5 Maurie Backman/The Motley Fool, "One-third of Americans have less than $5,000 set aside in retirement savings," USA Today, May 14, 2018.
6 Emmie Martin, "61% of Americans have no idea how much they'll need to retire—and it could leave them broke," CNBC.com, June 8, 2018.
7 Interview with Lori Lucas conducted on June 5, 2018.
8 Cited by Sudipto Banerjee, "Cumulative Out-of-Pocket Health Care Expenses After the Age of 70," EBRI, April 3, 2018. Retrieved from https://www.ebri.org/pdf/briefspdf/EBRI_IB_446.pdf.
9 2017 Retirement Health Care Costs Data Report, published by HealthView Services. Retrieved from http://www.hvsfinancial.com/PublicFiles/2017_Retirement_Health_Care_Costs_Data_Report_FINAL_6.13_V2.pdf.
10 Lucas interview, op. cit.
11 "Life Expectancy at Birth by Race and Sex, 1930–2010," Infoplease. Retrieved from https://www.infoplease.com/life-expectancy-birth-race-and-sex-1930-2010.
12 Ben Tinker, "US life expectancy drops for second year in a row," CNN.com, December 21, 2017.

Presumably playing into that increase is the fact that Americans have experienced a much improved quality of life. "As measured by mortality risk, a 59-year-old man in 1970 was the same effective age as a 65-year-old in 2000," said J. M. (Jack) Towarnicky, executive director of the Plan Sponsor Council of America (PSCA), in an interview for this report.[13]

Rausser also suggested that lessons had been learned from the "dot-com" bubble era of 1997-2002 ~~a~~ period that saw the market value of Nasdaq companies peak at $6.7 trillion in March 2000 and fall to $1.6 trillion in October 2002.[14] "People retired [during the boom period] thinking they'd have enough. After those heavy market declines, they had to go back to work. It was almost as bad as just spending their assets recklessly. "And a lot of people, even in the financial industry, are 'math-challenged,' and simply don't know how to put it all together," Rausser added.[15]



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The Future

As the general population of the U.S. continues to rise – it is projected to stand at nearly 326.8 million in 2018 and is projected to reach 354.7 million by 2030—so too does its number of retirees.

According to Pew Research Center, beginning in 2011, 10,000 Baby Boomers have turned 65 per day, something Pew said will continue through 2030. By that year, when all members of the Baby Boom generation have reached 65, at least 18 percent of the U.S. population will be aged 65 or over, compared with 13 percent in 2011.[17]

Towarnicky at PSCA said that, rather than a cause for further alarm about the state of retirement savings in the U.S., "In June 2018, tens of thousands of Baby Boomers will commence a financially successful retirement." Though speaking broadly, Towarnicky said such success could be expected because Baby Boomers, having come of age in the 1960s and '70s, "had the opportunity to observe the retirement decisions of their grandparents – few, if any of whom were financially prepared to stop working before they were physically unable to continue working."

In addition, Towarnicky noted the shift in the work landscape: "Those retiring in the 1960s and 1970s had work that was often much more blue collar and physical. Over the past 75 years, the percentage of America's workers employed in manufacturing and agriculture declined from 34 percent to less than 10 percent , from approximately 23 million in 1960 to approximately 13 million in 2016, while agricultural and manufacturing output soared, sextupled."

13 Interview with Jack Towarnicky conducted on June 12, 2018.
14 Chris Gaither and Dawn C. Chmielewski, "Fears of Dot-Com Crash, Version 2.0," Los Angeles Times, July 16, 2006.
15 Interview with Richard Rausser conducted on May 31, 2018.
16 Retrieved from http://www.worldometers.info/world-population/us-population/.
17 Russell Heimlich, "Baby Boomers Retire," Pew Research Center, December 29, 2010.

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He further noted that financial preparation for retirement has changed while simultaneously decrying what he termed "the myth of widespread, lucrative, defined benefit pension plans."

