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What Individuals Should Plan For Retirement Risk Management

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Marsh & McLennan Companies



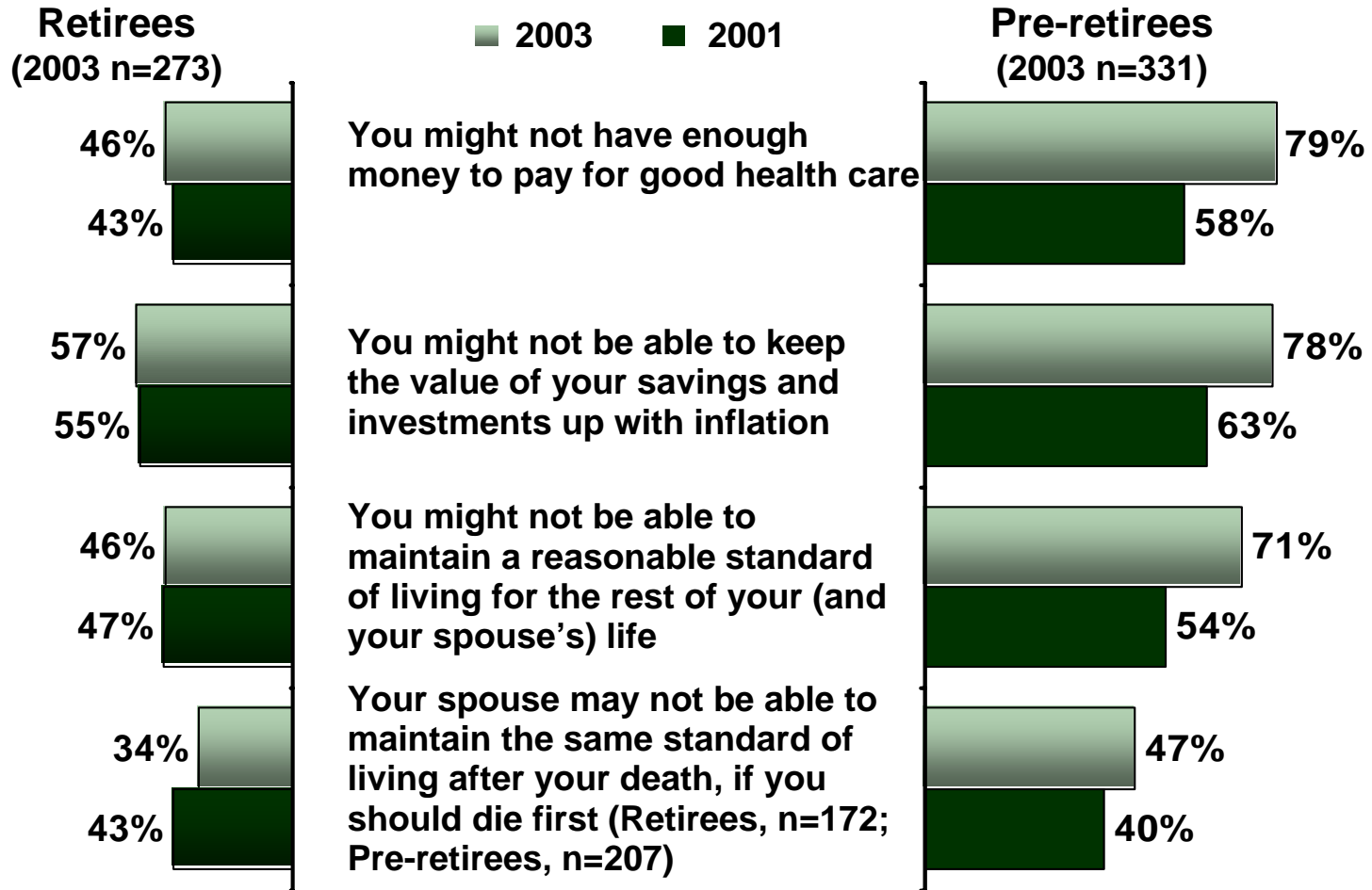
Retirement World Today - Context

- Many people choose to retire and are happy in retirement
- Decline in employer sponsored DB plans and retiree health
 - More individual responsibility, DC plans, lump sums
 - Long service employees often have good benefits: DB, DC and retiree health
- Low savings rates
- People want and need to work longer, return to work
- Misunderstandings about retirement risk
- Couples much better off than women alone
- Little use of annuitization, but stated preference for regular income in studies
- Big questions about future of retirement security



