Managing Life and Spending Changes During Retirement

Plan participants should anticipate inevitable changes that will take place after retirement.

By Anna M. Rappaport, F.S.A., M.A.A.A. Thanks to Steve Siegel, Zenaida Samaniego, and Barbara Butrica for assistance with the article and the Roundtable.

This article presents highlights from a Roundtable Discussion showcasing recent Society of Actuaries (SOA) research that was held at the 2008 Annual Conference of the National Academy of Social Insurance (NASI). Steve Siegel, Zenaida Samaniego, and Anna Rappaport, all members of both the SOA and NASI, jointly proposed the Roundtable to the conference organizers. The Roundtable, led by Anna Rappaport and Zenaida Samaniego and Urban Institute economist and researcher Barbara Butrica, proved to be an important opportunity to leverage synergy between the organizations and promote future partnerships.

Retirement is often conceptualized as a monolithic, homogeneous stage of life. However, many retirees experience a number of distinct phases and life-altering changes during retirement. For some Americans, retirement can last 30 or even 40 years. Only relatively few survive beyond age 100, but that number will increase as life expectancies rise. Given the increasing length of time in retirement, change is inevitable.

Bottom Line on Change During Retirement

We can think about change during retirement in several ways — as a function of changing health and capability, as a function of age, as a function of changing family status, or as a result of employment status, among others.

Before considering the dynamics of change during retirement, it is useful to have some background on the perception of risks during retirement. The SOA surveys on post-retirement risks have demonstrated pre-retiree and retiree gaps in knowledge and expectations, and situations where knowledge and reality are in conflict. For example, pre-retirees regularly indicate that they expect personal savings and pensions to be major sources of income in retirement whereas retirees indicate that Social Security is among their primary sources of income. A second example relates to expectations about when people will retire. The trend toward early retirement appears to be continuing; however, those not yet retired continue to indicate that they expect to work to high ages. About one-third of respondents in the most recent survey do not expect to retire at all. Yet, it is apparent that very few people work beyond age 75. According to the Retirement Confidence Survey series, about four in 10 people end up retiring before they had planned to. The 2007 Risks and Process of Retirement Survey reveals a significant disconnect between what people say they plan to do and what they actually do. 67 percent of the retirees in this survey retired from their primary occupation before age 65, whereas only 29 percent of pre-retirees expect to retire that early and 32 percent say that retirement does not apply to them at all. Other surveys confirm these findings with similar results as well.

In light of these disconnects, the dynamics and impact of changes are all the more magnified. First, people spend less in retirement than before retirement, with housing usually representing the largest source of spending in retirement. Income and most spending decline as age increases. However, medical spending increases after age 65 as age increases.

Next, most people expect to have periods during retirement when they are somewhat or much less capable of functioning as they did before they retired. However, for many of them planning is concentrated only on the period just after retirement before their decline in capability. This is not surprising since it appears that most people tend to plan only for relatively short periods, rather than taking a long-term perspective.

Another life-altering change can occur in marital status. Even though other research has shown a decline in economic status upon widowhood, and even though older women alone are much more likely to be poor or near poor than are married couples, the 2007 risk survey indicated that most retired couples do not expect the surviving spouse to be financially worse off than the couple was. This misperception can magnify the effect of the status change.

Finally, in terms of labor force change, about half of the population moves from full-time work to full-time retirement in a piecemeal fashion. Patterns include a number of movements in and out of the paid labor force, as well as working part-time before fully leaving the labor force. Working in retirement is increasing, but more people expect to work in retirement than actually do.

Gradual vs. Sudden Change

As the last paragraph hinted at, change can be sudden or gradual. Sudden unplanned change can come from a number of causes including:

- Loss of a spouse
- Severe personal illness or illness of a spouse that produces an immediate change in capabilities or needs
- Loss of a job
- Major loss in investments
- Loss of health insurance

On the other hand, gradual change may come from such causes as a slow but consistent decline in health and physical capabilities. This declination can be caused simply by aging, by chronic disease, or by the aftermath of an acute condition. Besides health changes, it can also come from financial causes such as inflation and/or over-consumption of financial assets so that there is less money available to support retirement.

In addition to gradual and sudden change, there are significant planned changes in retirement. These can occur as a result of:

- Moving to a new location, including senior housing or a continuing care retirement community
- Establishing new family relationships
- Improving health status through surgical procedures, long-term rehabilitation or other premeditated health intervention.

What People Say

A new module in the 2007 Risks and Process of Retirement Survey asks respondents about retirement phases, which is defined in terms of ability. The first phase is defined as a period "when your needs and abilities are about the same as before you retired." 52 percent of retirees and 60 percent of pre-retirees have experienced or expect to experience this phase. The second phase, based on being "somewhat less able", has been experienced or is expected by 72 percent of retirees and 84 percent of pre-retirees. The third phase involves being "much less able" to do things, and about 66 percent of both groups indicate they expect this phase. Saving more and investing to make money last is the major planning approach for the later phases. Insurance and financial products, in contrast, are not a major factor in preparing for the later phases. Most concerning, however, is that 28 percent of retirees and 15 percent of pre-retirees have done nothing to prepare for these phases or don't know if they have.