Towarnicky continued: "Tales are still told that once upon a time, the majority of American workers were covered by a lucrative, non-contributory, defined benefit pension plan that offered immediate eligibility and vesting, incorporating a generous final average pay formula with early retirement subsidies and generous post-retirement cost of living adjustments. Never happened, never will. The reality is that most American workers were never eligible for a defined benefit pension plan, and most who were covered at one time or another by a defined benefit pension during the 1970s and early 1980s, never vested. Data show that the high point in defined benefit pension coverage was 39 percent in 1980. However, most plans of that era incorporated age and service eligibility provisions and 10-year vesting requirements.[18]"

The PSCA today maintains that the period of retirement for many workers will increase by 33-50 percent: "Instead of 12-15 years in retirement, we are expecting 15-30 years for many retirees."[19]

It is worth noting that, while the risks in terms of health care and long-term care increase commensurate with the period of retirement, those who have notionally been retired for at least 20 years have indicated that they are relatively unconcerned about their finances. According to "Post-Retirement Experiences of Individuals over 85 Years Old," a report published by the Society of Actuaries (SOA) in May 2018, "Most report that they do not worry that much about their finances, and a large percentage report being at least somewhat financially secure. Like the qualitative research, very few Americans ages 85 and over express regrets about the decisions they made in life regarding their finances, and most of the regrets they have stem from the years before they retired. Most adult children confirm that their parents do not worry that much about their finances and are not concerned about supporting themselves for a long time to come.

Furthermore, the report continued, there is little evidence of octogenarian-and-above retirees experiencing recent financial events that impact them greatly: "A small percentage of those ages 85 and over report medical expenses as having a major impact; these are primarily low-asset respondents. Adult children with parents this age confirm that their parents can handle health care expenses with Medicare and Medigap. Interestingly, slightly more elderly, especially those with lower incomes, report that utility bill increases have a major impact than report this for medical expenses."[20]

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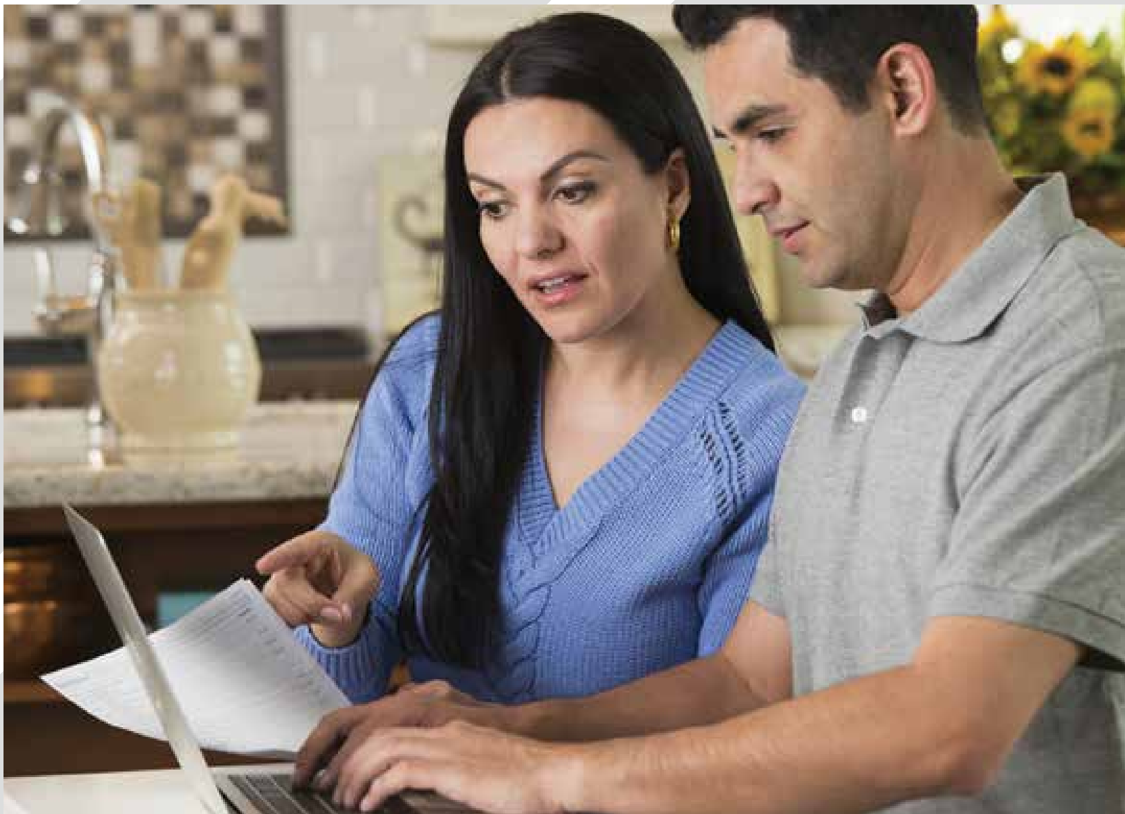
20 Greenwald & Associates, Inc. on behalf of the Society of Actuaries, "Post-Retirement Experiences of Individuals over 85 Years Old," May 2018.