Pre-retirees, Not Retirees, Are More Concerned About Risks Than in 2001

How concerned are you that...? (% very or somewhat concerned)



SOA, 2003 Risks and Process of Retirement Survey

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Knowledge and Understanding of Longevity Risk

- SOA/AAA Retirement Plan Preferences survey shows people prefer regular monthly income, but this is not supported by choices often made
- Seems to be little focus on variability of life span
- Retirement planning software generally asks for expected date at death
- Outliving assets not a major concern and very incomplete understanding of longevity risk protection
- We believe the public overvalues lump sums compared to regular lifetime income



Retirees' Top Concern is Inflation Risk

How concerned are you that...?

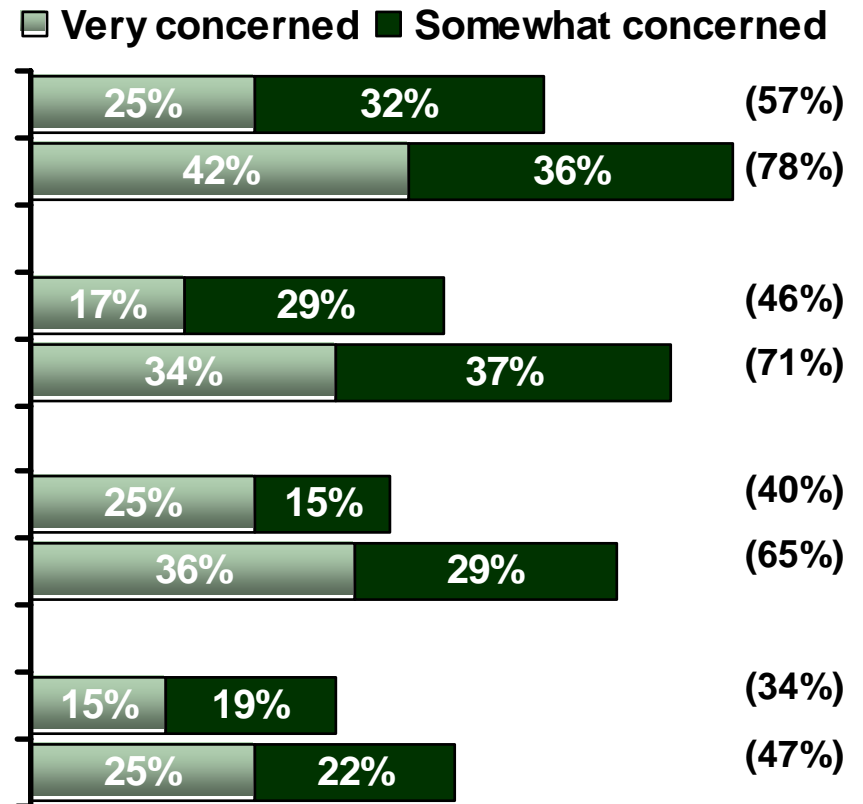
(Retirees, n=273; Pre-retirees, n=331)

You might not be able to keep the value of your savings and investments growing faster than inflation

You might not be able to maintain a reasonable standard of living for the rest of your (and your spouse's) life

You might deplete all of your savings and be left only with Social Security

Your spouse may not be able to maintain the same standard of living after your death (Retirees, n=172; Pre-retirees, n=207)