Regarding other results, the major findings from the 2007 survey were overall similar to those in 2005. There continues to be major gaps in understanding around retirement risk. In terms of specific risks, health care, long term care, and inflation are the major areas of concern as in previous studies. However, there is more concern about health care than there was in 2001. When honing in on pre-retirees versus retirees, the survey indicates that pre-retirees are more concerned about these risks than retirees.

The full report of the survey findings can be found on the SOA website. A report highlighting key findings from the survey focusing on phases of retirement and related research is in process and will be released later in 2008.

What People Do

Planning for retirement success and satisfaction requires thinking about health, finances, and engagement in productive activities. Butrica and her colleagues at the Urban Institute analyzed engagement among adults age 55 and older using the 2002 HRS, where engagement is defined as time spent in paid work, formal volunteering, informal volunteering, and care-giving activities.

They find that engagement, particularly work and care giving, declines with age. Although adults age 75 and older are least likely to participate in work, volunteer, or care-giving activities, more than half of them are still engaged. Results also indicate that engagement falls off as health status, which is correlated with age, worsens. However, care giving varies much less by health than the other activities observed, likely reflecting the nature of care giving, which unlike work or volunteering is difficult to get out of. See Exhibits 1 and 2.

Finally, an important finding from this data is that retirees who participate in most types of engagement are more likely to be very satisfied with retirement (Butrica and Schaner 2005). An exception is care giving. Satisfaction not only declines for those engaged only in care giving, but even more so for those performing multiple care-giving tasks.

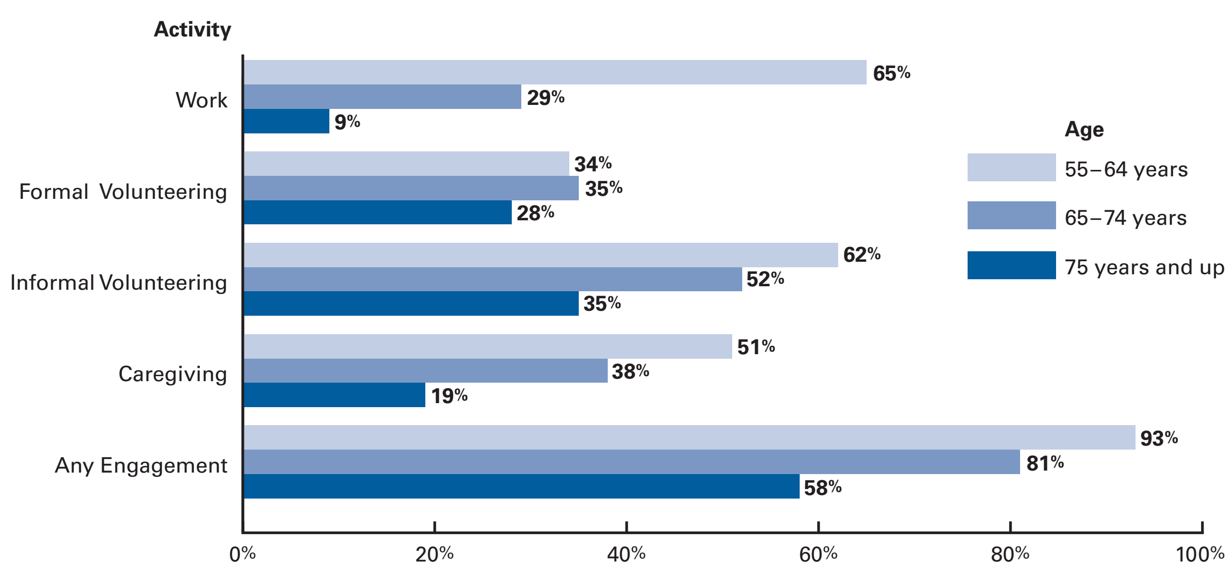
What People Need and Spend

Papers from the "Needs and Spending in Retirement: Unraveling the Mystery" can be found in an online monograph on the SOA Web site. The Web page is at: http://www.soa.org/research/pension/research-post-retirement-needs-and-risks.aspx

The six papers taken together conclude that spending declines over retirement, and that the declines appear to be linked to events that cause income problems. The papers further explicate what decisions retirees can make to manage and reduce spending; that housing, on average, is by far the largest item of expenditure; and the impact of life-changing events, such as widowhood or health shocks, on spending.

The paper by Hatcher looks at spending during retirement and whether spending changes are based on age or specific events. He finds that spending drops markedly at the time of retirement and at the time of widowhood. This leads to the observation that the drops in spending are linked to a reduction in income rather than by choice. In her paper, Rappaport also looked at spending by age group and type of spending. Housing is by far the largest source of spending and represents more than 30 percent of total spending at all age groups. Decisions about where to live are not only vital from a financial perspective, but they also drive access to transportation, services, and activities. Furthermore, income drops significantly by age, and at the same time spending as a percentage of income increases. Rappaport indicated that health spending was 11 percent of total spending at age 65–74 and 15 percent over age 75, but that it varied greatly by household. The Rappaport paper also provides data that indicates that over half of health care dollars are spent by only 10 percent of the population. Among the least healthy, spending is even more concentrated as health status declines, with the top 1 percent of the population ranked by health care spending consuming 22 times the average. Another paper at the symposium corroborated these trends

Exhibit 1: What Older Americans Do with Their Time — Percent Engaging in Various Activities by Age



Source: Zedlewski and Schaner (2005)

in rising health care costs by age for both retirees and non-retirees.