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Recommendations and Advice

Despite the evidence that, in general, those who have retired – especially those who have been retired for a significant amount of time – are spending less/at a slower rate than might have been assumed, there would seem to be little reason to believe that this behavior will hold true for future generations.

In its annual survey of retirement habits, Go Banking Rates found that 42 percent of Americans have less than $10,000 put away for retirement, while 57 percent of Millennials – the youngest subsector of Americans working today – have $10,000 or less saved for retirement.[21] According to the Bureau of Labor Statistics, in 2016 the average expenditure for persons aged 65 and older was $45,756.[22]

However, while experts continue to exhort all currently employed Americans to adopt a prudent approach to accumulating savings for retirement, what do they recommend to those already retired when it comes to decumulation?

Rausser recommended seeking the advice of a professional financial advisor to mitigate the risk of what he called "living too long and running out of money."[23] Lucas at EBRI agreed, noting that individuals should also keep in mind their family history in terms of longevity and life expectancy.[24]

Rausser notes, that the transition to retirement is not just a financial one; it's also a psychological one. There are many factors to consider as you enter this phase. For your entire career, you have been focused on saving—and on the amount needed to retire securely. Once you make the decision to retire, there's another amount that you need to focus on: how much you can spend each month, and which source of retirement income it will come from. This is what the industry calls "decumulation," or the process of distributing the savings you have spent your lifetime accumulating. How you spend your savings is as important as how you accumulated them. Many of the same factors that shaped your savings decisions will also shape how you spend them.

21 Cameron Huddleston, "Survey Finds 42% of Americans Will Retire Broke – Here's Why," GOBanking Rates, March 6, 2018.
22 Bureau of Labor Statistics, "Consumer Expenditures – 2016," August 29, 2017.
23 Rausser, op. cit.
24 Lucas, op. cit

As you consider how to maximize your retirement income, you may be concerned about how to balance spending too much in the early years of your retirement and running out of savings, or being too frugal and leaving excess savings behind. Most of us face real risks related to inflation, longevity and market volatility. A primary concern for many baby boomers will be how to "pensionize" their retirement savings.

For many retirees, this can be overwhelming and often confusing. You may have savings from many different sources—employer-sponsored retirement plans, such as 401(k) or pension plans, plus IRAs and Social Security. Many of your income sources offer different methods of distribution that you will need to choose from. The first step is to understand which options are available to you from each of your income sources, and the advantages and implications of each.

The transition to retirement is not just a financial one; it's also a psychological one.

Annuities

Both Rausser and the American Academy of Actuaries indicated that investing in annuities could be attractive to retirees looking to manage longevity risk.[25] Lifetime income annuities provide a way to maximize retirement benefits to provide comfort and security throughout retirement; in effect it delivers a guaranteed monthly income based on the retiree's accumulated retirement benefits for as long as one lives and, if the retiree so chooses, for as long as their beneficiary lives.

What is an annuity and how does it work?

Lifetime income annuities provide a way to maximize your retirement benefits to provide comfort and security throughout retirement. An annuity provides a guaranteed monthly benefit payment based on your accumulated retirement benefits. These benefit payments continue for as long as you live and, if you choose, for as long as your beneficiary lives. An annuity pays you monthly income that you cannot outlive.

Annuities may be an ideal choice because they enable you to make long-range plans by providing basic financial security—so that you can use personal savings and other income sources for whatever you like, without worrying about using all your retirement income. Annuities also offer key tax advantages. The tax code specifically protects money in retirement plans, deferring taxes until you receive the income.

Determining the best kind of annuity involves examining an individual's sources of retirement income, how they are invested, the retiree's health, and the health of their beneficiary. Different types of annuities pay different levels of income because they take different factors into consideration.[26]

How do different types of annuities compare?