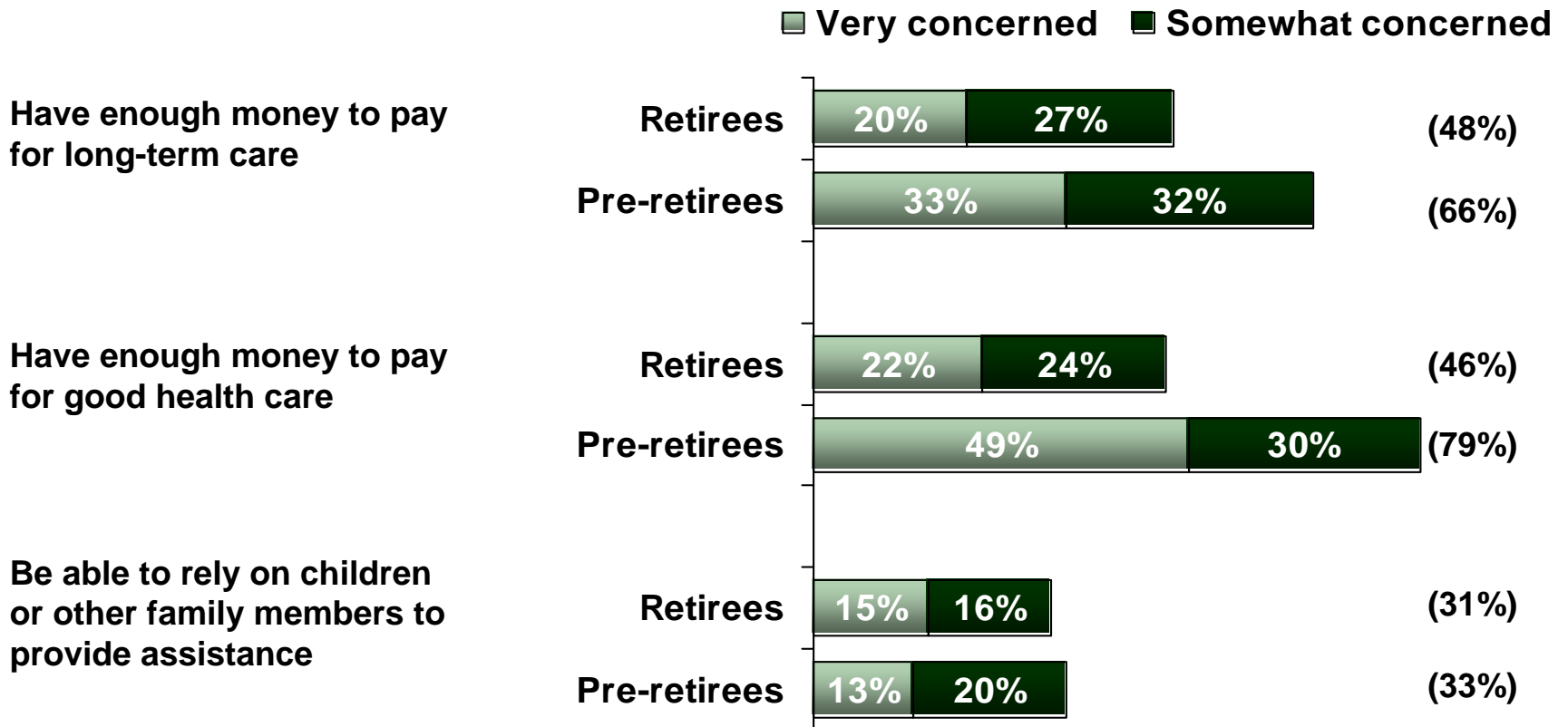
SOA, 2003 Risks and Process of Retirement Survey



Pre-retirees are More Concerned About Health Care Risks Than Retirees

How concerned are you that you might not...?

(Retirees, n=273; Pre-retirees, n=331)



