


**ANNA RAPPAPORT CONSULTING**  
STRATEGIES FOR A SECURE RETIREMENT<sup>SM</sup>



Signals: The Role of Information and  
Expectations in Retirement Planning

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Today's presentation goals

- Focus on employer role
- Discussion focused on primary DC plans
- Link signals and communicating about income
- Focus on realities
- Think about default options



## Agenda

- Situation today
- Realities
- Financial literacy and signals
- What one plan sponsor said
- Default options
- Employer actions



## Situation today

- Replacement ratios
  - Goal = 70% to 80% of pre-retirement income if we spent most income before retirement and want same living standard
- No agreement – right minimum amount of guaranteed life income beyond Social Security
- Challenging to illustrate income if not in plan
  - When does it start?
  - What form? Indexed for inflation?
  - Market price and what product?
  - Keep price up to date?



## Realities

- Evolution of employer retirement support – from income to lump sum based
  - DB plans – joint and survivor income
  - DC plans – not required to offer income option
- Products enable purchasing deferred life income – as investment option
- Trade-offs
  - More market risk for hope of higher return + variability
  - Lifetime guarantee vs. payout product with return of unused funds and no guarantee
  - Features and guarantees for a price
- Individual vs. institutional annuity purchase, possibly through IRA



## Examples of trade-offs

### Couple – male age 75/female age 70 – \$200,000 balance

- No purchase of annuity
  - 4% per year payout – starts at \$667/month
  - 5 year payout – \$3,566
  - 10 year payout – \$2,077
- Purchase of annuity
  - Male – life only - \$1,990/\$0
  - Life income with 100% to survivor – \$1,416/\$1,416
  - Life income with 50% to survivor – \$1,753/\$876
  - Life income with 50% to survivor and 20 years payments guaranteed – \$1,312/\$656

Note: Payments based on quotes from Fidelity website on 6/7/2008



## What people know and do

- Many lack financial literacy
- Short-term focus
- Lump sums overvalued compared to income
- Difficult to communicate time value
- Over-optimism about future investment returns
- Serious misunderstandings of investment risks
- Retirement planning seen as investment planning, not balanced with risk management
- Misunderstandings about life spans
- Lack of knowledge about financial products
- People say they want income, but choose lump sums
- Much changes during retirement – but not planned for



## Ideas from others

- Steve Vernon – think about your 401(k) balance as a monthly paycheck generator
  - Then Income should exceed Expenses
  - Maintain this balance and all will be well
- Ontario Pension Board
  - Require that DC plans illustrate monthly income
  - From testimony to Ontario Expert Commission on Pensions



## Default options

- In many endeavors, defaults are a powerful “Nudge”
- Much emphasis on DC defaults in last few years
  - Auto-enrollment and increases
  - New investment options
  - Not on distribution defaults
- Ideas are emerging
  - Life income – all or part
  - Deferred life income spread out over time for 50%
  - Two year trial life income
  - May include survivor income
- Area needs much more discussion – on ERISA Advisory Council agenda in 2008



## Employer roles in retirement income

- Offer benefits and pay for them
- Offer programs for individual saving
- Provide plans that limit lump sums – can mandate income for all of part of the benefit
- Serve as purchasing agent
- Create expectations and provide information
- Advise
- Education



## Information needed by employees

- Keep Income bigger than Expenses (using assets as an income generator)
- Importance of longer-term
- Earlier vs. later retirement – \$
- Variability and potential length of lifespan
- How to translate lump sums to income
- Survivor benefit info for couples
- Importance of long-term care plan
- How to think about risk protection
- Basic re investing
- Evaluating and finding advice alternatives



## Encourage employers to provide

- Basic information
  - Life spans and variability
  - Types of income alternatives
  - Risks
- Strong recommendation – re planning horizon
- Strong recommendation – balance risk management with investment issues
- Explanation of link between lump sums and income
- Provide an income amount or statement about income whenever lump sums are provided
- Questions to ask and information to help people with decisions
- General information about buying products



## Practical solutions

- Encourage neutral sources (e.g. DOL, WISER, Actuarial Foundation) to offer resources
  - NAIC as source of Buyer's Guides
- Link messages to life stage
  - Before nearing retirement – introduce income concept with lump sum
  - Plans with no income option – nearing retirement – discuss concept and provide way to get quotes plus example
  - Plans with income option – provide illustration of income amounts
- Alternative – develop schedule of lump sums needed at different ages to provide approximate income amounts



## Postscript

- Paper about communicating, but don't forget
  - Limits on education and need for get program structure and defaults
  - Group purchasing of financial products
  - Potential to limit how much will be provided as lump sum



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