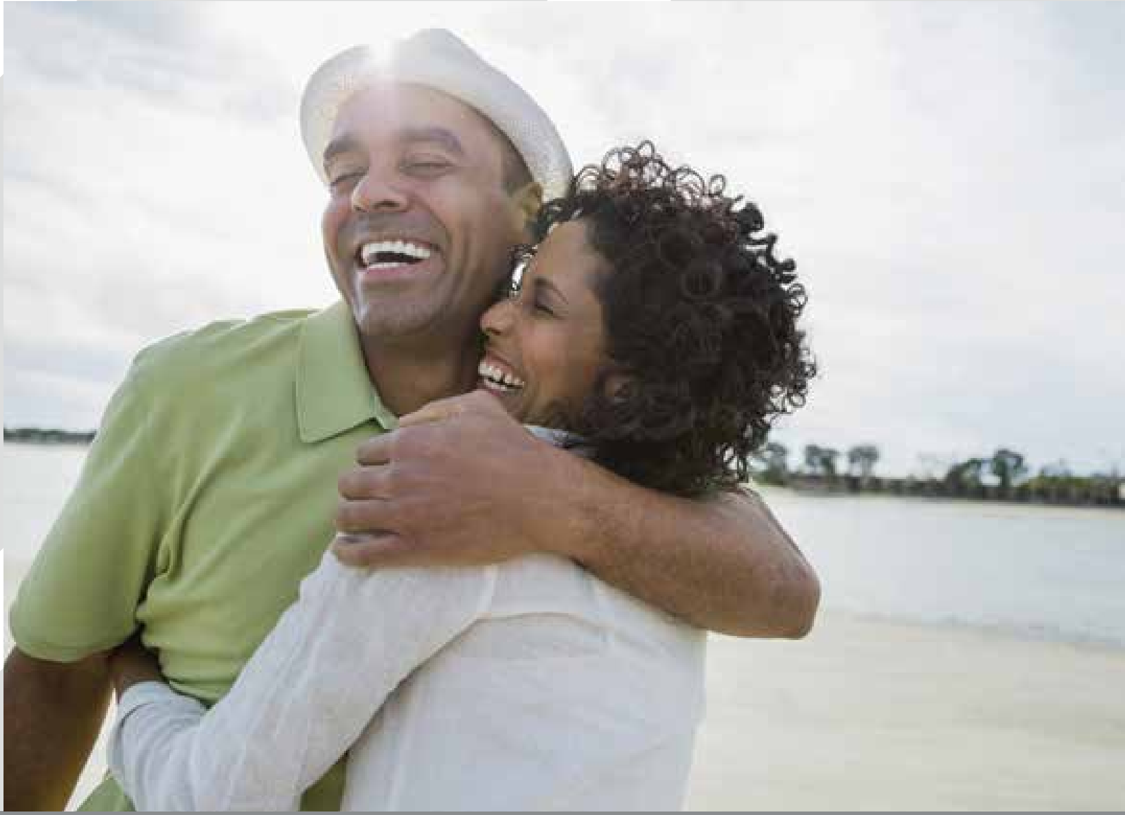
Annuity payments are not "one size fits all." If any of your income sources provide an annuity option, you will need to explore and understand the different annuity forms available. First, you have flexibility in when you wish to begin receiving your annuity benefits.

Immediate Income Annuity Payments begin within 12 months of your purchase date. In exchange for a lump sum, an insurance company provides a guaranteed monthly income for life or over a specific time frame.

25 Academy of American Actuaries, "Risky Business: Living Longer Without Income for Life Information for Current and Future Retirees," October 2015.
26 "Pensionizing Your Retirement Savings," retrieved from https://www.pentegra.com/current-thinking/the-pentegra-smartpath/pensionizing-retirement-savings/, March 3, 2016.

Deferred Income Annuity Payments begin at any time from several months to years after your purchase date. In exchange for a lump sum, an insurance company provides a guaranteed monthly income for life to begin at a future date that you select.

QLAC (Qualified Longevity Annuity Contract) Payments begin as late as age 85. In exchange for a one-time payment, an insurance company provides a guaranteed monthly income for life to begin well after retirement but not later than 85. QLACs permit you to "spend down" more of your remaining savings earlier in your retirement and provide you with the peace of mind that comes with having another income stream much later in life.