SOA, 2003 Risks and Process of Retirement Survey

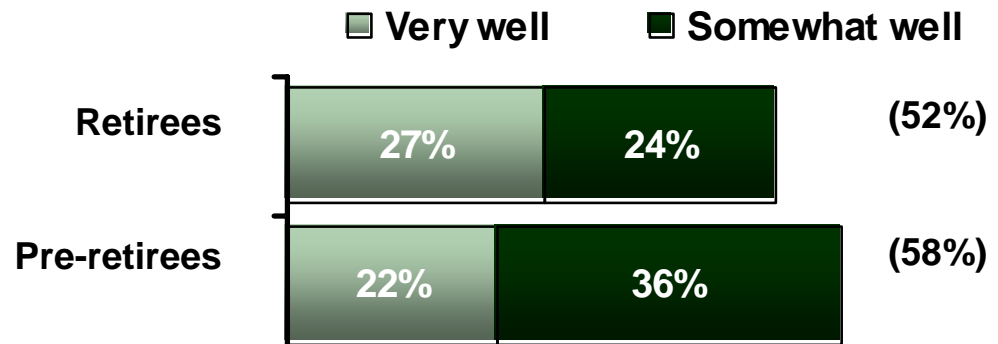


Few Turn to Risk-reducing Products to Protect Themselves

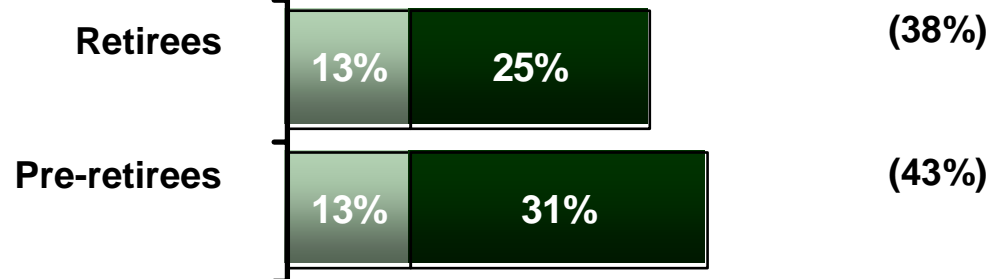
How well does the statement about managing money in retirement describe you (and your spouse)?

(Retirees, n=273; Pre-retirees, n=331)

I think it is a good idea to buy insurance to protect financially against things like the possibility of needing extended nursing care.



I think it is a good idea to buy annuities, because they protect people by paying a guaranteed income for life, no matter how long you live.



SOA, 2003 Risks and Process of Retirement Survey

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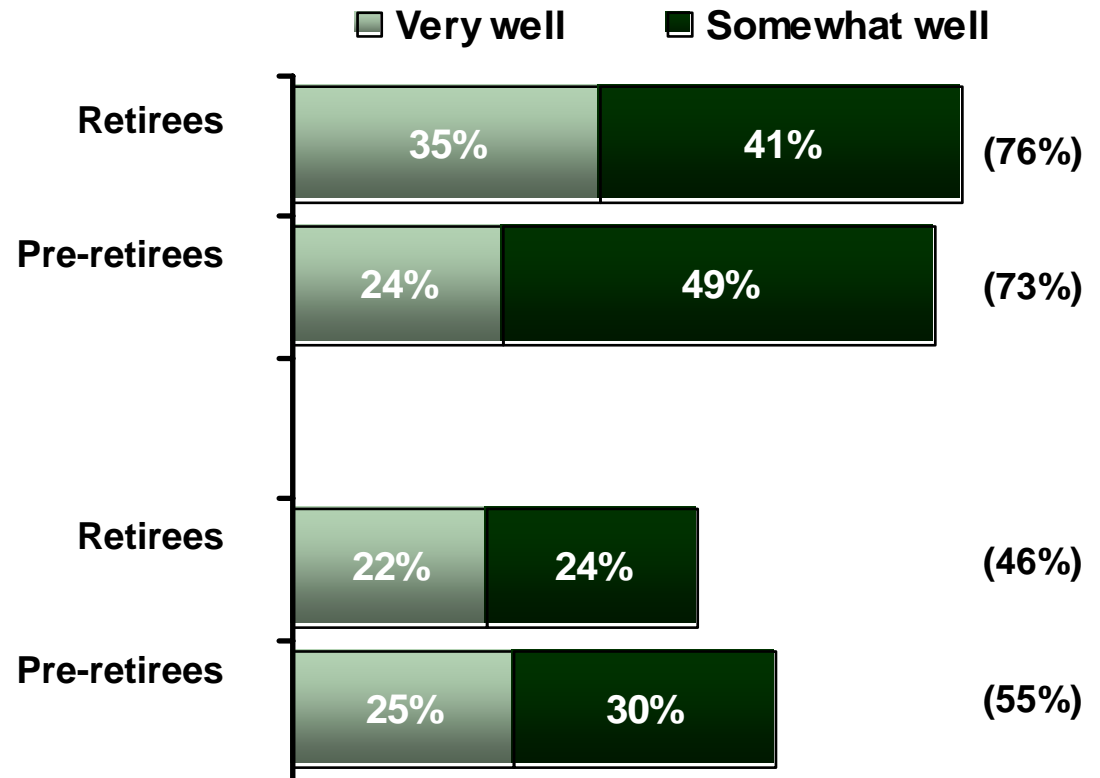
Instead, People Try to Reduce Spending

How well does the statement about managing money in retirement describe you (and your spouse)?