Another topic discussed at the symposium was the quality of decision-making during the planning process and beyond. It was observed that the quality of financial decision-making peaks in an individual's 50s and then declines after that point. A paper presented at the symposium analyzed decision making in ten different areas to investigate this and came to the aforementioned conclusion. Meanwhile, another paper showed that the more wealth is annuitized (pensions, Social Security) as a proportion of total wealth (including financial assets and housing), then the greater spending declines.

As noted earlier in this article, changes in retirement can be gradual or sudden. This is also true for changes in health status. A paper by Bajtelsmit and Bermin using data from the HRS analyzed the probability of a variety of health shocks during retirement at different ages. The paper showed that in 2003, 70 percent of elderly households had out-of-pocket medical expenses in excess of $2,000, 20 percent in excess of $5,000, and 2 percent in excess of $10,000. For those who had Medicare and private non-group insurance, the percentages rose to 92 percent, 46 percent, and 14 percent, respectively. Note that this analysis is based on experience prior to the availability of prescription drug coverage through Medicare Part D. Further observations from the paper included that job loss may be a shock for some, but not a major event for others, and loss of a spouse is a major change. Overall, it is apparent that retirement occurs in stages and planning and decision-making evolve with changing needs, risks, and preferences at these various stages.

Conclusion

The 2007 survey was the first to focus on phases of retirement. When combined with the papers and work from the Urban Institute, there are now several different explorations into what is changing during retirement and how. It is the intention of the SOA's Committee on Post Retirement Needs and Risks to add to this material over time and use these insights to think about solutions and how to respond to the changes in retirement that have been identified.

This work is particularly important because it has been observed that many retirees are very short-term in their planning, and focusing on the later stages of retirement is often not part of the planning. This can leave generations of retirees vulnerable as they move into later stages, and may be particularly troublesome for widows.

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References

Butrica, Barbara A. and Simone G. Schaner. 2005. "Satisfaction and Engagement in Retirement." Perspectives on Productive Aging No. 2. Washington, DC: The Urban Institute.

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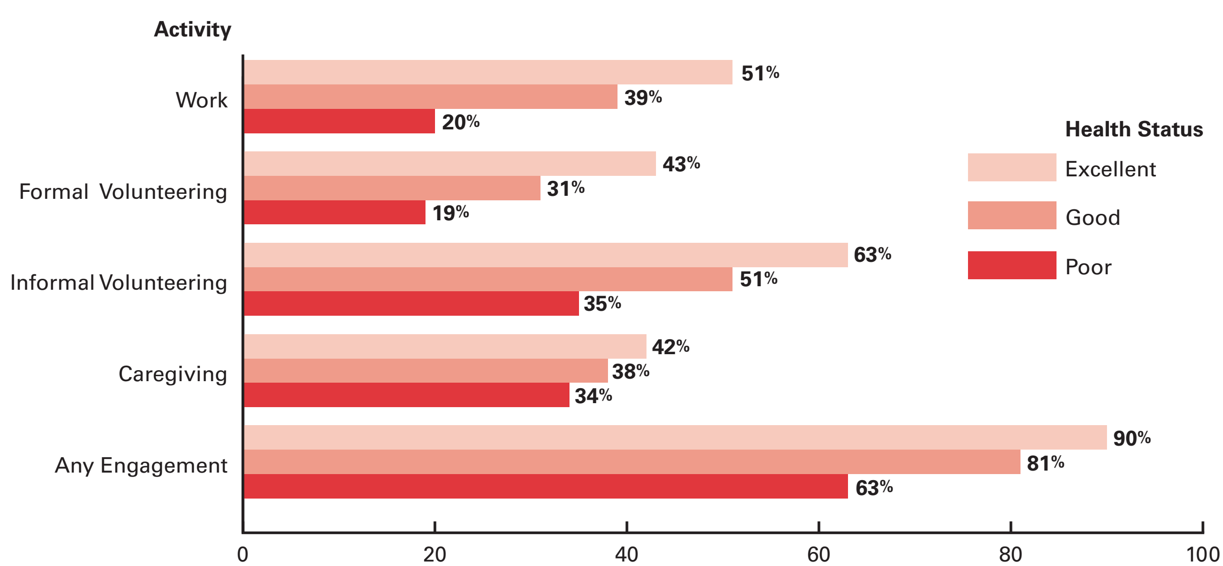
Exhibit 2: What Older Americans Do with Their Time — Percent Engaging in Various Activities by Health Status



Source: Calculations by Barbara Butrica