Annuity payments are not "one size fits all."

Types of annuity payments

Joint and Survivor Annuity

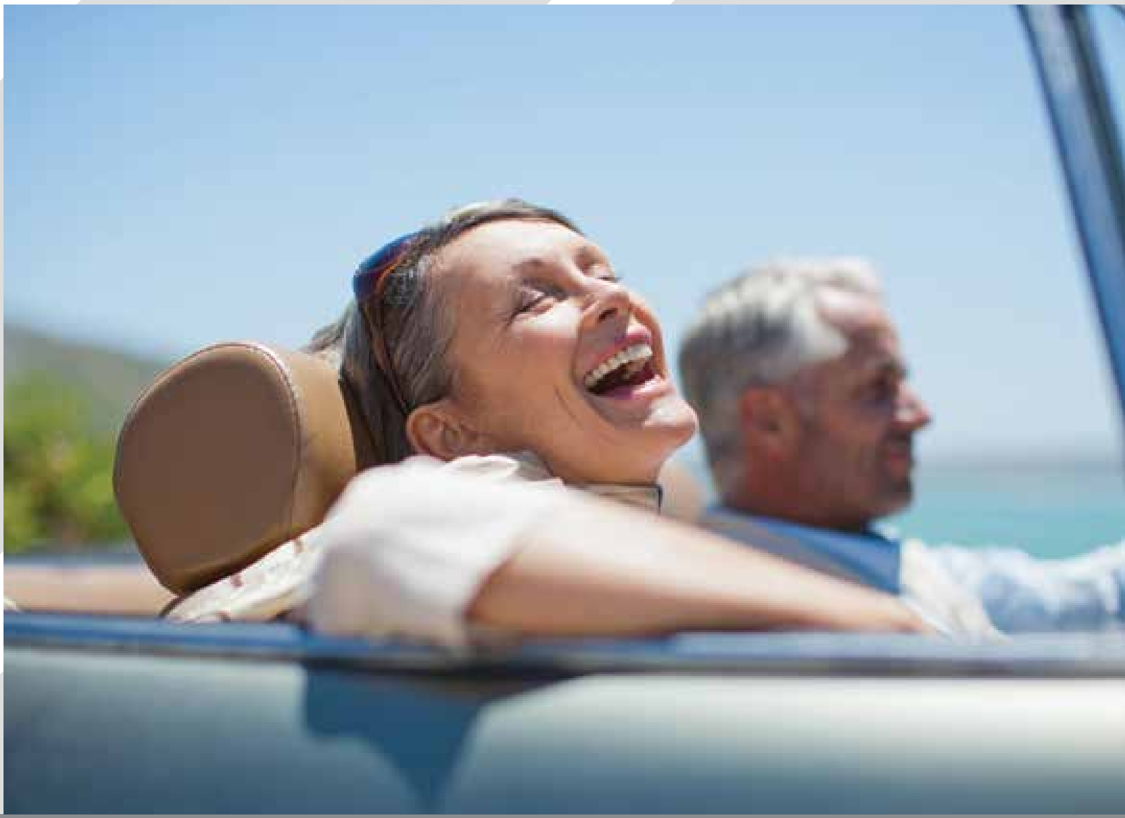
A joint and survivor annuity provides income over your lifetime and the lifetime of your spouse or beneficiary. A typical joint and survivor annuity provides you with a monthly retirement income, with a portion of that income continuing to your beneficiary upon your death. Generally the more you leave as a death benefit, the less you receive during your lifetime, and vice versa. The death benefit is a function of the percentage found in the benefit form name (e.g., 50% joint and survivor benefit provides 50% of what you were receiving as a death benefit). Because payments are guaranteed for your lifetime, with benefits continuing to your beneficiary upon your death, this type of annuity will generally pay less than a straight, or single life annuity because it offers guaranteed benefits upon your death, or death benefit protection.

Period Certain and Life Annuity

A life annuity may also be structured to provide retirement income for life with a "period certain," or a guaranteed benefit for a certain period of time. For example, a life annuity with 10 years certain means that the benefit would be paid over your life, with a minimum of 10 years of payments guaranteed. If you were to die after four years, your beneficiary would receive the remainder of the payments for six more years, because the annuity guarantees that the payments will be made for at least 10 years. The guaranteed portion of the benefit under this option is also referred to as a death benefit, or death benefit protection.