(Retirees, n=273; Pre-retirees, n=331)

I try to reduce unnecessary spending so that I can set aside as much money as possible to keep the value of my savings growing.

I try to invest a considerable portion of money in stocks and stock mutual funds, hoping that in the long run their value will rise.



SOA, 2003 Risks and Process of Retirement Survey



Key Messages and Conclusions

- Retirement plan participants are very concerned about regular income security
- Pre-retirees are much more concerned about retirement security than in 2001
- People do not assess and manage risk well
- The emerging pattern of phasing into retirement is likely to increase
- People tend to express a preference for the type of employer-provided retirement plan they already have



Conclusions from Research

- Individual responsibility is growing in importance
 - In preferences study: 88% of retirees had DB vs. 49% of workers
 - About half of workers currently not in employer plans
 - Less retiree health
- From 2001 to 2003
 - Pre-retirees increased risk focus
- Significant gaps in knowledge
- Major risk management strategy is “reduce spending”
- Very limited use of financial products for risk management
- Work growing in importance as part of retirement



Implications: Very Important Directions for Retirement System

- Policy action needed
 - Strengthen and revitalize DB system
 - Level the playing field
 - Support employer plans
- Without such action, many more people will be in trouble



Implications Educational priorities

- Education will not do whole job, but can help
- Education on post-retirement risks should be high priority
 - Understanding of risks/danger of focusing on the mean
 - Strategies for coping
- Tailor to individual circumstances
- Content
 - Savings
 - Investment strategies
 - Risk reducing vehicles
 - Public programs of last resort
 - Appropriate spending levels during retirement



Summary

Where we are today

- Large improvement in economic status of elderly
- Critical need for policy action if gains are not to be lost
- Disconnects are common
- Inadequate risk protection and savings
- Population will age dramatically as baby boomers age
- Still too much poverty, particularly among women alone
- More people working after retirement



There is Hope

“The corporate DB system can be healthy and efficient if plans make affordable choices and if both sponsors and regulators manage them appropriately. Neither group should overreact to the recent past; greater transparency and a balanced approach to reform are critical to both.”

Morgan Stanley report for CIEBA

Appendix



Overview of Post-Retirement Risks

Risk	Potential Range for Risk	Risk Transfer Options
<ul style="list-style-type: none"> Outliving assets 	<ul style="list-style-type: none"> Life spans at age 65 range from 0 years to over 40 years. 	<ul style="list-style-type: none"> Annuities, including joint and survivor annuities
<ul style="list-style-type: none"> Loss of a spouse 	<ul style="list-style-type: none"> Periods of widowhood of 15 years or more are not uncommon. 	<ul style="list-style-type: none"> Joint and survivor annuities; life insurance; pension benefits with payment to survivor
<ul style="list-style-type: none"> Decline in functional status 	<ul style="list-style-type: none"> Cost of care on account of frailty can range from \$0 to over \$2,000,000 for a couple over their lifetimes. Nursing home care costs may run \$70,000 or more per person per year today. 	<ul style="list-style-type: none"> Long-term care insurance and continuing care retirement communities .
<ul style="list-style-type: none"> Out-of-pocket medical expenses 	<ul style="list-style-type: none"> Medical costs not covered by Medicare for retirees over age 65 can range from \$0 to over \$1,000,000 for a couple over their lives. 	<ul style="list-style-type: none"> Medical insurance
<ul style="list-style-type: none"> Inflation 	<ul style="list-style-type: none"> Inflation can range from 0% in any year to 10% or more; inflation has been much higher in other countries. 	<ul style="list-style-type: none"> Products with cost-of-living adjustments Better education on investing lump sums



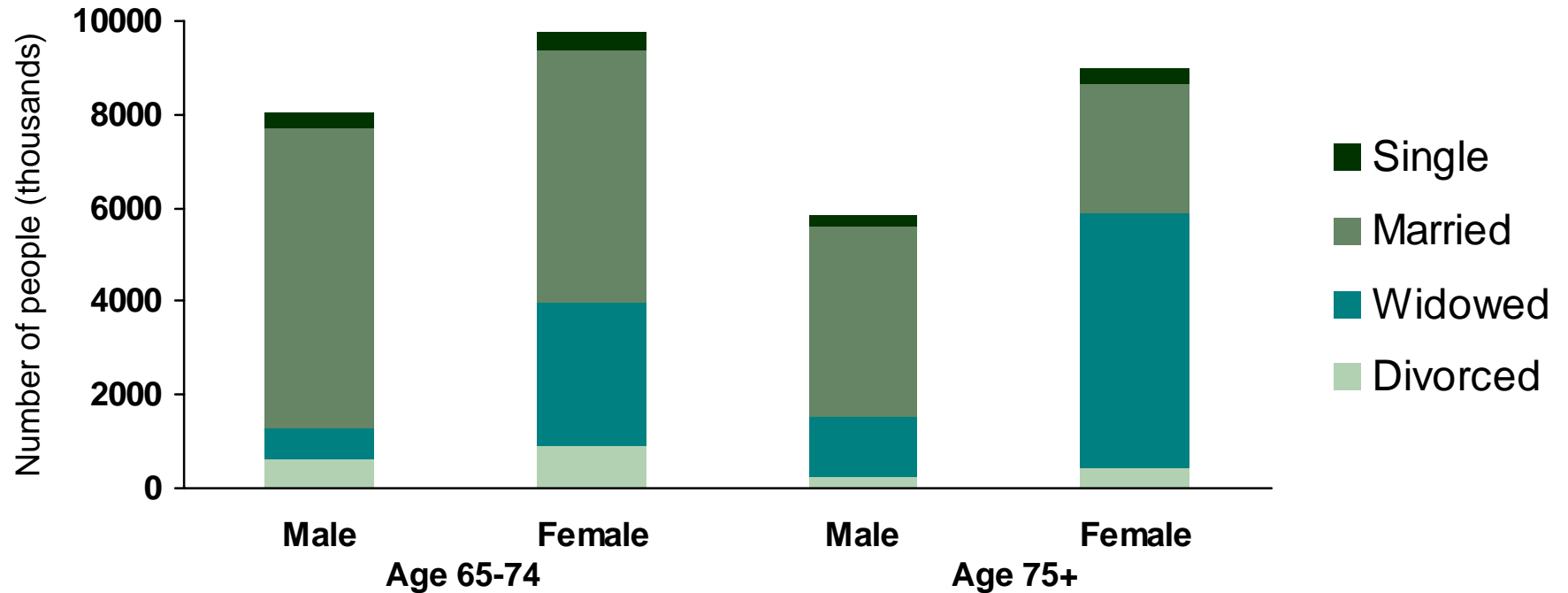
Four Studies of Risk

Study	Methodology	Sponsors and Partners	Sample
Retirement Plan Preference Survey (2003)	Two stage mail panel	<ul style="list-style-type: none"> ▪ SOA ▪ AAA 	Second stage surveys: sent to 1,088 workers and 1,889 retirees. Response rate for workers 75% and 33% for retirees
2003 Risks and Process of Retirement Survey (2003)	Telephone interviews	<ul style="list-style-type: none"> ▪ SOA ▪ Matthew Greenwald & Associates ▪ EBRI 	Americans age 45 to 80 split between retirees and pre-retirees – total of 604 interviews
Retirement Confidence Survey (2003)	Telephone Interviews Series starting in 1993	<ul style="list-style-type: none"> ▪ EBRI ▪ ASEC ▪ Matthew Greenwald & Associates 	1000 individuals were interviewed, 782 workers, 218 retirees
Insight into Participant Investment Knowledge & Behavior	Eight in a series starting in 1991	<ul style="list-style-type: none"> ▪ John Hancock ▪ Mathew Greenwald & Associates 	801 respondents Respondents were people who contributed to 401(k) plan and had a choice of funds to invest.