Straight or Single Life Annuity

A straight life, or single life annuity provides retirement income for your lifetime. It is essentially a series of monthly payments that continue for as long as you live. When you elect a straight life annuity, payments end upon your death, with no remaining payments to your beneficiary. While this type of annuity provides the highest level of monthly benefit, it offers no death benefit protection. This is because in exchange for a higher level of retirement income, you give up a continuing benefit for your beneficiary.



Annuities may be attractive to retirees looking to manage longevity risk.

Other Options—Installment Payments and Distributions Over Time

Installment payments are a way to structure your retirement savings to provide regular income throughout retirement. An installment payment program lets you make long-range plans so that you can use personal savings and other income sources for whatever you like without worrying about using all of your retirement income. Installment payments generally offer a great deal of flexibility in structuring your payments. Under this option, installment payments offer you the ability to create an income stream and payment cycle that works best for you.

The "4 Percent Rule"

For years, the retirement plan services industry has generally relied upon the "4 percent rule" when it comes to the decumulation phase of retirement savings: Assuming the retiree had accumulated sufficient assets by retirement age, it was widely accepted that if they withdrew 4 percent a year from those savings, they should have sufficient funds for approximately 30 years.

However, the 4 percent rule was introduced in the 1990s, when interest rates were considerably higher than they have been over the past several years. In addition, as mentioned above, the average life expectancy rates have increased, and market volatility remains a concern.[27]

Towarnicky at the PSCA also discouraged relying upon the 4 percent rule; in fact, the organization does not recommend retirees adopt any specific distribution strategy. "At various times in the past, we have encouraged retirees estimate the amount of retirement income they will need to meet their basic, everyday needs," Towarnicky said. "Similarly, we have also encouraged retirees consider alternative payout strategies and products that will fund those basic, everyday needs with guaranteed, inflation-indexed retirement income."[28]

27 Ibid.
28 Towarnicky, op. cit.

Installment payments are a way to structure your retirement savings to provide regular income throughout retirement.

Key Takeaways

While retirees can be applauded for not overspending their savings, the fact that so many seem to be doing so to a fault can be problematic. After all, for most if not all of their careers they have been focused on saving — and on the amount needed to retire.

As discussed here, a lack of financial education can play a significant role. Shifting from a working lifetime strategy of saving to one of post-working spending can be a daunting proposition. But – assuming that one has indeed accumulated the necessary assets to fund a comfortable retirement for a number of years -- there are solutions to this conundrum.

- As with a savings accumulation plan, devise a decumulation strategy. Realistically determining what one expects to comfortably spend on a monthly basis -- including mortgages, children's college loans, car payments, and other outstanding debts – can just be the start. Budgeting for expenditures above and beyond those– downsizing/relocating, taking long-deferred trips, and so on – will as a result be easier to map out.
- Consider potential health/medical expenses. There is no perfect formula for the guesswork involved here, but examining not only one's own health but also family histories of illnesses/diseases, potential health effects of one's environment – and remembering the general trend towards longer life expectancies – can help formulate an informed outlook.
- Consider Investigating an annuity. As illustrated above, these can guarantee income for a retiree's lifetime, and/or that of their beneficiary.
- Meet with a qualified financial advisor who specializes in retirement planning. Ideally this will have already been done during one's working years, but either way it is highly recommended to ensure that the retiree understands what their options are – and what can work best for them.

Pentegra's Decumulation Solutions

From an industry perspective, Pentegra offers a broader and much more diverse set of distribution options for participants, including an out-of-plan lifetime income solution through Hueler Investment Services.

PENTEGRA DISTRIBUTION OPTIONS	
Lifetime Income Solutions Through Annuities Straight Life Annuity Life Annuity with Period Certain Joint & Servivor Life Annuity Qualified Longevity Annuity Contract (QLAC)	**Installment Payments/Structured Distribution Over Time** Annual/Periodic Distribution Payments Annual/Periodic Distribution Payments Based on Life Expectancy Periodic Ad-Hoc Distributions **Lump Sum Payout/Partial Lump Sum Payout**

As with a savings accumulation plan, devise a decumulation strategy.

For more information on Pentegra's decumulation solutions, contact us at 800.872.3473 or visit us at www.pentegra.com

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