US Marital Status, Age 65+

Marital Status By Age and Sex, United States 2000



Source: Table 51, Statistical Abstract of the United States 2001, U.S. Census Bureau



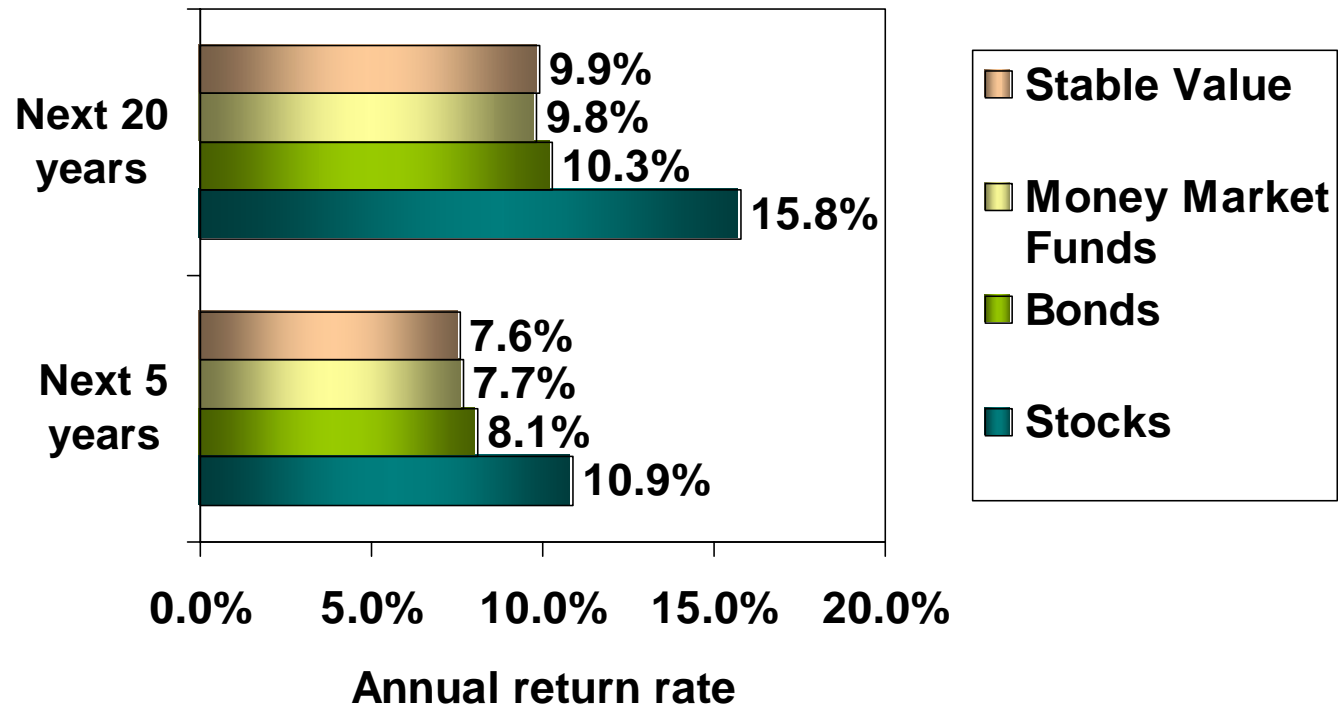
Educational Messages Might Be Targeted to Four Age Groups

Content	Long Before Retirement	Age 50 - Retirement	At Retirement	Post-Retirement
Savings	Get people to save enough	Continue to save	Save to keep up with inflation	Maintain assets or start conservative spend-down
Investment	Invest well for the long term	Invest for different time horizon	Shift investments Consider “regular income” for some money	Maintain investment program Shift more money into “regular income”
Risk Management	Don't spend Start to consider retirement dollars	Finalize risk putting risk management in place	Maintain risk management program and be sure it is fully implemented	Management program



Misperceptions of Average Investment Returns

What do you expect stocks, bonds, money market and stable value investments to earn annually, on average during the next five and twenty years?



Source: Responses to the John Hancock Survey of Defined Contribution Plan Participants 2002



Workers Have Other Significant Knowledge Gaps

- Cannot estimate eventual retirement benefit:
 - 50 % of DC workers, 34% of DB workers
- Do not know method used to determine benefit:
 - 22% of DC workers, 12% of DB workers
- Cannot estimate current termination benefit:
 - 33% of DC workers, 39% of DB workers
- Do not know when they would be able to access that termination benefit:
 - 25% of DC workers, 20% of DB workers

SOA/Academy, Retirement Plan Preferences Survey

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